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Sticks and Carrots: The implementation and enforcement of conditionality in EMU law

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**"Scheitert der Euro,
dann scheitert Europa"**
("If the euro fails, Europe fails")
Angela Merkel – 2012

"Доверяй, но проверяй!"
("Trust, but verify!")
Russian Proverb

Statutory Declaration

I hereby declare that this Master thesis is the product of my own unaided work. All direct or indirect sources used are acknowledged as bibliographic references.

I'm aware that this contribution can be examined in order to determine whether its whole content or incorporated parts constitute plagiarism.

I agree that my work shall be entered in a database where it will also remain after examination, to enable comparison with existing sources as well as with the future theses submitted.

This work was not previously presented to any other examination commission and has never been published.

February 2023

Matteo Eichhorn

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English Abstract

The Economic and Monetary Union (EMU) is perhaps one of most tangible and impactful achievements of the European Union. The euro as the EU's single currency not only influences every transaction made in the Eurozone, its legal framework also has an increasing impact on the fiscal and economic policies of the Member States. This thesis will try to explain how EU institutions influence national budgets through EMU instruments relying on conditionality. This research question shall be answered by classifying such instruments according to four main aspects: typology, implementation, enforcement and application.

After a brief explanation of the asymmetric legal design underlying the Economic and Monetary Union, the research will set out to describe and classify the conditionality-based instruments according to the four research criteria. The added value of this publication lies in providing for the first time a side-by-side comparison of both fiscal and monetary instruments. Particular attention will be dedicated to the instruments adopted to mitigate the impact of the Covid-19 pandemic, namely the Next Generation EU fund and the European Central Bank's most recent purchasing programs.

The outcome of this analysis will be presented in form of a self-drafted taxonomy table of conditionality in EMU law. The discussion of the findings will show how the reliance on conditional solidarity by the EU has reached unprecedented dimensions. This paradigm shift has the potential to cause a transformation of the EU's constitutional architecture.

The research can be subdivided into three separate stages of conditionality: An early Development Phase (1997-2009), the subsequent Experimentation Phase (2010-2019) during the Eurozone crisis, and finally the current Expansion Phase (2020-2023) triggered by the Covid-19 pandemic. The development thus has some remarkable similarities to the spread of the conditional spending doctrine in the USA.

The main findings of this thesis are that EU institutions are increasingly opting for incentive-based instruments, as sanctions have proven to be too difficult to implement in the legislative practice. A trend towards hybrid enforcement mechanisms combining both rule-based and cooperation-based elements can also be observed. While the Development Phase has been characterized by a soft hands-off approach granting extensive sovereignty, the national room for maneuver has become much narrower in the Experimentation Phase. While conditionality was applied very strictly during the Eurozone crisis, the EU now seems to have reached an equilibrium in this area. The role of monetary instruments as ultimate enforcers of conditionality remains decisive as long as a treaty amendment is out of reach. Important open questions remain concerning the legitimacy as well as legality of this spread of conditionality that should be addressed in further research.

German Abstract

Die Wirtschafts- und Währungsunion (WWU) ist vermutlich eine der greifbarsten und wirkungsvollsten Errungenschaften der Europäischen Union. Der Euro als Einheitswährung der EU beeinflusst nicht nur jede Transaktion in der Eurozone, der rechtliche Rahmen der Währungsunion wirkt sich auch zunehmend auf die Fiskal- und Wirtschaftspolitik der Mitgliedstaaten aus. In dieser Arbeit wird erklärt, wie die EU-Institutionen die nationalen Haushalte durch Instrumente beeinflussen, die auf Konditionalität beruhen. Zur Beantwortung dieser Forschungsfrage werden solche Instrumente anhand von vier Hauptaspekten klassifiziert: Typologie, Umsetzung, Durchsetzung und Anwendung.

Nach einer kurzen Erläuterung des asymmetrischen Rechtssystems der WWU werden die auf Konditionalität beruhenden Instrumente anhand dieser vier Kategorien beschrieben und klassifiziert. Der Mehrwert dieser Arbeit besteht in der erstmaligen Gegenüberstellung von fiskalischen und monetären Instrumenten. Besondere Aufmerksamkeit gilt den Maßnahmen, die zur Abschwächung der Auswirkungen der Covid-19-Pandemie verabschiedet wurden, nämlich dem EU-Wiederaufbaufonds und den jüngsten Anleihenkaufprogrammen der EZB.

Das Ergebnis dieser Analyse wird in Form einer selbst erstellten Taxonomie-Tabelle der Konditionalität im WWU-Recht präsentiert. Die Diskussion der Erkenntnisse wird zeigen, dass die Abhängigkeit der EU von bedingter Solidarität ein nie dagewesenes Ausmaß erreicht hat. Dieser Paradigmenwechsel hat das Potenzial, den Verfassungsrahmen der EU zu verändern. Die Untersuchung kann in drei verschiedene Phasen der Konditionalität unterteilt werden: Eine frühe Entwicklungsphase (1997-2009), die anschließende Experimentierphase (2010-2019) während der Schuldenkrise und schließlich die aktuelle Expansionsphase (2020-2023), ausgelöst durch die Covid-19 Pandemie. Die Entwicklung weist somit einige bemerkenswerte Ähnlichkeiten mit der Verbreitung der "conditional spending doctrine" in den USA auf.

Die wichtigsten Ergebnisse dieser Arbeit sind, dass die EU-Institutionen zunehmend auf anreizbasierte Instrumente setzen, da sich Sanktionen in der Rechtsanwendung als undurchsetzbar erwiesen haben. Auch ist ein Trend zu hybriden Durchsetzungsmechanismen zu beobachten, welche regelbasierte und kooperationsbasierte Elemente kombinieren. Während die Entwicklungsphase durch einen nachgiebigen und zurückhaltenden Ansatz gekennzeichnet war, welcher den Mitgliedsstaaten weitgehende Souveränität in der Fiskal- und Wirtschaftspolitik gewährte, ist der nationale Handlungsspielraum in der Experimentierphase deutlich enger geworden. Während die Konditionalität in Zeiten der Schuldenkrise sehr strikt angewendet wurde, scheint die EU nun ein Gleichgewicht erreicht zu haben. Die Rolle der monetären Instrumente als letztinstanzliche Vollstrecker der Konditionalität wird entscheidend bleiben, solange eine Reform der EU-Verträge außer Reichweite ist. Es bleiben wichtige offene Fragen zur Legitimität und Rechtmäßigkeit dieser Entwicklung, welche in weiteren Publikationen untersucht werden sollten.

Italian Abstract

L'Unione economica e monetaria (UEM) è forse il successo più tangibile e significativo dell'Unione Europea. L'euro, in quanto valuta unica dell'UE, non soltanto influenza ogni transazione effettuata nella zona euro, ma il suo quadro giuridico ha anche un impatto crescente sulle politiche fiscali ed economiche degli Stati membri. Questa tesi cercherà di spiegare come le istituzioni dell'UE influenzino i bilanci nazionali attraverso strumenti basati sulla condizionalità. A questa domanda di ricerca si cercherà di rispondere classificando tali strumenti secondo quattro caratteristiche principali: Tipologia, attuazione, esecuzione e applicazione.

Dopo una breve descrizione della struttura giuridica asimmetrica alla base dell'Unione economica e monetaria, la ricerca si propone di descrivere e classificare gli strumenti basati sulla condizionalità secondo i quattro criteri di ricerca. Il valore aggiunto di questa pubblicazione risiede nel fornire per la prima volta un confronto parallelo tra strumenti fiscali e monetari. Particolare attenzione sarà dedicata agli strumenti adottati per mitigare l'impatto della pandemia del Covid-19, ovvero il fondo Next Generation EU e i più recenti programmi di acquisto della Banca Centrale Europea.

Il risultato di quest'analisi sarà presentato sottoforma di una tabella di tassonomia della condizionalità nell'area dell'UEM. La discussione dei risultati mostrerà come il ricorso alla solidarietà condizionata da parte dell'UE abbia raggiunto dimensioni senza precedenti. Questo cambiamento di paradigma potrebbe causare una trasformazione dell'architettura costituzionale dell'UE.

La ricerca può essere suddivisa in tre fasi distinte della condizionalità: una prima fase di sviluppo (1997-2009), la successiva fase di sperimentazione (2010-2019) durante la crisi dell'euro e infine l'attuale fase di espansione (2020-2023) innescata dalla pandemia. Lo sviluppo presenta quindi alcune notevoli somiglianze con la diffusione della dottrina di spesa condizionata negli Stati Uniti.

I principali risultati di questa tesi sono che le istituzioni dell'UE optano sempre più spesso per strumenti basati su incentivi, dato che le sanzioni si sono rivelate troppo difficili da attuare nella pratica legislativa. Si osserva anche una tendenza verso meccanismi di applicazione ibridi che combinano elementi basati sia su regole che sulla cooperazione. Mentre la fase di sviluppo è stata caratterizzata da un approccio premuroso che concedeva un'ampia sovranità, il margine di manovra nazionale si è ristretto nella fase di sperimentazione. Mentre la condizionalità è stata applicata in modo molto rigido durante la crisi dell'euro, l'UE sembra ora aver raggiunto un equilibrio. Il ruolo degli strumenti monetari come esecutori finali della condizionalità rimane decisivo fino a quando una modifica dei trattati europei resta fuori portata. Rimangono aperte importanti questioni riguardo alla legittimità e legalità di quest'espansione di condizionalità, che dovrebbero essere affrontate in ulteriori ricerche.

1. Introduction

In the last two decades, the concept of conditionality has become increasingly widespread within the legal framework of the EU. Put simply, this means that different leverage mechanisms are applied by the supranational institutions to incentivize political reforms.¹ Many citizens, even those who are unaware of the underlying institutional dynamics, have witnessed a far-reaching application of EU rules to their respective home states.

The most well-known and controversial example is probably the financial and monetary assistance granted during the Eurozone crisis, which was tied to austerity measures. While those instruments were initially implemented bilaterally as an "emergency tool"², their use has been increasingly institutionalized. Many Eurosceptic parties and movements have denounced an interference into policy fields that are traditionally the domain of national administrations. In the aftermath of the Covid-19 pandemic, the European Union has adopted and implemented several new instruments, whose conditionality mechanisms go beyond the preexisting framework. Within this thesis, their new and innovative approach to conditionality will be analyzed and compared with respect to the preexisting instruments.

Conditionality can best be thought of as a system based either reward or punishment, and sometimes both. To follow the metaphor spelled out in the title, the EU's Member States are nudged into complying with common objectives in two ways: By promising the reward of financial incentives (carrot) or by sanctioning non-compliance (stick).³ *Vita* has described this development as a "paradigm shift towards a conditional solidarity" with "high potential implications for the EU constitutional architecture".⁴

Originally, this rule-based, vertical approach has emerged within the Union's external policy towards third countries (the European Neighborhood Policy and the accession procedure).⁵ However, its use in the so-called Economic and Monetary Union has become increasingly widespread. Since the Eurozone crisis, this tool has "progressively entered into the vocabulary and the normative sphere of the EU economic governance"⁶. While previously, conditional aid was granted "only in exceptional circumstances, such as in cases of economic emergency"⁷, the reliance on conditional solidarity has now reached unprecedented dimensions.⁸

¹ cf. Svea Koch, 'A Typology of Political Conditionality Beyond Aid: Conceptual Horizons Based on Lessons from the European Union' [2015] 75 *Political Conditionality and EU Foreign Aid* 97, 98.

² Antonia Baraggia, 'Conditionality through the Lens of the CJEU: A "Blurry" View' [2016] *Verfassungsblog: On Matters Constitutional* 1, 1.

³ cf. Viorica Vita, 'Revisiting the Dominant Discourse on Conditionality in the EU: The Case of EU Spending Conditionality' [2017] 19 *Cambridge Yearbook of European Legal Studies* 116, 122.

⁴ *ibid* 119.

⁵ cf. Koch (n 1) 100.

⁶ Baraggia (n 2) 1.

⁷ Vita, 'Revisiting the Dominant Discourse on Conditionality in the EU: The Case of EU Spending Conditionality' (n 3) 136.

⁸ cf. Päivi Leino-Sandberg and Matthias Ruffert, 'Next Generation EU and Its Constitutional Ramifications: A Critical Assessment' [2022] *Common Market Law Review* 433, 470.

It is important to note that the origins of spending conditionality are not rooted in a gradual power-grab by the European bureaucracy: It is rather an effect of the increasing distrust among the Member States. The necessity for spending conditionality clauses comes from the fear that arguably "in the absence of conditionality, the safety net provided by the stabilization function [EU instruments] could result in moral hazard, i.e. could lure countries to engage in reckless fiscal and macroeconomic policies without worrying about the consequences".⁹ Another contributing factor is the "increased concern regarding the failure of certain Member States to uphold core EU treaty commitments"¹⁰, making conditionality a tool for policy enforcement. This development has been upheld as legal by the CJEU as long as there is a "sufficiently direct link" between the financed measure and the alleged breach of EU law.¹¹

Despite its potentially big impact on the EU's legal framework and Member States' budgets, the internal use of conditionality remains "under-researched and far too little discussed in scholarly debates".¹² Scholarly contributions will still be extensively used to provide the necessary context and analysis, such as the anthology "EU Law of Economic and Monetary Union", edited by *Antenbrink and Herrmann*. Several insightful contributions concerning the NGEU fund have been made by *Fabbrini*¹³ and *Rayo*,¹⁴ while the works published by *Zilioli*,¹⁵ *Ioannidis*,¹⁶ and *Viterbo*¹⁷ will be relevant for the chapter regarding the implementation of conditionality by the means of monetary policy.

1.1. Conceptual framework: What conditionality?

Vita has identified two necessary conditions for the legal concept of internal conditionality: "the conduct prescribed [by EU institutions] and the financial sanction or additional benefit attached [for the Member States]".¹⁸ This definition is useful also because it already hints towards a first necessary distinction to be made between positive (incentive-based) and negative (sanction-

⁹ Päivi Leino-Sandberg and Tuomas Saarenheimo, 'Fiscal Stabilisation for EMU: Managing Incompleteness' [2018] *European law review* 623, 14.

¹⁰ Vita, 'Revisiting the Dominant Discourse on Conditionality in the EU: The Case of EU Spending Conditionality' (n 3) 121.

¹¹ Case C-385/13 P *Italian Republic v European Commission* [2013] EU:C:2014:2350 [para 1].

¹² Vita, 'Revisiting the Dominant Discourse on Conditionality in the EU: The Case of EU Spending Conditionality' (n 3) 143.

¹³ Federico Fabbrini, *Next Generation EU: Il futuro di Europa e Italia dopo la pandemia* (1st edn, Il Mulino 2022).

¹⁴ Andreu Olesti Rayo, 'The Next Generation EU Instrument and the European Union New Budget Cycle' [2021] *Revista Catalana De Dret Public* 4.

¹⁵ Chiara Zilioli, 'The ECB's Powers and Institutional Role in the Financial Crisis: A Confirmation from the Court of Justice of the European Union' [2016] 23 *Maastricht Journal of European and Comparative Law* 171.

¹⁶ Michael Ioannidis, 'Europe's New Transformations: How the EU Economic Constitution Changed during the Eurozone Crisis' [2016] 53 *Common Market Law Review* 1237.

¹⁷ Annamaria Viterbo, 'Legal and Accountability Issues Arising from the ECB's Conditionality' [2016] 1 *European Papers* 501.

¹⁸ Vita, 'Revisiting the Dominant Discourse on Conditionality in the EU: The Case of EU Spending Conditionality' (n 3) 122.

based) conditionality measures. *Vita* has made a further subdivision regarding the temporal scope of positive spending conditionality.¹⁹ The notion is rather easy to understand: Does the compliance with the prescribed conduct have to come before (*ex ante*) or after (*ex post*) the disbursement of the financial benefit?

On the one hand, the incentive can have the status of a reward: the previous compliance with the prescribed conduct serves as the precondition in the case of *ex ante* positive conditionality.²⁰ On the other hand, in the case of *ex post* positive conditionality, the control is implemented only after the disbursement of the financial incentive. It can be withdrawn in cases of non-compliance as a measure of last resort. In practice however, the lines between *ex ante* and *ex post* positive conditionality are often blurred: Most EU financial instruments involve thresholds at the beginning as well as further monitoring after the incentive has been granted. This double safeguard mechanism is referred to as "sticks-and-carrots" conditionality.²¹

Negative conditionality measures are always *ex post* in the internal policy dimension: They do not involve any sort of incentive but rather sanctions as a disincentive or punishment for non-compliance with the prescribed conduct. As such, their main aim is to prevent a certain (undesired) behavior, rather than fostering a certain (desired) behavior. It is difficult to imagine a case where EU institutions implement sanctions preemptively (*ex ante*) against a Member State even before it has violated common rules. This sort of informal pressure has only been "documented sparsely" in the field of external policy, as a way of exerting informal pressure behind closed doors on third countries.²² Therefore, this research will only distinguish between four different types of conditionality, as illustrated by the following chart.

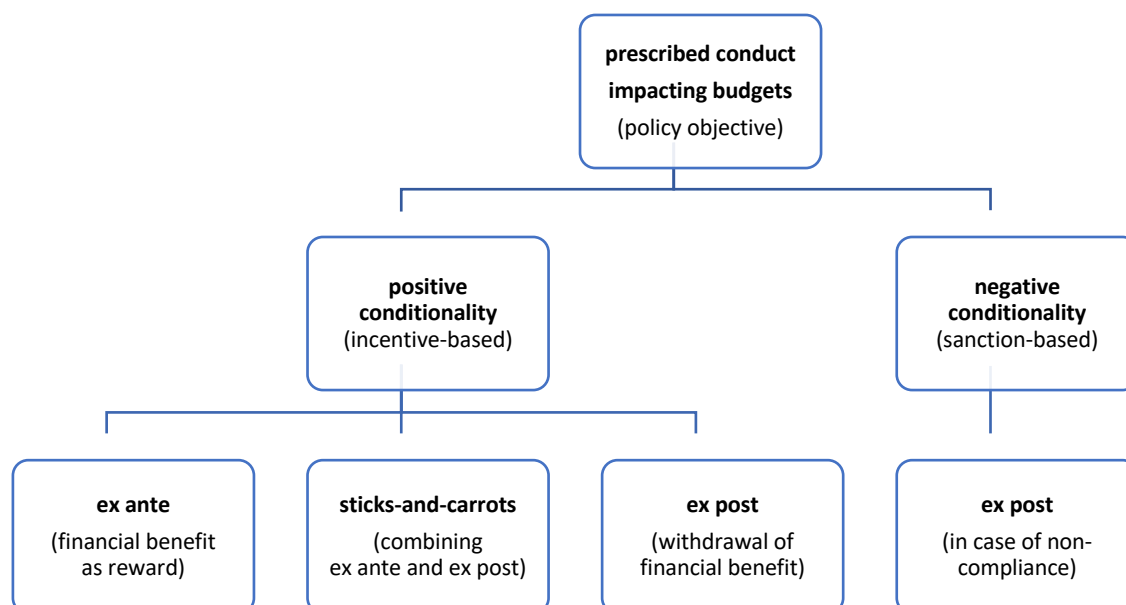


Table 1: Classification of conditionality-based fiscal instruments by typology

¹⁹ *ibid.*

²⁰ *cf. ibid* 116–118.

²¹ *ibid* 122.

²² Koch (n 1) 101.

What those four types all have in common is the push towards a "policy objective which goes beyond the primary purpose of spending"²³, the main intention being to "support broader interests at the national level, in the pursuit of effective EU government".²⁴

1.2. Research question and scope

While there is plenty of literature regarding either the legality²⁵ or the legitimacy²⁶ of conditionality-based instruments, this thesis will dwell on the implementation and enforcement of conditionality rules. This aspect has been less considered by legal scholars, and most of the existing research on conditionality-based instruments does not include the measures that have been adopted recently in the aftermath of the Covid-19 pandemic.²⁷

This thesis will try to explain how EU institutions influence Member State budgets through EMU instruments relying on conditionality. This research question shall be answered by classifying the EU's instruments according to four aspects: Typology, implementation, enforcement and application. The typology refers to the previously outlined distinction between positive and negative conditionality, as well as between ex ante and/or ex post oversight. In case of chapter 5, the taxonomy will instead distinguish between selective and quantitative instruments. The second aspect, implementation, goes into further detail concerning the practicalities of enforcement. It will describe how the enforcement mechanism is intended to work in practice, e.g. which EU institutions are responsible for the oversight and which legal tools are at their disposal. The third aspect, enforcement, will distinguish between instruments with a rule-based and a cooperation-based mechanism or both (hybrid).²⁸ In case of the monetary instruments (see chapter 5), the enforcement will be subdivided into implicit and explicit references to conditionality.²⁹

²³ Vita, 'Revisiting the Dominant Discourse on Conditionality in the EU: The Case of EU Spending Conditionality' (n 3) 122.

²⁴ *ibid* 143.

²⁵ cf. f. ex. Allan Rosas, 'EMU in the Case Law of the Union Courts: A General Overview and Some Observations' [2022] 2021 European Papers-A Journal on Law and Integration 1397; and Vestert Borger, 'The ESM and the European Court's Predicament in Pringle' [2013] 14 German Law Journal 113.

²⁶ cf. f. ex. Nik de Boer and Jens Van't Klooster, 'The ECB, the Courts and the Issue of Democratic Legitimacy after Weiss' [2020] 57 Common market law review; and Simona Piattoni, 'La Qualità Democratica Del Semestre Europeo' [2020] 15 Rivista Italiana di Politiche Pubbliche 187, as well as Christian Joerges, 'Three Transformations of Europe and the Search for a Way Out of Its Crisis' [2014] The European Crisis and the Transformation of Transnational Governance. Authoritarian Managerialism versus Democratic Governance 25.

²⁷ cf. Viorica Vita, 'In the Shadow of Sovereign Debt Conditionality: The Rise of Spending Conditionality in the EU' [2016] Verfassungsblog: On Matters Constitutional; and Michael Ioannidis, 'EU Financial Assistance Conditionality after "Two Pack"' [2014] 74 Zeitschrift für ausländisches öffentliches Recht und Völkerrecht 61.

²⁸ cf. Kenneth A Armstrong, 'The New Governance of EU Fiscal Discipline' [2013] 38 European law review 601, 603.

²⁹ cf. Stefano Sacchi, 'Conditionality by Other Means: European Union Involvement in Italy's Structural Reforms in the Sovereign Debt Crisis', *The sovereign debt crisis, the EU and welfare state reform* (Springer 2016).

Finally, there will be a classification concerning the application of the imposed conditions, i.e. how high or low the thresholds are for the implementation of the incentive or sanction (soft/medium/strict). Ideally, the reader shall gain an understanding of how the implementation of conditionality has evolved over the last two decades. Unlike previous publications, this thesis will make a direct comparison between fiscal and monetary instruments. The research results will be summarized in form of a self-drafted taxonomy table (see chapter 7).

The research will focus on internal conditionality and not discuss the usage in the EU's external relations. The second important limitation of the scope will be that only instruments impacting national budgets directly will be considered: Even though spending conditionality has long been used in the scope of the EU's Multiannual Financial Framework (MFF),³⁰ the mechanisms at work here are fundamentally different to those prescribed by "independent" legislative instruments. Therefore, the notoriously controversial "rule of law conditionality"³¹ will not be discussed in much detail by this thesis, because it is implemented through the EU budget. The thesis will not only discuss instruments that are subject to judicial review in front of EU courts, but also the sovereign debt conditionality instruments that were adopted on an intergovernmental level outside of the EU's legal framework.³² It also worth pointing out that this thesis will only tackle spending conditionality measures that are targeted towards national actors and exclude those directed towards private stakeholders.

1.3. Legal methodology

This work will focus on the conceptual evolution of conditionality, rather than on the legality of the instruments in a stricter sense. While this issue is also relevant, it has been sufficiently discussed on the one hand concerning the pre-Covid instruments, and on the other hand, the legality of the NGEU fund, PEPP and TPI is not sufficiently settled to be covered in this thesis. The issue of legitimacy will not be covered within this publication: While the question of whether states are to be treated like donkeys in the sense of the sticks-and-carrots metaphor seems pertinent, it would go beyond the available resources of this research to find a satisfying answer.³³ Therefore, the research conducted will be descriptive in nature and will not rely on critical analysis (legality) or on a normative discussion (legitimacy).

³⁰ Leino-Sandberg and Saarenheimo (n 9) 14.

³¹ Regulation (EU, Euratom) No 2020/2092 of the European Parliament and of the Council of 16 December 2020 on a general regime of conditionality for the protection of the Union budget [2020] OJ L433/1.

³² cf. Vita, 'Revisiting the Dominant Discourse on Conditionality in the EU: The Case of EU Spending Conditionality' (n 3) 138.

³³ For a discussion of legitimacy and accountability issues of EU conditionality instruments see Viorica Vita, 'The Rise of Spending Conditionality in the EU: What Can EU Learn from the US Conditional Spending Doctrine and Policies?' [2017] EUI Department of Law Research Paper; and Diane Fromage and Menelaos Markakis, 'The European Parliament in the Economic and Monetary Union after COVID: Towards a Slow Empowerment?' [2022] *The Journal of Legislative Studies* 1, as well as Viterbo (n 17); and de Boer and Van't Klooster (n 26).

2. Origins and design of EMU: A short overview

The Economic and Monetary Union (EMU) is best known for one of the most tangible and important achievements of the EU: The common currency area called the Eurozone. Most of the EU's citizens interact with the euro daily, for example when buying groceries, receiving their paycheck or when spending their earnings abroad without having to exchange the currency at the border.

Despite its big impact on daily life, few people can claim to understand how the EMU works and why it has been proven to be unstable when facing economic turmoil. This is what this chapter is for: Ideally, an undiscerning reader should gather all the necessary knowledge on the legal origins and design of this policy field to understand the following chapters.

First of all, it is important to note that the Economic and Monetary Union (EMU) is much more than a "body of purely technical rules that have no impact on the lives of European citizens".³⁴ It also goes beyond a regular common currency area: "It envisages a single monetary policy, conducted by a single monetary authority [the ECB]; a single currency, the euro, and coordination of national economic policies."³⁵

At this point, it is important to point out that not all Member States have the same degree of integration within the EMU. This means that as of 2023, only 20 Member States have already given up their national currency and adopted the euro. The seven remaining states (except for Denmark which has an opt-out) are committed to adopting the euro, but their economies have not yet met the convergence criteria.³⁶

Therefore, the reader must bear in mind during the following chapters that not all countries are equally affected by conditionality-based instruments, as they are in different phases of EMU integration. For example, the entire chapter 5 of this thesis will only concern Eurozone countries, as the bond purchasing programs by the ECB have been implemented only for Member States with the euro as their currency.

The differentiation between Euro- and Non-Euro-Member States also becomes evident by analyzing the structure of the European Central Bank: While the European System of Central Banks (ESCB) comprises all national central banks, including those of countries that have not adopted the euro, there is a specialized system running parallel within the same institution: The Eurosystem, which is led by the ECB's Governing Council, taking decisions only concerning the single monetary policy of the Eurozone.

³⁴ Koen Lenaerts, 'EMU and the European Union's Constitutional Framework' [2014] 39 *European law review* 753, 768.

³⁵ Alicia Hinarejos, 'Economic and Monetary Union' in Catherine Barnard and Steve Peers (eds), *European Union Law* (3rd edn, Oxford University Press 2020) 583.

³⁶ cf. *ibid* 584; and Consolidated Version of the Treaty on the Functioning of the European Union [2016] OJ C202 139 for the primary law basis.

While the euro has recently reached an all-time high in its approval rating, with 72% of EU citizens (80% when excluding non-euro states) supporting the single currency,³⁷ it has long been considered one of the most controversial aspects of EU integration.³⁸ At the peak of the Eurozone crisis in early 2013, the euro was supported only by a narrow majority of 51% of EU citizens.³⁹

While it will not be possible to describe the macroeconomic dynamics that have brought the Eurozone to the brink of collapse, this chapter will now briefly outline the origins of EMU law and the systemic legal flaws that have gradually been exposed by the global financial crisis and the consequent sovereign debt crisis.

After the fall of the Berlin Wall, the EMU was proposed as the "next logical step of economic integration after the establishment of the internal market".⁴⁰ However, while there was a "strong political will" to establish a currency union, the Member States lacked a "common political vision of how to govern it".⁴¹ As almost always in the field of EU law, the design of EMU is the "product of a large-scale bargaining exercise between the Member State governments".⁴² In the end, monetarists prevailed over economists: "It was believed that the starting point of EMU should be fixing exchange rates or the introduction of a common currency, and that coordination of economic policies would then follow."⁴³

The main hope at the time was "that the euro could be the first modern money without a state".⁴⁴ The main difference to other monetary unions that have emerged in the course of history, such as the United States of America, is the lack of a "centralized exercise of fiscal power"⁴⁵. This means that "while monetary policy is centralized, the 'economic' leg of EMU remains firmly in the hands of the different national governments"⁴⁶.

On the one hand, monetary policy is an exclusive EU competence for the Member States that have given up their national currencies.⁴⁷ This means that this aspect of EMU always has enjoyed the highest level of supranational integration: national central banks must not act independently, outside of the European Central Bank, whose independence from institutional bodies is protected by primary law.⁴⁸

³⁷ NN, 'Standard Eurobarometer - First Results (No. 97 Summer 2022)' (*data.europa.eu*, 6 September 2022) 33 <<https://bit.ly/3JjEPGx>>.

³⁸ cf. Hinarejos (n 35) 583.

³⁹ NN, 'Standard Eurobarometer - First Results (No. 97 Summer 2022)' (n 37) 33.

⁴⁰ Hinarejos (n 35) 584.

⁴¹ Marco Dani and others, "It's the Political Economy...!" A Moment of Truth for the Eurozone and the EU' [2021] 19 *International Journal of Constitutional Law* 309, 311.

⁴² Stefano Merlo and Cristina Fasone, 'Differentiated Fiscal Surveillance and the Democratic Promise of Independent Fiscal Institutions in the Economic and Monetary Union' [2021] 27 *Swiss Political Science Review* 582, 584.

⁴³ Hinarejos (n 35) 586.

⁴⁴ Dani and others (n 41) 311.

⁴⁵ Lenaerts (n 34) 754.

⁴⁶ Merlo and Fasone (n 42) 583.

⁴⁷ TFEU (n 36) art 3(1c).

⁴⁸ cf. *ibid* art 130.

On the other hand, fiscal and economic issues have instead been "organised around a process of policy coordination aimed at balancing two objectives that have been seen as conflicting, namely: the respect of a MS's fiscal sovereignty and the need to limit the externalities that autonomously contracting parties can impose on one another."⁴⁹ According to Art. 2(3) TFEU, the EU only has a coordinating competence in the field of economic and fiscal policy.⁵⁰ This article, also in its subsequent wording, clearly places economic policy in the hands of the Member States.⁵¹ In practice, this provision has led to an extremely decentralized economic policy: "Financially speaking, every Member State was on its own."⁵² To be more specific, Member States are competent to adopt measures in the field of economic policy, as long as they do not infringe their obligations or the competences of the Union.⁵³

This asymmetric construction, which combined "a federalized and depoliticized monetary policy with a plurality of national fiscal policies"⁵⁴, seemed to work quite well in its first decade. The unprecedented removal of the previous transaction costs made cross-border transactions within the single market much more attractive and convenient. This does not mean however that the EMU was completely without constraints in its early period. It was based on two "different yet complementary" sets of rules: The first concerned fiscal discipline, aiming at keeping "public deficits and public debt under a certain threshold while limiting the borrowing capacity"⁵⁵. This goal was to be reached through the SGP, as discussed in chapter 3.1.

The second set of rules were guidelines for sustainable and inclusive economic growth, as presented by the EU institutions (see chapter 3.2.). While not legally binding, those recommendations were intended to be implemented through peer pressure.⁵⁶ Decisions on taxation and spending were left entirely in the hands of the Member States.⁵⁷ In this early period, only very few EMU-related issues were brought before the courts.⁵⁸

It was the global recession and the subsequent sovereign debt crisis that made EMU's weaknesses evident. According to *Dani et al*, EMU proved to be a "highly dysfunctional construction that would be prone to crises".⁵⁹ The scholars argue that it was the previously described legal imbalance that was the cause of a "multidimensional European crisis" on a level that was both "financial, fiscal, economic, institutional, and political".⁶⁰ There has been

⁴⁹ Merlo and Fasone (n 42) 584.

⁵⁰ TFEU (n 36) art 2(3).

⁵¹ cf. Rainer 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] *European Law Review* 771, 773.

⁵² Lenaerts (n 34) 755.

⁵³ cf. Palmstorfer (n 51) 774.

⁵⁴ Dani and others (n 41) 311.

⁵⁵ Lenaerts (n 34) 754.

⁵⁶ *ibid* 754–755.

⁵⁷ *ibid* 755.

⁵⁸ Rosas (n 25) 54.

⁵⁹ Dani and others (n 41) 312.

⁶⁰ *ibid*.

much legal and political debate whether the sovereign debt crisis was "almost unavoidable" due to the "enduring structural differences within the Eurozone",⁶¹ thus being an exceptional occurrence beyond Member State control,⁶² or whether it was "merely the last straw to break the camel's back" due to the "high government debts piled up over the years".⁶³

While the lack of economic coordination was finally acknowledged as a potential source of instability, many states were still reluctant to cede "core state power" to technocratic management in the field of economic policy.⁶⁴ As the redistribution of resources was off the table, the Member States had to agree upon rigid constraints on their fiscal autonomy.⁶⁵ In order to "shore up EMU", the EU Member States and institutions thus established a "framework of financial assistance, conditionality, limitation of national fiscal sovereignty, and 'unconventional' monetary policy."⁶⁶ The use of conditionality within this framework will be the research focus of this thesis.

Perhaps surprisingly, the treaty provisions concerning EMU have remained almost identical throughout their existence, despite the impactful economic crises.⁶⁷ The existing system was instead "tweaked, not to say fundamentally modified"⁶⁸ both by the adoption of new directives or regulations (secondary law) and by relevant judgements of the CJEU. This is because the EMU is based on a "rigid constitutional framework"⁶⁹: In case of a treaty amendment, every Member State must ratify the changes according to national law,⁷⁰ a requirement that in practice has guaranteed a veto right for every government.

In practice, this rigid procedure has caused a "constant fear of Treaty change failure"⁷¹, ultimately leading to a "constitutional deadlock".⁷² While a treaty change would have been "recommendable if not indispensable"⁷³ in most cases, the existing legal framework has been "stretched to the outmost",⁷⁴ arguably posing a threat to legal certainty and the rule of law.⁷⁵ The judges of the CJEU have been said to "bend the law for the sake of avoiding economic turmoil or collapse".⁷⁶

⁶¹ *ibid.*

⁶² *cf.* TFEU (n 36) art 122(2).

⁶³ Palmstorfer (n 51) 781.

⁶⁴ *cf.* Merlo and Fasone (n 42) 583.

⁶⁵ Dani and others (n 41) 312.

⁶⁶ *ibid.*

⁶⁷ With the only exception of TFEU (n 36) art 136(3).

⁶⁸ Stefan Griller and Elisabeth Lentsch, 'Why the EU's Constitutional Deadlock Is Hampering EMU Reforms, and How This Could Be Resolved' [2021] 28 *Journal of European Public Policy* 914, 1.

⁶⁹ Dani and others (n 41) 313.

⁷⁰ Consolidated Version of the Treaty on European Union [2016] OJ C202 48.

⁷¹ Griller and Lentsch (n 68) 1.

⁷² *ibid.* 4.

⁷³ *ibid.* 3.

⁷⁴ *ibid.* 4.

⁷⁵ *cf.* *ibid.* 1 and 4.

⁷⁶ *ibid.* 4.

While this is a controversial claim, it is fair to say that "the legal foundations [of EMU] were stirred up" in the aftermath of the Eurozone crisis, triggering "essential and extensive debate".⁷⁷ Some of the judgements delivered by the CJEU during that period "may be considered vitally important for the future of EMU and even the EU itself".⁷⁸ Those groundbreaking contestations have "called into question the original assumptions and arrangements underpinning EMU"⁷⁹, involving novel subject matters that were not previously considered as "issues of Union law nor (...) as judicial questions anywhere in the world".⁸⁰ Those cases have raised important issues concerning the nature and functioning of EMU law, the division of powers on the EU level and also questions of responsibility and liability.⁸¹

The most famous and controversial example of a new interpretation regarding an existing treaty provision concerns the so-called no bail-out clause.⁸² This article of the TFEU was based on the assumption that "financial markets would, through eventually imposing high-interest rates as 'sanctions' for high annual deficits and overall debts, exert sufficient pressure" for fiscal discipline.⁸³ Originally, the no bail-out clause was meant to signal that "in the field of credit neither creditors nor the Member States should expect solidarity except in cases of emergency".⁸⁴ Otherwise, it was believed that distorted interest rates could "fuel the appetite for more debt than appropriate – the moral hazard problem".⁸⁵

During the Eurozone crisis, there had been much debate whether this treaty provision concerning financial assistance was meant as a clarification, exemption, or prohibition.⁸⁶ In *Pringle*, the CJEU has sanctioned the adopted fiscal assistance instrument as legal, precisely because of its reliance on strict conditionality rules: "Article 125 TFEU does not prohibit the granting of financial assistance by one or more Member States to a Member State (...) provided that the conditions attached to such assistance are such as to prompt that Member State to implement a sound budgetary policy."⁸⁷

This deviation from a free market principle to a public centralized enforcement⁸⁸ can be seen as a watershed moment in the implementation of conditionality. For the first time, the ECJ

⁷⁷ *ibid* 1.

⁷⁸ Rosas (n 25) 1398.

⁷⁹ Lenaerts (n 34) 755.

⁸⁰ Rosas (n 25) 1398.

⁸¹ *cf.* *ibid* 1399.

⁸² TFEU (n 36) art 125.

⁸³ Griller and Lentsch (n 68) 2; see also Ioannidis, 'Europe's New Transformations: How the EU Economic Constitution Changed during the Eurozone Crisis' (n 16) 1249.

⁸⁴ Ioannidis, 'Europe's New Transformations: How the EU Economic Constitution Changed during the Eurozone Crisis' (n 16) 1250.

⁸⁵ *ibid.*

⁸⁶ *cf.* Palmstorfer (n 51) 775–776; and Ioannidis, 'Europe's New Transformations: How the EU Economic Constitution Changed during the Eurozone Crisis' (n 16) 1250–1253 for a more detailed discussion.

⁸⁷ Case C-370/12 *Thomas Pringle v Government of Ireland and Others* [2012] EU:C:2012:756 [137].

⁸⁸ *cf.* Ioannidis, 'Europe's New Transformations: How the EU Economic Constitution Changed during the Eurozone Crisis' (n 16) 1259.

acknowledged its role as a sufficient "safety net" to prevent a moral hazard.⁸⁹ The reliance on conditionality was also decisive in a case concerning not financial but monetary assistance,⁹⁰ where the judgement upheld the broadening of the ECB's monetary policy mandate⁹¹, allowing it to play the "role of lender of last resort"⁹²

While the legality and legitimacy aspects will not be central to the upcoming research, it is important to mention that a strict enforcement of conditionality can have "far-reaching consequences on the democratic nature and political content of economic policy decision-making".⁹³ In practice, it has expanded the power of the executive level, especially some of the Commission's services and certain technical committees.⁹⁴ This is especially problematic considering that "the EP's prerogatives have not been the strongest in the area of EMU and had indeed remained rather weak even after the Euro crisis"⁹⁵. The European Parliament has even been described as a "dwarf in EMU matters"⁹⁶ by *Fromage and Markakis*, as it "is not involved in an executive role in the surveillance process and has not obtained decision-making powers in the daily management of the EU fiscal and economic governance framework".⁹⁷ Its main task is instead to hold the responsible EU officials accountable, monitor compliance with the relevant EU rules and to foster national ownership of the EU's fiscal rules and recommendations through its interactions with the Member States.⁹⁸

To sum up, the legal structure of EMU has been influenced by the constant tension caused by the imbalance between the supranational monetary policy and intergovernmental fiscal/economic policy. As it turned out during the Eurozone crisis, the trust the Maastricht treaty had placed on market mechanism was "largely misplaced".⁹⁹ In order to fix this problem without resorting to the cumbersome treaty revision procedure, the EU has increasingly resorted to conditionality-based instruments as a workaround. This development is not entirely unproblematic, especially in the case of negative conditionality: "if they are not carefully designed, sanctioning mechanisms may backfire, upsetting constitutional arrangements in ways that would weaken rather than strengthen the authority of EU law."¹⁰⁰

⁸⁹ cf. Leino-Sandberg and Saarenheimo (n 9) 14.

⁹⁰ Case C-62/14 *Peter Gauweiler and Others v Deutscher Bundestag* [2015] EU:C:2015:400.

⁹¹ Griller and Lentsch (n 68) 3.

⁹² Ioannidis, 'Europe's New Transformations: How the EU Economic Constitution Changed during the Eurozone Crisis' (n 16) 1249.

⁹³ Leino-Sandberg and Saarenheimo (n 9) 15.

⁹⁴ *ibid.*

⁹⁵ *Fromage and Markakis* (n 33) 3.

⁹⁶ *ibid.* 1.

⁹⁷ *ibid.* 5.

⁹⁸ *ibid.*

⁹⁹ Ioannidis, 'Europe's New Transformations: How the EU Economic Constitution Changed during the Eurozone Crisis' (n 16) 1252.

¹⁰⁰ Roland Bieber and Francesco Maiani, 'Enhancing Centralized Enforcement of EU Law: Pandora's Toolbox?' [2014] 51 *Common Market Law Review* 1057, 1059.

3. Conditionality-based fiscal instruments

This chapter will cover two distinct periods of conditionality-based fiscal instruments: a development phase and an experimentation phase.¹⁰¹ Until the global financial crisis, there were essentially only two mechanisms in place: the SGP (chapter 3.1.) and soft law measures (3.2.). From 1999 until 2008, the EMU conditionality rules were characterized by "informality and obscurity"¹⁰² which resulted in a lack of proper implementation. In essence, the currency union operated without substantial constraints on fiscal sovereignty during this early period.

During the Eurozone crisis, the weaknesses of those minimal constraints became apparent and had to be addressed within several reforms. The following experimentation phase (2008-2019) saw the introduction of most currently enforced conditionality-based instruments in a very short period. The urgency of the looming collapse of the Eurozone triggered a rapid expansion of conditionality rules relying on different typologies and enforcement mechanisms. Due to major distributive and political conflicts, many of the hastily drafted policies that were introduced (2011-2013) had deficiencies that have since only partially been addressed .

During the experimentation phase, fiscal and economic sovereignty was curtailed by three main responses: Constraints on sovereign debt and deficit were strengthened (see chapter 3.1. and 3.4.), economic coordination was increased (see chapter 3.2. and 3.3.) and financial stabilization was granted for countries in fiscal stress (see chapter 3.5.).

3.1. Stability and Growth Pact (SGP)

This policy framework is the oldest conditionality-based instrument in the EMU legal framework, as its origins go back to the signing of the Maastricht Treaty in 1992. Its rules are meant to ensure that the Member States coordinate their fiscal policies and pursue sound public finances by keeping their annual deficit and debt below a certain GDP percentage.¹⁰³

The SGP applies to all EU Member States equally, as during the drafting of the Maastricht treaty, "it was expected that all Member States would quickly fulfil the conditions for joining the euro area"¹⁰⁴. It consists of a preventive and a corrective arm. The preventive arm is meant to "ensure sound budgetary policies over the medium term by setting parameters for Member States' fiscal planning and policies during normal economic times".¹⁰⁵ The corrective arm on the other hand is meant to provoke "appropriate policy responses" in case that an excessive

¹⁰¹ cf. Vita, 'The Rise of Spending Conditionality in the EU: What Can EU Learn from the US Conditional Spending Doctrine and Policies?' (n 33) 17.

¹⁰² Ioannidis, 'EU Financial Assistance Conditionality after "Two Pack"' (n 27) 104.

¹⁰³ NN, 'Stability and Growth Pact' (*ec.europa.eu*) <<https://bit.ly/3EF711n>> accessed 27 November 2022; and Hinarejos (n 35) 586.

¹⁰⁴ cf. Jean-Paul Keppenne, 'EU Fiscal Governance on The Member States: The Stability and Growth Pact and Beyond' in Fabian Amtenbrink, Christoph Herrmann and René Repasi (eds), *The EU Law of Economic and Monetary Union* (Oxford University Press 2020) 820.

¹⁰⁵ NN, 'The Preventive Arm' (*ec.europa.eu*) <<https://bit.ly/3VALJdv>> accessed 27 November 2022.

deficit has emerged.¹⁰⁶ Therefore, the corrective arm "only applies to those Member States whose financial situation is a source of concern for the Union"¹⁰⁷ whereas the preventive arm applies to all Member States.

Unlike the other conditionality-based instruments that will be discussed in this section, the SGP has its roots mainly in primary EU law. While its secondary law framework has been amended on several occasions, primary law provisions were left unchanged. Firstly, Art. 121 TFEU (post-Lisbon numbering) serves as the backbone for the SGP's preventive arm. This article urges the Member States to "regard their economic policies as a matter of common concern" and to "coordinate them within the Council".¹⁰⁸ The Commission "may address a warning" according to Art. 121 if the economic policies of a Member State "risk jeopardising the proper functioning of economic and monetary union".¹⁰⁹ The Council "may" then issue "recommendations" that "may" be published after a QMV without the Member State concerned.¹¹⁰

This hesitant wording seems to suggest that conditionality under the preventive arm of the SGP is applied softly in practice. The treaty acknowledges this issue in the final provision of Art. 121 TFEU by stating that the EU institutions "may adopt detailed rules for the multilateral surveillance procedure" by resorting to the OLP.¹¹¹ The EU has made widespread use of this power in the aftermath of the Eurozone crisis by introducing the European Semester (see chapter 3.3.). The far-reaching reforms of the preventive arm have led over time to "paradoxical situations of Member States slightly missing the EDP targets voluntarily and thereby remaining within the corrective arm in order to avoid the harshness of the preventive arm."¹¹²

The SGP's corrective arm is grounded in Art. 126 TFEU, which spells out the procedure in case that "excessive government deficits" do arise despite the previously described provision.¹¹³ For this reason, this article is also often referred to as the Excessive Deficit Procedure (EDP). Again, the EC acts as a watchdog, "identifying gross errors" and examining "compliance with budgetary discipline".¹¹⁴ It does so by monitoring if the ratio of government deficit or debt to GDP exceed a reference value.¹¹⁵ The SGP is thus a rule-based instrument. Those reference values are specified by the Protocol No. 12 annexed to the TFEU: The threshold of government deficit to GDP is set at 3%, whereas the ratio of debt to GDP shall not exceed 60%.¹¹⁶ Those nominal values contained in the Protocol seem arbitrary, as they

¹⁰⁶ NN, 'The Corrective Arm/Excessive Deficit Procedure' (*ec.europa.eu*) <<https://bit.ly/3XNzFYe>> accessed 27 November 2022.

¹⁰⁷ Keppenne (n 104) 817.

¹⁰⁸ TFEU (n 36) art 121(1).

¹⁰⁹ *ibid* art 121(4).

¹¹⁰ *ibid*.

¹¹¹ *ibid* art 121(6).

¹¹² Keppenne (n 104) 821.

¹¹³ *cf.* TFEU (n 36) art 126(1).

¹¹⁴ *ibid* art 126(2).

¹¹⁵ *ibid*.

¹¹⁶ Protocol (No 12) of the Treaty on the Functioning of the European Union on the excessive deficit procedure [2012] OJ C326/1 art 1.

lack a "strong economic justification"¹¹⁷: One number can never give the full picture on the sustainability of public finances. Therefore, the Commission may also turn a blind eye if the debt or deficit ratio "has declined substantially and continuously" or if the deficit ratio is "only exceptional and temporary"¹¹⁸ according to the Treaty.

The EDP's first measure in case of a breach of these obligations is a non-binding Commission report.¹¹⁹ It is then up to the Council to "decide after an overall assessment whether an excessive deficit exists".¹²⁰ In case that the situation does not improve, the Council has to issue three different kinds of recommendations,¹²¹ before it can ultimately impose, among other measures, "fines of an appropriate size".¹²² Similar as in the SGP's preventive arm, the Council takes those decisions by QMV without the Member State concerned.¹²³ At this point, it is important to point out that the aforementioned coercive measures under the EDP can only be enforced against Member States who are already part of the Eurozone.¹²⁴

However, as the Council needs to pass four separate decisions by qualified majority before being able to vote on sanctions,¹²⁵ the enforcement of fines and other financial penalties becomes very unlikely in practice. This is also because other countries, who themselves are in risk of breaching the obligations, retain their voting rights,¹²⁶ opening the door to mutual protection in a QMV decision. In practice, the coercive measures have never been adopted since the introduction of the common currency,¹²⁷ leading to "recurring breaches without significant consequences."¹²⁸

From early on, the SGP's soft application caused by the high political thresholds has been a point of concern for scholars.¹²⁹ This "Achilles heel"¹³⁰ has been countered by the EU with several reform attempts by means of secondary law. Already in 1997, only four years after the entry into force of the Maastricht treaty and the SGP provisions, two regulations were adopted to "strengthen", "speed up" and "clarify" the Pact.¹³¹ Those two regulations mirrored the previous subdivision in a preventive and a corrective arm. The preventive arm now included

¹¹⁷ Keppenne (n 104) 821.

¹¹⁸ TFEU (n 36) art 126(2a) and 126(2b).

¹¹⁹ *ibid* art 126(3).

¹²⁰ *ibid* art 126(6).

¹²¹ *ibid* arts 126(7), 126(8) and 126(9).

¹²² *ibid* art 126(11).

¹²³ *ibid* art 126(13).

¹²⁴ *ibid* art 139(2b).

¹²⁵ *ibid* arts 126(6), 126(7), 126(8) and 126(9).

¹²⁶ Ludger Schuknecht and others, 'The Stability and Growth Pact: Crisis and Reform' [2011] ECB Occasional Paper 1, 9.

¹²⁷ Bieber and Maiani (n 100) 1066.

¹²⁸ Hinarejos (n 35) 587.

¹²⁹ *cf.* *ibid* 586; and Griller and Lentsch (n 68) 2.

¹³⁰ Schuknecht and others (n 126) 9.

¹³¹ Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies [1997] OJ L209/1; Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure [1997] OJ L209/6.

the regular and obligatory submission of "stability programs"¹³² (called "convergence programs"¹³³ for non-Eurozone MS) to the Council and the Commission. All EU Member States are since then under the obligation to submit and publish a medium-term budgetary objective (MTO) as well as a description of the adopted national economic policy measures.¹³⁴

The functioning of the EDP was left largely identical in the 1997 reform, except for new deadlines¹³⁵ that were meant to speed up the procedure: "Nothing was done to improve the incentives for strict implementation by the Commission and effective enforcement in the ECOFIN Council."¹³⁶ Despite the wide discretion of the provisions, "things got off to a good start" before the introduction of the euro, as "developments in public finances were remarkably positive".¹³⁷ However, the initial high degree of compliance was arguably caused by the political "threat of not being allowed to join the euro area"¹³⁸ and less about the SGP provisions themselves: "Almost as soon as the euro had been introduced, consolidation fatigue set in."¹³⁹ Not only did the political application remain soft, an attempt by the EC to enforce the SGP rules legally at the ECJ¹⁴⁰ was also unsuccessful: "The Court rejected the Commission's claim that the Council's failure to adopt the Commission's recommendation was in itself a decision, and one that should be annulled. Ultimately, the Commission could not require the Council to pursue further action."¹⁴¹ The judgement focused on procedural issues,¹⁴² however the CJEU also stressed the discretion of the EDP provisions¹⁴³ as well as the fact that "responsibility for making the Member States observe budgetary discipline lies essentially with the Council"¹⁴⁴. In this context, it is important to point out that the applicable procedures for judicial enforcement in the context of the SGP are different from the usual rules of EU law: The provisions of the Pact are not directly applicable, not enforceable through the infringement procedure¹⁴⁵ and not directly effective¹⁴⁶: "Consequently, there is a relatively low degree of judicial control over the implementation".¹⁴⁷

¹³² Regulation 1466/97 (n 131) art 3.

¹³³ *ibid* art 7.

¹³⁴ *ibid* arts 3(1), 3(2a, 2c) and 4(2).

¹³⁵ Regulation 1467/97 (n 131) arts 3–8.

¹³⁶ Schuknecht and others (n 126) 10.

¹³⁷ *ibid* 9.

¹³⁸ *ibid*.

¹³⁹ *ibid* 10.

¹⁴⁰ Case 27/04 *Commission of the European Communities v Council of the European Union* [2004] EU:C:2004:436.

¹⁴¹ *Hinarejos* (n 35) 586–587.

¹⁴² *cf.* Case 27/04 *Commission v. Council* (n 140) para 90.

¹⁴³ *ibid* para 80.

¹⁴⁴ *ibid* para 76.

¹⁴⁵ *cf.* TFEU (n 36) art 216(10).

¹⁴⁶ Case 9/73 *Carl Schlüter v Hauptzollamt Lörrach* [1973] EU:C:1973:110 [para 39]; and Case T-541/10 *ADEDY and Others v Council (Order of the General Court)* [2012] EU:T:2012:626 [para 1].

¹⁴⁷ *Keppenne* (n 104) 814.

Ultimately, this "complete absence of judicial competence"¹⁴⁸ makes the launching of an EDP a political decision: "The highly sensitive issue of national government deficits led to this awkward construct of a prohibition, which is ultimately assessed and decided by a political institution."¹⁴⁹ The SGP has thus essentially remained a "rule-based system, where the Commission proposes but the Council decides".¹⁵⁰ "At the time when the system was set up, it was considered (...) more appropriate to reserve its application to political institutions, namely the Commission and the Council. A complementary control by the Court was therefore considered superfluous, if not inappropriate given the political nature of the whole process."¹⁵¹ The already high discretion was further expanded by a reform in 2005, which amended the regulations covering the SGP.¹⁵² The newly adopted regulation led to even "greater discretion, leniency and political control into procedures"¹⁵³ than before: "The strictness of the 3% limit and the time frame for correcting excessive deficits were relaxed, while procedural deadlines were extended."¹⁵⁴ While the reform's objective was to make the Pact more "intelligent" and "flexible" by "taking better account of economic circumstances and country-specific characteristics"¹⁵⁵, in practice "the Pact appeared to have lost its teeth".¹⁵⁶ Therefore, the reform attempt in 2005 can even be considered as a step backwards in terms of fiscal sustainability and enforcement of conditionality.

Therefore, it has been argued that the SGP did not achieve its objectives as "once Member States joined the euro area, there was no perceived risk of being effectively sanctioned and the financial markets did not exercise the expected pressure on the individual Member States."¹⁵⁷ Despite several reform attempts, the SGP's provisions have retained a "considerable degree of administrative and political discretion"¹⁵⁸ in both the preventive arm and the EDP: "All in all, the changes envisaged do not represent the 'quantum leap' in the euro area's fiscal surveillance which is necessary to ensure its stability and smooth functioning."¹⁵⁹ The SGP's weak conditionality provisions were, according to some scholars, one of the reasons why the Eurozone was so severely hit by the global financial crisis in 2008: "Hollow

¹⁴⁸ Bieber and Maiani (n 100) 1066.

¹⁴⁹ cf. *ibid.*

¹⁵⁰ Keppenne (n 104) 816.

¹⁵¹ *ibid.* 815.

¹⁵² Council Regulation (EC) No 1055/2005 of 27 June 2005 amending Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies [2005] OJ L174/1; and Council Regulation (EC) No 1056/2005 of 27 June 2005 amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure [2005] OJ L174/5.

¹⁵³ Schuknecht and others (n 126) 10.

¹⁵⁴ *ibid.*; see Regulation 1056/2005 (n 152) art 1(1), 1(3b) and 1(5b).

¹⁵⁵ Keppenne (n 104) 819.

¹⁵⁶ Hinarejos (n 35) 587.

¹⁵⁷ Keppenne (n 104) 820.

¹⁵⁸ Schuknecht and others (n 126) 15.

¹⁵⁹ *ibid.* 5.

enforcement is always conducive to moral hazard."¹⁶⁰ There has also been much debate, whether larger Member States have been granted "a more lenient treatment"¹⁶¹ due to their big political influence. Some scholars even went as far as to criticize the Stability and Growth Pact as a "macroeconomic constitution of mutual congratulations"¹⁶² due to its ineffective enforcement. While the SGP's precise role in the outbreak of the Eurozone crisis is contested, it is in any case a prime example of how in EU law "any leeway risks being exploited in the interests of short-term political considerations at the expense of consistent and rigorous implementation."¹⁶³

The global financial crisis of 2008 has made the need for a reform of the SGP evident, clearly showing how "it was not sufficient to focus solely on the fiscal position of the Member States."¹⁶⁴ Apart from the introduction of the European Semester, which will be analyzed separately in chapter 3.3., there were two major changes made to the SGP framework: Firstly, the six-pack legislation pack introduced a new sanctioning mechanism for "manipulation of statistics", following the experience of the Greek sovereign debt crisis: Now, fines can be imposed following a QMV decision in the Council upon Member States who "intentionally or by serious negligence misrepresent deficit and debt data"¹⁶⁵.

The same regulation also introduced a procedure called Reverse Qualified Majority Voting (RQMV) to the EDP: Contrary to the wording of Art. 126 TFEU, now recommendations by the Commission are "deemed to be adopted by the Council unless it decides to reject" within ten days.¹⁶⁶ This ultimately means that "a qualified majority in the Council would be necessary to avoid the imposition of a sanction, rather than in order to impose it"¹⁶⁷, turning the tables in the political game. This reform has effectively led to a medium application of SGP rules. This latest reform has also led to an even stronger focus on MTOs, as the SGP has become more and more fine-tuned on the specificities of the Member States. Although the corrective arm has never led to sanctions, the MTO and its specifications from the preventive arm have become the conditions against which any correction has to be made.

To conclude, the SGP is the oldest conditionality-based instrument affecting national budgets in the context of EMU law. Due to several legislative reforms, the enforcement of SGP rules has become medium. However, the SGP seems to have lost relevance recently, as exemplified by the most recent triggering of the general escape clause in the aftermath of the Covid-19

¹⁶⁰ Dariusz Adamski, 'Europe's (Misguided) Constitution of Economic Prosperity' [2013] 50 Common Market Law Review 52.

¹⁶¹ Bieber and Maiani (n 100) 1066.

¹⁶² Adamski (n 160) 50.

¹⁶³ Schuknecht and others (n 126) 15.

¹⁶⁴ Keppenne (n 104) 819.

¹⁶⁵ Regulation (EU) No 1173/2011 of the European and of the Council of 16 November 2011 on the effective enforcement of budgetary surveillance in the euro area [2011] OJ L306/1 8(1).

¹⁶⁶ *ibid* arts 4(2), 5(2) and 6(2).

¹⁶⁷ Hinarejos (n 35) 599.

pandemic.¹⁶⁸ The SGP's Excessive Deficit Procedure is a prime example of ex post negative conditionality: Theoretically, sanctions are adopted after non-compliance has occurred. As there is no positive incentive involved, the EU lacks effective legal remedies of enforcement, as compliance with EU law by the Member States is "ultimately voluntary": "The EU is, unlike several federal States, not even theoretically empowered to use coercion in order to enforce EU law."¹⁶⁹ Ultimately, sanctions under the SGP are only a nominal step of last resort, while in practice the Pact relies heavily on peer pressure and recommendations.¹⁷⁰

While the (primary law) treaty provisions have "remained largely unchanged over the years", their implementation has "greatly evolved through their inclusion within the broader set of [secondary law] rules of the SGP"¹⁷¹. The introduction of RQMV to the EDP is thus a good example in how EU institutions circumvent the over-constitutionalization¹⁷² of the rigid SGP rules of the TFEU by resorting to implementing legislation instead of treaty reforms in order to "facilitate and sharpen sanctions".¹⁷³

As a direct result of this band aid approach, "the complexity of the pact has increased over time to such an extent that only a small group of experts could claim to understand the whole edifice".¹⁷⁴ This legal unpredictability is unlikely to change soon, as the SGP framework is currently undergoing yet another revision.¹⁷⁵

3.2. Soft law measures

The previous chapter has shown how even sanction-based (negative) conditionality instruments ultimately "operate primarily on mechanisms that rely on peer-pressure and encouragement".¹⁷⁶ As previously mentioned, this is due to the fact that compliance with EMU rules is "ultimately voluntary"¹⁷⁷ as the EU lacks remedies of coercion. The flipside of this aspect is that "non-legally binding instruments may be quite as effective (or ineffective) as legally binding ones".¹⁷⁸ Therefore, soft law measures are often used in the context of EMU law as a "convenient tool for the exercise of naked political power" that can be used for "informal standard-setting".¹⁷⁹

¹⁶⁸ cf. Caroline De la Porte and Elke Heins, 'Introduction: EU Constraints and Opportunities in the COVID-19 Pandemic—the Politics of NGEU' [2022] 20 Comparative European Politics 135, 137.

¹⁶⁹ Bieber and Maiani (n 100) 1061.

¹⁷⁰ Keppenne (n 104) 817.

¹⁷¹ *ibid.*

¹⁷² cf. Griller and Lentsch (n 68) 1–2.

¹⁷³ Bieber and Maiani (n 100) 1066.

¹⁷⁴ Keppenne (n 104) 821.

¹⁷⁵ cf. Fromage and Markakis (n 33) 2.

¹⁷⁶ Leo Flynn, 'Non-Fiscal Surveillance of the Member States' in Fabian Amtenbrink, Christoph Herrmann and René Repasi (eds), *The EU Law of Economic and Monetary Union* (Oxford University Press 2020) 850.

¹⁷⁷ Bieber and Maiani (n 100) 1061.

¹⁷⁸ Jan Klabbers, *An Introduction to International Organizations Law* (Fourth edition, Cambridge University Press 2022) 160.

¹⁷⁹ *ibid.*

Consequently, soft law measures have been used extensively in the field of EMU since its early days despite their apparent lack of "normative force".¹⁸⁰ Before the global financial crisis, non-binding recommendations were essentially the only instrument of EMU law apart from the previously described SGP. The legal rank of soft law measures is contained in Art. 288 of the Treaty, which explicitly provides that – unlike regulations, directives and decisions – recommendations and opinions "shall have no binding force".¹⁸¹

Despite this article's unambiguous wording, the CJEU has "most often found some legal obligation to be contained in them, presumably on the theory that such instruments would not be made if there was not the intention to have them adhered to."¹⁸² In *Grimaldi*, the ECJ cryptically ruled that EU recommendations "cannot (...) be regarded as having no legal effect" and therefore need to be taken into account by national courts when interpreting domestic law.¹⁸³ According to *Klabbers*, this interpretation beyond Art. 288 TFEU that was delivered by the ECJ "could only mean one thing: the recommendation produced legal effects after all".¹⁸⁴ This uncertainty regarding their legal rank shows how, in practice, the lines between the EU's legislative instruments can be blurred. This is especially true considering that several soft law measures adopted by the EU such as "action programs", "guidelines", "codes of conduct" or "resolutions" are not even mentioned in primary law.¹⁸⁵ What all those non-binding instruments have in common is that they are mainly adopted when a unanimous vote cannot be reached, but a majority still wants to take action.¹⁸⁶ In the context of EMU, soft law measures strive to describe the "conditions for inclusive economic growth"¹⁸⁷, trying to "influence behavior, but without creating law".¹⁸⁸ They are thus cooperation-based rather than rule-based.

In the context of EMU law, non-binding measures are often adopted through the so-called open method of coordination (OMC). This procedure does not serve to create binding EU legislation, it is instead a "method of soft governance that aims to spread best practice and achieve convergence towards Union goals in those policy areas in which the Member States are the primary actors".¹⁸⁹

A prominent non-binding instrument that has been introduced by this procedure in March 2011 is the so-called Europlus Pact.¹⁹⁰ This Pact was established to increase coordination in the field of economic policy by using a holistic approach, aspiring towards higher competitiveness

¹⁸⁰ cf. Lenaerts (n 34) 755.

¹⁸¹ TFEU (n 36) art 288.

¹⁸² *Klabbers* (n 178) 173.

¹⁸³ Case C-322/88 *Salvatore Grimaldi v Fonds des maladies professionnelles* [1989] EU:C:1989:646 [para 18].

¹⁸⁴ *Klabbers* (n 178) 173.

¹⁸⁵ *ibid.*

¹⁸⁶ *ibid* 160.

¹⁸⁷ Lenaerts (n 34) 754.

¹⁸⁸ *Klabbers* (n 178) 159.

¹⁸⁹ Flynn (n 176) 851.

¹⁹⁰ Marios Psychalis, 'The Structure of Euro Plus Pact. A Path for Measuring It's Adoption' [2019] 1 Finance, Accounting and Business Analysis (FABA) 138, 138.

and convergence.¹⁹¹ The Europlus Pact is different from the other conditionality-based instruments that are discussed in this research in one key aspect: It is not based on either primary or secondary law, but on a conclusion by the EUCO, thus on a political declaration. This commitment is also unique because it was joined by six countries that were not part of the EZ at the time¹⁹² (two of which have since adopted the common currency). The Europlus Pact rests upon four pillars, which aim at fostering competitiveness, employment, sustainability of public finances and financial stability.¹⁹³

In practice however, the Europlus Pact has proven to be rather inefficient, due to its "lack of an evaluation control for the implementation of the goals and rules".¹⁹⁴ The EC is not even entitled to create regular non-binding reports to monitor compliance.¹⁹⁵ According to *Hinarejos*, "[t]here is a feeling that the Pact is largely 'dormant' and has lost traction with the Member States in the years since its adoption".¹⁹⁶ A revival of the Pact with new enforcement rules seems very unlikely at the moment.¹⁹⁷

Another soft law initiative that had more impact in the field of EMU is the Structural Reform Support Programme (SRSP), which was adopted in 2017: "The SRSP offers technical assistance to all Member States, aimed at improving their institutional and administrative capacities for implementing structural reforms with a view to building strong economic foundations."¹⁹⁸ Eligible actions that could be financed by the SRSP included various non-binding actions such as workshops, expert advice, working visits, training, data collection and research.¹⁹⁹

According to *Flynn*, the SRSP "drew on experience with technical assistance for reforms in Greece (...) and Cyprus (...), extending that model to all Member States, on a voluntary basis and at the Member State's request."²⁰⁰ The SRSP was supplied with € 222.8 millions²⁰¹ of funding, which is relatively modest in EU standards, since the SRSP "does not provide funding to Member States, but only technical support."²⁰²

Despite, or perhaps because of its soft application, the SRSP proved to be very prized by the Member States: Requests for support significantly exceeded the amount of available funding.

¹⁹¹ *ibid* 139.

¹⁹² Conclusion EUCO 10/1/11 REV 1 14 of the European Council of 24 March 2011 s 1 para 11.

¹⁹³ *ibid* app 1, 15.

¹⁹⁴ *Psychalis* (n 190) 139.

¹⁹⁵ EUCO 10/1/11 REV 1 (n 192) app 1; see also *Flynn* (n 176) 877.

¹⁹⁶ *Hinarejos* (n 35) 600.

¹⁹⁷ *cf.* *Psychalis* (n 190) 138.

¹⁹⁸ *Flynn* (n 176) 872.

¹⁹⁹ Regulation (EU) No 2017/825 of the European Parliament and of the Council of 17 May 2017 on the establishment of the Structural Reform Support Programme for the period 2017 to 2020 and amending Regulations (EU) No 1303/2013 and (EU) No 1305/2013 [2017] OJ L129/1 art 6.

²⁰⁰ *Flynn* (n 176) 871–872.

²⁰¹ Regulation (EU) No 2018/1671 of the European Parliament and of the Council of 23 October 2018 amending Regulation (EU) 2017/825 to increase the financial envelope of the Structural Reform Support Programme and adapt its general objective [2018] OJ L284/3 art 1(3a).

²⁰² *Flynn* (n 176) 873.

Consequently, the financial envelope of this instrument was almost quadrupled (€ 864 million)²⁰³ as part of the new 2021-2027 MFF budgetary framework. The instrument was also renamed Technical Support Instrument (TSI), reflecting the extended scope of the objectives pursuant the jointly adopted RFF.²⁰⁴ Apart from those changes, the legal structure of the TSI has remained essentially identical to the SRSP.²⁰⁵

To conclude, soft law measures are based on cooperation and soft application. They are implemented primarily on the political level, setting informal standards through encouragement by the Commission as well as peer pressure in the Council. Yet again, the EP is completely sidelined in this process. As this section has shown, soft law measures are not devoid of legal effect, however they only work through the back door in an area of jurisprudential uncertainty. Soft law measures can best be described as relying on ex ante positive conditionality, as most of the previously described instruments are based on political incentives and a retroactive encouragement: Ideally, soft law measures should foster an economic dialogue, offering an exchange of experiences and best practice solutions. However, an element of negative conditionality is also present: In some cases, the monitoring can be used to "shame" non-compliant Member States and therefore diminish their political capital on the EU level.

3.3. European Semester:

The need for a coordination mechanism in the field of economic policy had become evident in the context of the Eurozone crisis, during which "neither the preventive nor the corrective arm of the SGP appeared to be effective".²⁰⁶ Introduced in 2011, the European Semester (ES) is a cycle for the coordination of national economic and fiscal policies under a common budgetary timeline.²⁰⁷ This mechanism is designed to ensure "much closer" surveillance of budget rules, as contained in the Stability and Growth Pact (SGP) and the Macroeconomic Imbalance Procedure (MIP).²⁰⁸

The ES process involves a systematic review of budgetary plans before the formal adoption in the fall: "In this way, Member States coordinate their budgetary decisions to avoid, prevent or, as far as possible, cope with the negative externalities inherent in having a common monetary policy and different fiscal policies."²⁰⁹ To reach these aims, the European Semester "brings

²⁰³ Regulation (EU) No 2021/240 of the European Parliament and of the Council of 10 February 2021 establishing a Technical Support Instrument [2021] OJ L57/1 art 6(1).

²⁰⁴ *ibid* arts 4(b) and 5.

²⁰⁵ *cf.* *ibid* art 8.

²⁰⁶ Lenaerts (n 34) 755.

²⁰⁷ *cf.* Flynn (n 176) 852; and Keppenne (n 104) 848.

²⁰⁸ *cf.* Federico Fabbrini, *EU Fiscal Capacity: Legal Integration after Covid-19 and the War in Ukraine*. (1st edn, Oxford University Press 2023) 15; as well as Fromage and Markakis (n 33) 2.

²⁰⁹ Adrián Fernández Domínguez, 'La Respuesta Europea a La Crisis de La Covid-19: Análisis Jurídico Del Next Generation EU y Gobernanza Económica Del Mecanismo de Recuperación y Resiliencia' [2021] 69 *Estudios de Deusto* 265, 289 (translated from Spanish by the author).

together into a single policy cycle a variety of policy instruments aiming at strengthening coordination among Member States and between macroeconomic and structural issues²¹⁰. Many scholars believe that this instrument represents a fundamental shift in EU socioeconomic governance,²¹¹ as it has led to a regular and institutionalized interaction between Member States and EU bodies, primarily the Commission and the Council of the EU.²¹² In the field of economic and fiscal policy, the ES has become a "privileged site for coordination and is increasingly a point from which other union-level tools start".²¹³ Despite its relevance, the ES has remained a "work in progress": "The Semester's policy content and decision-making procedures have evolved considerably since its creation in 2010, and further revisions have been mooted."²¹⁴ Over the years, its scope has been progressively expanded to include a "greater focus on sustainable growth" beyond the initial "core fiscal and economic focus".²¹⁵ It is important to note that even though the ES did not formally confer any new competences to the EU level, it has still "given the EU institutions a more visible and authoritative role than ever before in monitoring, scrutinizing and guiding national economic, fiscal and social policies, especially within the euro area."²¹⁶ The annual policy cycle of the ES process can be subdivided in four inter-related activities: "priorities-setting, policy guidance, monitoring and implementation".²¹⁷ This regular policy cycle does not produce one final agreement, it "rather acts as a succession of open-ended decisions".²¹⁸

The European Semester begins in late autumn with the publication of the Annual Sustainable Growth Strategy (ASGS) presented by the Commission. This document "identifies the key reform priorities for the EU and offers general policy guidance to the member states for the coming year".²¹⁹ Following those general guidelines to boost growth and employment, the EC proposes specific collective recommendations for the entire euro area (EAR), which are discussed by the European Council and approved by the Council in the spring.²²⁰ In April, the Member States present National Reform Programs defining the main structural investments, as well as either their Stability Programs (for EZ-countries) or a Convergence Program (for Non-EZ-countries) outlining their budgetary strategy.²²¹ In May, the Commission evaluates the

²¹⁰ Manuela Moschella, 'What Role for the European Semester in the Recovery Plan?' (2020) Economic Governance Support Unit 16.

²¹¹ Amy Verdun and Jonathan Zeitlin, 'Introduction: The European Semester as a New Architecture of EU Socioeconomic Governance in Theory and Practice' [2018] 25 *Journal of European Public Policy* 137, 139.

²¹² Fromage and Markakis (n 33) 2.

²¹³ Flynn (n 176) 855.

²¹⁴ Verdun and Zeitlin (n 211) 145.

²¹⁵ Moschella (n 210) 16.

²¹⁶ Verdun and Zeitlin (n 211) 138.

²¹⁷ Moschella (n 210) 16.

²¹⁸ Domínguez (n 209) 290 (translated from Spanish by the author).

²¹⁹ Verdun and Zeitlin (n 211) 138.

²²⁰ cf. TFEU (n 36) art 121(2).

²²¹ Regulation (EU) No 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of

submitted programs and proposes draft country-specific recommendations (CSRs), which are endorsed by the European Council and adopted by the Council of the EU in July.²²²

The CSR are a functional equivalent of the EAR, but for each individual EZ-Member State.²²³

They act as public recommendations and are meant to "provide tailored advice to individual Member States on how to boost jobs, growth and investment, while maintaining sound public finances."²²⁴ The CSR are "far-reaching as to the aspects of Member States' conduct they scrutinize"²²⁵ and can be enforced by a process of peer review and possible sanctions (only for EZ-Member States).²²⁶ The European Semester thus combines the two previously mentioned instruments into a hybrid framework, relying on both rules and coordination.

From July to December, the National Semester (= autumn package) takes place, in which the Member States take the received recommendations into account when drawing up their national programs. All Eurozone countries²²⁷ must submit draft budgetary plans (DBP) to the Commission and the Eurogroup by mid-October.²²⁸ The Commission then examines the submitted draft budget plans and may require the Member State to revise the draft in case of a particularly serious failure to comply with the budgetary policy obligations²²⁹ laid down in the SGP: "So far, the Commission has never used that power, which could have deep political impact."²³⁰ Finally, the Member States adopt the budgets at the end of the year.²³¹

Within this policy framework, national independent fiscal institutions (IFI) in the Member States play a key role in preparing and monitoring the macroeconomic and budgetary decisions by the respective government.²³² The two-pack Regulation 473/2013 defines IFIs as "bodies that are structurally independent or bodies endowed with functional autonomy vis-à-vis the budgetary authorities of the Member State, and which are underpinned by national legal provisions ensuring a high degree of functional autonomy and accountability."²³³ They provide public assessments with respect to national fiscal rules, evaluating especially the occurrence of the conditions to activate the correction mechanism.²³⁴

excessive deficit of the Member States in the euro area [2013] OJ L140/11 4(1); as well as Regulation (EU) No 1175/2011 of the European and of the Council of 16 November 2011 amending Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies [2011] OJ L306/12 art 1(3/2a-d).

²²² TFEU (n 36) art 121(3); as well as NN, 'The Autumn Package Explained' (*commission.europa.eu*) <<https://bit.ly/3hRxCC8>> accessed 27 December 2022.

²²³ cf. Flynn (n 176) 855.

²²⁴ NN, 'The European Semester Timeline: Spring Package' (*commission.europa.eu*) <<https://bit.ly/3hdMhqY>> accessed 11 December 2022.

²²⁵ Flynn (n 176) 854.

²²⁶ *ibid* 871; for the legal base cf. TFEU (n 36) art 136(1) and 136(2).

²²⁷ Regulation 473/2013 (n 221) art 1(3).

²²⁸ *ibid* art 4(2) and 6(1).

²²⁹ *ibid* art 7(2).

²³⁰ Keppenne (n 104) 849.

²³¹ Regulation 473/2013 (n 221) art 4(3).

²³² Keppenne (n 104) 849; as well as Merlo and Fasone (n 42) 588.

²³³ Regulation 473/2013 (n 221) art 2(1a).

²³⁴ *ibid* arts 5(1a) and 5(2a).

Who does what in the European Semester?

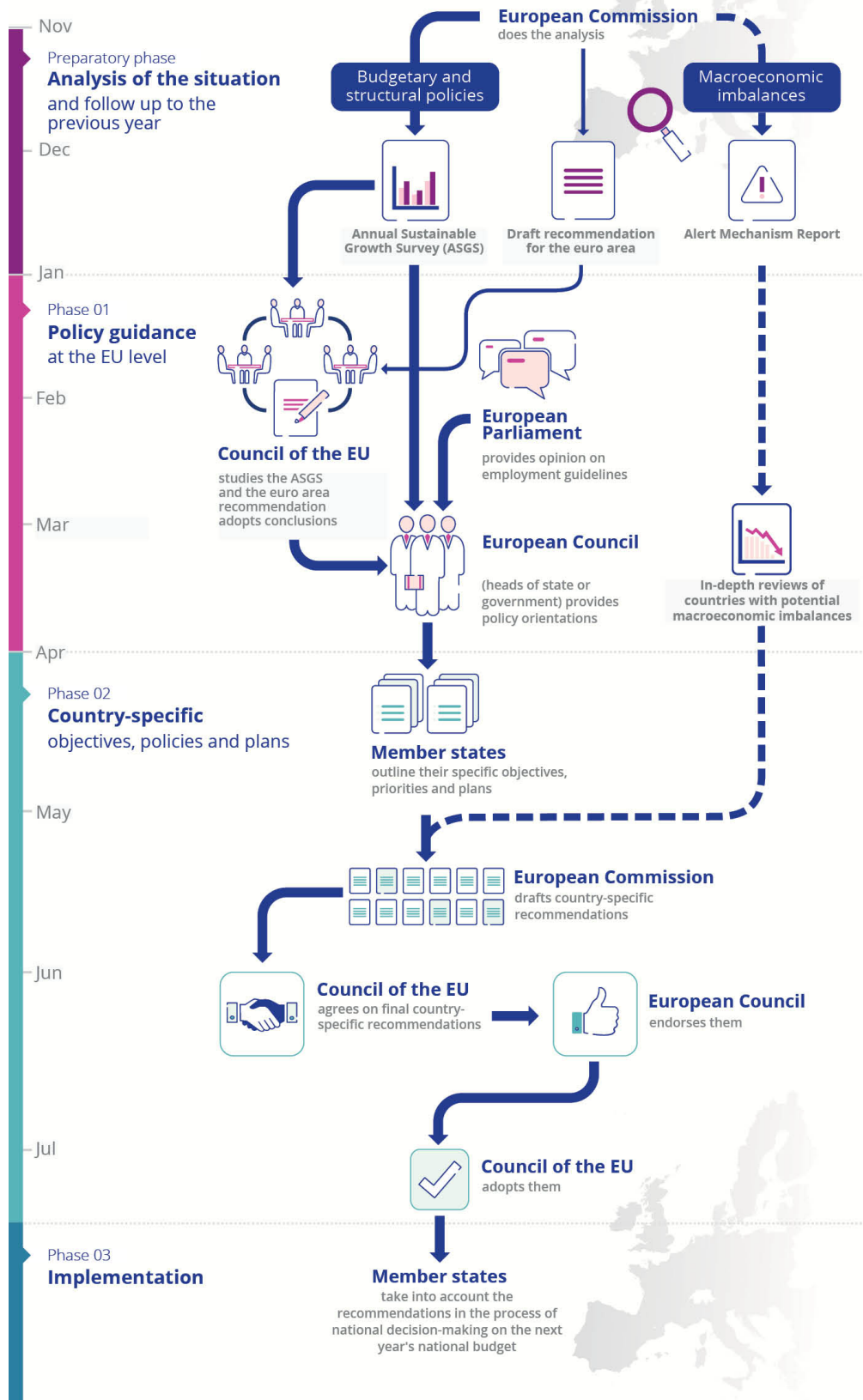


Illustration 1: Governance procedure of the European Semester

The application of this admittedly rather complex procedure has produced mixed results in practice, as the Member States of the Eurozone have shown very different rates of CSR implementation (see illustration 2 below).²³⁵ This can be explained by three different factors at play, that have been identified by *Flynn*. Firstly, in terms of realpolitik, the national governments "may be more concerned about avoiding a recommendation being made to them than about following up on those received."²³⁶ This trend has been intensified by an effective lack of sanctioning at the EU level: "the 'sticks' that could be used against euro area countries may be as hard for the Union institutions to wield as the resulting 'blows' would be for those countries to experience."²³⁷ Thirdly, it is also important to point out that most of the issues addressed in the CSR "may require many years of multi-faceted action that fits poorly within an annual cycle"²³⁸, raising the threshold for effective action even further.

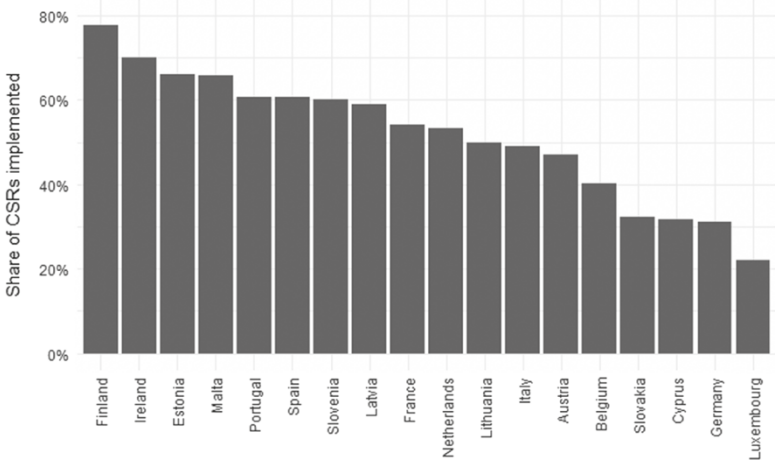


Illustration 2: Share of implemented CSRs by country

Therefore, it can be concluded, that the low compliance with the ES process in the pre-Covid period was due to the lack of an effective incentive or disincentive: "Without proper carrots and sticks, there is always a way for member states not to implement the CSRs."²³⁹ The application of conditionality in the ES can best be described as medium: "It is set-up as 'not too soft and not too hard', leaving ample room for manoeuvre regarding the choice of policies to be implemented."²⁴⁰

²³⁵ Bart Vanhercke and Amy Verdun, 'The European Semester as Goldilocks: Macroeconomic Policy Coordination and the Recovery and Resilience Facility' [2022] 60 *JCMS: Journal of Common Market Studies* 204, 207.

²³⁶ *Flynn* (n 176) 871.

²³⁷ *ibid.*

²³⁸ *ibid.*

²³⁹ Valerie D'Erman and Amy Verdun, 'An Introduction: "Macroeconomic Policy Coordination and Domestic Politics: Policy Coordination in the EU from the European Semester to the Covid-19 Crisis"' [2022] 60 *JCMS: Journal of Common Market Studies* 3, 7.

²⁴⁰ Vanhercke and Verdun (n 235) 207.

For this reason, this instrument has triggered a lot of different responses by journalists and scholars alike: Whereas some point to the bureaucratic burden and interference with domestic politics, others who are more in favor of EU-level intervention have described the ES as "toothless" and "not stringent enough".²⁴¹ *Flynn* even has indirectly attributed the lack of compliance precisely to this mixture of strict and soft conditionality application.²⁴²

However, the medium application of this instrument can also be framed as an asset: "It provides structure and direction, while not being overly intrusive."²⁴³ The scholars continue to affirm that the ES provides an appropriate "balance between providing sufficient constraints, while leaving considerable leeway to the member states to choose and implement their preferred domestic policy options"²⁴⁴ in areas that traditionally belong to national sovereignty. Scholars have thus shared opposing views whether the mixture of strict and soft conditionality within the ES has improved or worsened its effectiveness. What matters for this research is the uncontested hybrid enforcement within the instrument's governance architecture,²⁴⁵ which strikes a balance "between 'hard', rules-based elements derived from the SGP and 'softer', more deliberative forms of policy co-ordination associated with the OMC".²⁴⁶

This balance is also reflected in the institutional set-up of the ES: "Member states do not control the European Semester, nor have supranational institutions become all-powerful. Although the European Council formally remains the political master of the Semester, it cannot and does not run the process itself. The Commission plays a pivotal role in steering the Semester, having gained new powers and developed new capacities to set priorities, review national policies and performance, draft CSRs and propose sanctions under the EDP and MIP. But the Commission does not exercise these powers and capacities in isolation from national actors."²⁴⁷ The result is an "increasingly intense bilateral and multilateral dialogue", which has "blurred the boundaries between 'European' and 'national' actors in EU policy co-ordination."²⁴⁸

As is usual in the field of EMU, the European Parliament has only been granted minor involvement within this dialogue. The institution regularly takes part in the so-called Economic Dialogue. In order to "ensure greater transparency and accountability" of the ES, the competent committee of the EP may invite the Presidents of the Council, EC, EUCO or Eurogroup to relevant issues.²⁴⁹ Apart from this, it has been criticized that the EP is "not

²⁴¹ *ibid* 207–208; and D'Erman and Verdun (n 239) 6.

²⁴² Vanhercke and Verdun (n 235) 207.

²⁴³ *ibid*.

²⁴⁴ *ibid* 208.

²⁴⁵ Armstrong (n 28) 610.

²⁴⁶ Verdun and Zeitlin (n 211) 140.

²⁴⁷ *ibid* 144.

²⁴⁸ *ibid* 145.

²⁴⁹ Regulation 473/2013 (n 221) art 15(1).

involved in an executive role in the surveillance process and has not obtained decision-making powers in the daily management of the EU fiscal and economic governance framework."²⁵⁰

The only directly elected EU institution has thus no say in the formulation or adoption²⁵¹ of the CSR: "Instead, its role lies in holding the responsible EU officials accountable (to the extent permitted by the structure of the European Semester), in monitoring compliance with the relevant EU rules and in fostering national ownership of the EU's fiscal rules and recommendations through its interactions with the Member States."²⁵² Even though the EP's role has remained weak, some "improvements were introduced over time, notably thanks to a change in the calendar with a view to allowing its involvement at a more suitable time."²⁵³

A new development that could increase domestic ownership of the Semester process is the integration of the newly adopted Recovery and Resilience Facility (RRF) within the ES.²⁵⁴

While effects of further conditionality-based instruments on the the European Semester will be further covered in the chapters 4.4. and 5.4., at this point it is important to note that the ES "may well fundamentally change in character from being a non-binding structure for policy coordination to a vehicle for the allocation of a major economic impetus which is to have more teeth".²⁵⁵ *Vanhercke and Verdun*, who have written a publication on the reciprocal influence, continue arguing: "This link with the RRFs [national recovery and resilience plans] should, in principle, provide the Commission and national stakeholders with a powerful new opportunity to combine the 'sticks' of past CSRs with the 'carrots' of significant funding, including for social and labour market policies. The RRF thus 'upgrades' the Semester, in that it offers financial incentives in return for a coherent package of public investments and (potentially painful) reforms, thereby giving European governments additional means to overcome domestic institutional resistance in the face of Semester tools and recommendations."²⁵⁶

To conclude, the European Semester has become an integral part of the EU's fiscal and economic governance.²⁵⁷ It serves as an enforcement tool for greater budgetary discipline²⁵⁸ as well as a forum for the coordination of economic, employment and social policy.²⁵⁹ Its relevance has been greatly increased by the incorporation of the RRF in the process. Despite its complex and bureaucratic procedures, its medium application strikes a balance between on the one hand strict, rule-based governance and on the other hand a soft and coordination-based approach based on mutual trust and collaboration.²⁶⁰ Due to the connection with the

²⁵⁰ Fromage and Markakis (n 33) 5.

²⁵¹ cf. Regulation 473/2013 (n 221) art 4.

²⁵² Fromage and Markakis (n 33) 5.

²⁵³ *ibid* 9.

²⁵⁴ cf. *Vanhercke and Verdun* (n 235) 218.

²⁵⁵ *ibid* 217–218.

²⁵⁶ *ibid* 218.

²⁵⁷ *ibid* 207; as well as Domínguez (n 209) 289.

²⁵⁸ Fabbrini, *Next Generation EU* (n 13) 42.

²⁵⁹ Verdun and Zeitlin (n 211) 137; see also Armstrong (n 28) 609.

²⁶⁰ cf. Armstrong (n 28) 603.

RRF, the ES has become a prime example of sticks- and carrots-conditional, as it involves both a negative incentive (sanctions for EZ-countries) and a positive incentive (funds of the NGEU). Despite the ramped-up enforcement, the role of the EP has remained weak, which for *Fromage and Markakis* raises the question, whether its prerogatives are still "commensurate" in the post-Covid legislative context,²⁶¹ which still sees the Commission and the Council "in the driver's seat"²⁶². It can therefore be argued that the potential synergies between the ES and the RRF²⁶³ are "not fully exploited on implementation, ownership, and accountability".²⁶⁴

3.4. Fiscal Compact (SCG Treaty)

The Treaty on Stability, Coordination and Governance (TSCG), which is also known as the Fiscal Compact, is an intergovernmental agreement that has entered into force in 2013²⁶⁵, at the peak of the Eurozone crisis. It was launched by a Franco-German initiative, which proposed an EU treaty revision to enforce fiscal discipline,²⁶⁶ a proposal that "could not be achieved for political reasons under the Treaty framework due to the resistance of the UK"²⁶⁷. As the Czech Republic initially also refused to sign the TSCG and Croatia did not yet complete the enlargement procedure, it was initially adopted by only 25 Member States.²⁶⁸ Since then, it has been ratified by all current EU Member States.²⁶⁹

The TSCG consists of two distinctive parts: one dealing with budgetary discipline and one concerning economic convergence and cooperation.²⁷⁰ Since much of the TSCG rules regarding the governance of the euro are now also covered by EU law, this second part will not be further analyzed during this research. The most important addition that the Fiscal Compact has made to the EU fiscal governance framework is the obligation to implement rules on budgetary discipline into national law.²⁷¹ While this commitment had already been formulated in the Euro Plus Pact (see chapter 3.2.), the TSCG made it legally binding for the first time.

The Treaty thus "further tightened the deficit rule which Member States had to respect in drafting their budget laws"²⁷² that was contained in previous instruments such as the Stability

²⁶¹ Fromage and Markakis (n 33) 2.

²⁶² *ibid* 8.

²⁶³ cf. Domínguez (n 209) 295.

²⁶⁴ Moschella (n 210) 30.

²⁶⁵ Francesco Martucci, 'Non-EU Legal Instruments (EFSF, ESM, and Fiscal Compact)' in Fabian Amtenbrink, Christoph Herrmann and René Repasi (eds), *The EU Law of Economic and Monetary Union* (Oxford University Press 2020) 319.

²⁶⁶ Armstrong (n 28) 603.

²⁶⁷ Griller and Lentsch (n 68) 2.

²⁶⁸ cf. Martucci (n 265) 293.

²⁶⁹ NN, 'Treaty on Stability, Coordination and Governance in the Economic and Monetary Union. Entry into Force.' (*consilium.europa.eu*) <<https://bit.ly/3Rde0Wu>> accessed 1 December 2022.

²⁷⁰ Hinarejos (n 35) 600.

²⁷¹ *ibid*; and Armstrong (n 28) 604.

²⁷² Fabbrini, *EU Fiscal Capacity* (n 208) 14.

and Growth Pact²⁷³: After ratification of the TSCG, the Member States were bound to implement the so-called Golden Rule, a "lower limit of a structural deficit of 0.5 % of the gross domestic product at market prices"²⁷⁴. However, *Armstrong* has argued that the key feature of the TSCG "is less that the fiscal rules are being tightened and more that they are to be institutionalised and even constitutionalised in domestic law."²⁷⁵

Beyond this, it has been argued that "the Treaty did not add much that is 'new' in terms of economic or fiscal integration".²⁷⁶ Therefore, the TSCG has been described as a primarily political commitment and as "an attempt to show leadership and appease investors, as well as an attempt to make bailouts more palatable to (paying) domestic electorates."²⁷⁷ *Maduro* has further elaborated on the political aspect of the drafting: "It allows Mrs. Merkel to sell in Germany certain things that she knows need to be done but that she is not able to sell to her own political public opinion otherwise. (...) It is not because European political leaders genuinely believe that this is what the markets want to end the crisis – they know that it is not the case – but they believe that this may have a political legitimating function with respect to the national public opinions."²⁷⁸ *Hyvärinen* has added that "in many instances the language of the [TSCG] agreement resembles European Council Conclusions".²⁷⁹

As already mentioned, the Fiscal Compact is not part of EU law, even though EU institutions have played an important role in "negotiating, drafting and applying" the SCG Treaty.²⁸⁰ *Martucci* has therefore described the TSCG as a "non-identified legal object", characterizing its nature as not purely intergovernmental, but a hybrid between "international treaty, EU acts and national law".²⁸¹ *Hyvärinen* has also stressed its diversified purpose: "This treaty is a mix of many things, legally and politically."²⁸² Still, the Fiscal Compact is not entirely unique: "Creating a treaty instrument mostly outside the EU framework, but not quite, to which not all member states adhere, is not new, as the experiences with the Schengen Agreement and the Prüm Convention have taught us."²⁸³

The TSCG's unorthodox legal nature has several reasons: The most obvious being perhaps the need to find a quick and easy compromise to appease the strong German pressure on the one hand and the equally strong British resistance on the other hand.²⁸⁴ However, the rationale

²⁷³ cf. *Armstrong* (n 28) 603.

²⁷⁴ Treaty on stability, coordination and governance in the Economic and Monetary Union 2012 art 3(1b).

²⁷⁵ *Armstrong* (n 28) 604.

²⁷⁶ *Hinarejos* (n 35) 601.

²⁷⁷ *ibid.*

²⁷⁸ Loïc Azoulai and others, 'Another Legal Monster? An EUI Debate on the Fiscal Compact Treaty' [2012] EUI Working Paper 2012/9 3.

²⁷⁹ *ibid.* 9.

²⁸⁰ *Lenaerts* (n 34) 757.

²⁸¹ *Martucci* (n 265) 318.

²⁸² *Azoulai and others* (n 278) 9.

²⁸³ Leonard Besselink and Jan Herman Reestman, 'The Fiscal Compact and the European Constitutions: Europe Speaking German' [2012] 8 *European Constitutional Law Review* 1, 4.

²⁸⁴ cf. *Fabbrini*, *Next Generation EU* (n 13) 42.

for going outside the EU's legal framework also has other reasons: the treaty sets out to "effect domestic legal and constitutional change"²⁸⁵ and it is settled case-law that a regular EU legislative measure does not have the power to change EU primary law or even the constitutional systems of the Member States.²⁸⁶

Article 3(2) of the TSCG provides that the balanced budget rule shall be implemented "through provisions of binding force and permanent character, preferably constitutional".²⁸⁷ *Hinarejos* has highlighted that "[w]hereas a previous draft made it obligatory to implement these rules into the national constitution, the final Treaty does not go as far, merely stating that implementation at the constitutional level is 'preferable'".²⁸⁸ The drafters of the Fiscal Compact ultimately shied away from the constitutional requirement due to the "rigidity of several constitutions" and to avoid the "interference of the vox populi" that could have been triggered by a constitutional referendum.²⁸⁹ The United Kingdom based its refusal also on the aforementioned Art. 3(2), referring to its tradition as a common law country with extensive parliamentary sovereignty: Under British law, the House of Commons cannot bind itself by an act of parliament.²⁹⁰

Concerning the national implementation of the balanced budget rule under Art. 3(2) TSCG, an action can be brought to the CJEU if a contracting party believes that the Golden Rule has not been correctly transposed in national law according to this requirement.²⁹¹ This conferral of jurisdiction over possible disputes arising between parties has been granted by a "special agreement" in the sense of Art. 273 TFEU.²⁹² The EU Court thus enjoys "strong powers" that are similar to the interstate infringement procedure.²⁹³ Still, the TSCG does not enjoy "the same level of judicial protection as that guaranteed by EU law".²⁹⁴ This is because the CJEU has only been granted oversight concerning the (nonrecurring) implementation, and not concerning the (ongoing) enforcement of the balanced budget rule.²⁹⁵ However, the CJEU does have the "powerful judicial mechanism"²⁹⁶ to impose a "lump sum or a penalty payment appropriate in the circumstances and that shall not exceed 0,1 % of its gross domestic product",²⁹⁷ a provision that has also been clearly influenced by the EU infringement procedure.²⁹⁸

²⁸⁵ *Armstrong* (n 28) 604.

²⁸⁶ *Opinion 2/94 Accession by the Community to the European Convention for the Protection of Human Rights and Fundamental Freedoms* [1996] EU:C:1996:140 [paras 30, 34 and 35].

²⁸⁷ TSCG art 3(2).

²⁸⁸ *Hinarejos* (n 35) 600–601.

²⁸⁹ *Besselink and Reestman* (n 283) 3.

²⁹⁰ cf. *ibid.*

²⁹¹ cf. TSCG art 8.

²⁹² cf. *Lenaerts* (n 34) 757; and TFEU (n 36) art 273.

²⁹³ TFEU (n 36) art 257.

²⁹⁴ *Lenaerts* (n 34) 757; cf. also *Armstrong* (n 28) 605.

²⁹⁵ *Keppenne* (n 104) 815; cf. TSCG art 8(2).

²⁹⁶ Federico Fabbrini, 'The Fiscal Compact, the Golden Rule and the Paradox of European Federalism' [2012] 36 *Boston College International and Comparative Law Review* 36.

²⁹⁷ TSCG art 8(2).

²⁹⁸ cf. TFEU (n 36) art 260(2) and 260(3).

The TSCG thus relies on rule-based, ex post negative conditionality that is enforced judicially rather than politically, as is the case under the SGP framework.²⁹⁹ In practice however, the judicial application is very soft and unlikely to ever be used,³⁰⁰ as the imposition of "heavy financial penalties" on "disobedient states"³⁰¹ is regarded as a measure of "very last resort"³⁰², in the context of the Fiscal Compact. Ultimately, under the TSCG the compliance with fiscal rules "still remains predominantly an exercise in political rather than judicial accountability".³⁰³ The Fiscal Compact has brought an "increasing centralization in the EU architecture of economic governance"³⁰⁴. As the intergovernmental agreement "strikes at the heart of the institutions of parliamentary democracy by dislocating as a matter of constitutional principle the budgetary autonomy of the member states"³⁰⁵, the TSCG has received a lot of criticism. Some scholars have argued that the previously mentioned financial penalties "tend to have a disparate impact on wealthy and less wealthy Member States (...) which are the most frequent offenders".³⁰⁶ Others have criticized the non-involvement of the European Parliament in the procedure, making the transfer of sovereignty less legitimate.³⁰⁷ Some even went as far to call the SCG Treaty a "legal monster", as it is arguably "poorly drafted; it does not fit with the body of EU law (...) and it risks to undermine (sic!) the idea of the European Union"³⁰⁸. This criticism has been refuted by *Martucci*, who instead argues that the TSCG is merely "an extension of the existing EU regulations"³⁰⁹ that has been "useful to deepen European integration"³¹⁰. While the agreement could have theoretically been adopted under enhanced cooperation as provided by Art. 20 TEU, it seems that "some member states, in particular Germany, thought that a treaty would be symbolically more powerful"³¹¹. At the time of its adoption, the Fiscal Compact had been conceived as a temporary solution. Art. 16 TSCG even spells out the commitment to incorporate the substance of the agreement into EU law "within five years, at most".³¹² This period has already elapsed in 2018, and until the publication of this research all attempts to incorporate the Treaty into the EU legal framework have been unsuccessful.³¹³

²⁹⁹ cf. Bieber and Maiani (n 100) 1071.

³⁰⁰ cf. Azoulai and others (n 278) 3.

³⁰¹ Fabbrini, 'The Fiscal Compact, the Golden Rule and the Paradox of European Federalism' (n 296) 36–37.

³⁰² Bieber and Maiani (n 100) 1070.

³⁰³ Armstrong (n 28) 605.

³⁰⁴ Fabbrini, 'The Fiscal Compact, the Golden Rule and the Paradox of European Federalism' (n 296) 37.

³⁰⁵ Besselink and Reestman (n 283) 5.

³⁰⁶ Bieber and Maiani (n 100) 1069.

³⁰⁷ Fabbrini, 'The Fiscal Compact, the Golden Rule and the Paradox of European Federalism' (n 296) 27.

³⁰⁸ Azoulai and others (n 278) 3; see also Armstrong (n 28) 604.

³⁰⁹ Martucci (n 265) 321.

³¹⁰ *ibid* 294.

³¹¹ Azoulai and others (n 278) 4.

³¹² TSCG art 16.

³¹³ Hinarejos (n 35) 601.

The reason might be that a TFEU amendment "may encounter precisely the same political obstacles which led to the adoption of the international agreement in the first place."³¹⁴

To sum up, the Fiscal Compact is an intergovernmental agreement that is "intrinsically linked" to EU law³¹⁵, despite not formally being part of it. The TSCG introduced the requirement to introduce a balanced budget rule within the national legal system, a requirement whose implementation is subject to ex post negative conditionality. However, the enforcement of the Golden Rule itself is not part of the legal enforcement involving financial sanctions, making the rule-based enforcement very soft in practice.

3.5. European Stability Mechanism (ESM)

The ESM is a permanent instrument for financial assistance that has been established to "safeguard the financial stability of the euro area as a whole and of its Member States".³¹⁶

Faced with the possibility of a Eurozone-Member State going bankrupt, it quickly became clear that this scenario would have catastrophic effects on the European banking system. The market paradigm that had dominated EMU until the global financial crisis had proven to be "untenable", the EU Member States thus had to create a "system of financial assistance that allowed for public transfers and departed from the pre-crisis understanding of the Treaties".³¹⁷

At a European Council meeting in October 2010, it was therefore agreed to establish the European Stability Mechanism (ESM).³¹⁸ This was made possible by the first use of the simplified treaty amendment procedure, which added a third paragraph to Art. 136 TFEU.³¹⁹

The ESM is based on an intergovernmental treaty outside the scope of EU law, signed and ratified by all EZ-Members in 2012.³²⁰ Despite being created as a private company in Luxembourg under private law, the ESM is still "intrinsically linked"³²¹ to EU law and institutions: "This ambiguous nature of the ESM and its activities is part of its DNA, as a rescue mechanism to safeguard the euro, the financial stability of the euro area and of its Member States and being all the same a separate international organization, legally not part of the EU and capitalized with resources from Member States' budgets."³²²

³¹⁴ Armstrong (n 28) 604.

³¹⁵ Lenaerts (n 34) 757.

³¹⁶ Treaty establishing the European Stability Mechanism 2012 art 3.

³¹⁷ Ioannidis, 'Europe's New Transformations: How the EU Economic Constitution Changed during the Eurozone Crisis' (n 16) 1249.

³¹⁸ cf. Fabbrini, *Next Generation EU* (n 13) 44–45.

³¹⁹ European Council Decision 2011/199/EU of 25 March 2011 amending Article 136 of the Treaty on the Functioning of the European Union with regard to a stability mechanism for Member States whose currency is the euro [2011] OJ L 91/1.

³²⁰ Martucci (n 265) 301.

³²¹ Lenaerts (n 34) 757.

³²² Ulrich Forsthoff and Nathalie Lauer, 'Policy Conditionality Attached to ESM Financial Assistance' in Fabian Amtenbrink, Christoph Herrmann and René Repasi (eds), *The EU Law of Economic and Monetary Union* (Oxford University Press 2020) 881.

As in the TSCG context, the ESM treaty does not offer same legal protection as EU rules, as its primary dispute settlement mechanism is also based on Art. 273 TFEU. Principles that are protected under EU rules such as openness and transparency cannot be enforced under the TESM.³²³ As the ESM is not an EU institution, the principle of conferral also does not apply.³²⁴ Unlike the previously described SCG Treaty, the ESM Treaty (TESM) has been concluded outside of EU rules not so much because of political obstacles but rather due to "the limits and constitutional constraints on the financial capacity of the European Union to support Member States in need of financial assistance".³²⁵

It had soon become clear that the European Financial Stabilization Mechanism (EFSM), a small loan facility within the EU system,³²⁶ could only "operate within narrow legal and financial parameters".³²⁷ Unlike the ESM, which uses funds that are financed and guaranteed by the members of the ESM/Eurozone, the EFSM uses resources of the EU budget and is carried by all 27 EU Member States.³²⁸

Both the EFSM and the EFSF (the intergovernmental predecessor of the ESM) were "not sufficient to reassure the markets" as both financial aid instruments were "temporary in nature, and had limited lending power."³²⁹ Moreover, there were also serious doubts as to the conformity of these facilities with the EU treaty framework,³³⁰ in particular relating to the no-bailout clause (Art. 125 TFEU) as well as to the question whether the Eurozone crisis was triggered by "extraordinary circumstances" or instead by "flawed fiscal or economic policies".³³¹ A common feature of the EFSF, the EFSM, and the ESM is their strong emphasis on conditionality rules: To access the loans, the recipient countries must implement certain policies that are defined in a macro-economic adjustment program (MAP).³³² Those reforms often involve "socioeconomic redistributive choices, such as changes in labour law, pensions, income tax, education and healthcare"³³³ that are mostly "broad in scope" and "go very deeply into regulating details of social and economic policies"³³⁴. The exact content of the MAP "depends on the specific circumstances and weaknesses of the recipient country".³³⁵

³²³ Lenaerts (n 34) 763.

³²⁴ *ibid* 767.

³²⁵ Armstrong (n 28) 605.

³²⁶ Council Regulation (EU) No 407/2010 of 11 May 2010 establishing a European financial stabilisation mechanism [2010] OJ L118/1; Council Regulation (EU) No 2015/1360 of 4 August 2015 amending Regulation (EU) No 407/2010 establishing a European financial stabilisation mechanism [2015] OJ L210/1.

³²⁷ Armstrong (n 28) 605–606.

³²⁸ Ioannidis, 'Europe's New Transformations: How the EU Economic Constitution Changed during the Eurozone Crisis' (n 16) 1253–1254.

³²⁹ Hinarejos (n 35) 593.

³³⁰ Palmstorfer (n 51) 772.

³³¹ Hinarejos (n 35) 593–594 (see also Chapter 2 of this Thesis).

³³² TESM art 16(2).

³³³ Lenaerts (n 34) 767.

³³⁴ Ioannidis, 'Europe's New Transformations: How the EU Economic Constitution Changed during the Eurozone Crisis' (n 16) 1265–1266.

³³⁵ *ibid*.

All in all, there are six financial instruments within the "ESM toolbox".³³⁶ Those instruments can be used to mitigate different kinds of financial imbalances. So far, only two have been used: macroeconomic adjustment loans³³⁷ – arguably the "most important" part of the ESM that was used to rescue Greece and Cyprus³³⁸ – and the indirect recapitalization instrument.³³⁹

In the context of the global Covid-19 pandemic, the ESM also established a new temporary credit line containing €240 billion.³⁴⁰ It could be activated upon request and was conditional only to the requirement "to use the money to pay for direct and indirect healthcare, cure, and prevention-related costs in this crisis".³⁴¹ Its declared objective was to "provide a reliable and affordable source of revenue to bridge the time until money from the Recovery and Resilience Fund will start to flow".³⁴² Despite the ESM's promise that many countries of the Eurozone could "fund more cheaply via the ESM than by borrowing directly from capital markets",³⁴³ no ESM member has requested financial assistance. This can mainly be explained by the "public distrust" among Southern Member States, who are "not very politically inclined" to borrow money from the ESM due to the "vivid memories of the 'men in black' from the Troika".³⁴⁴

The ESM has so far acted by implementing "concessional loans, debt relief, and the direct assumption of liabilities".³⁴⁵ In total, five Eurozone Member States, who had lost access to the international financial markets, have received financial assistance through conditionality-based ESM programs: Greece, Portugal, Ireland, Cyprus, and (partially) Spain.³⁴⁶ Greece in particular has benefitted "one of the biggest financial aid packages in global financial history", receiving €204 billion in European rescue loans.³⁴⁷ The country has since successfully exited its financial assistance program with the ESM in 2018.³⁴⁸

According to *Forsthoff and Lauer*, financial assistance under the ESM in principle follows a simple three-step program: "(1) mobilizing financial resources (in particular on the capital

³³⁶ Martucci (n 265) 306.

³³⁷ TESM art 16.

³³⁸ Ioannidis, 'Europe's New Transformations: How the EU Economic Constitution Changed during the Eurozone Crisis' (n 16) 1254; Ulrich Forsthoff and Jasper Aerts, 'Financial Assistance to Euro Area Members (EFSF and ESM)' in Fabian Amtenbrink, Christoph Herrmann and René Repasi (eds), *The EU Law of Economic and Monetary Union* (Oxford University Press 2020) 985.

³³⁹ TESM art 15.

³⁴⁰ cf. Friedrich Heinemann, 'Die Überdeckung Der Next Generation EU-Schulden Im Neuen EU-Eigenmittelbeschluss: Ausmaß Und Haftungskonsequenzen' (Springer 2021) 134.

³⁴¹ Nicola Giammarioli, 'How the ESM Helps Europe' (*esm.europa.eu*, 20 April 2020) <<https://bit.ly/3WVdfTr>> accessed 31 December 2022.

³⁴² Mattis Leson, 'Pandemic Crisis Support Credit by the ESM - Just Cheap Money That No One Wants or an Infringement of EU Law?' (*pathforeurope.eu*, 15 June 2021) <<https://bit.ly/3GakmAV>> accessed 31 December 2022.

³⁴³ Kalin Anev Janse and Siegfried Ruhl, 'Why the Covid-19 Credit Line Still Makes Sense' (*esm.europa.eu*, 24 July 2020) <<https://bit.ly/3vtz2Gd>> accessed 31 December 2022.

³⁴⁴ Leson (n 342).

³⁴⁵ Ioannidis, 'Europe's New Transformations: How the EU Economic Constitution Changed during the Eurozone Crisis' (n 16) 1254.

³⁴⁶ cf. Forsthoff and Aerts (n 338) 1006; as well as Fabbrini, *EU Fiscal Capacity* (n 208) 15.

³⁴⁷ Forsthoff and Aerts (n 338) 1009.

³⁴⁸ *ibid.*

markets); (2) granting of funds as stability support against; (3) strict conditionality to be implemented by the recipient country."³⁴⁹ What makes the ESM different from a regular market transaction are the concessional interest rates that are substantially lower than those offered by private creditors on the market: "It is one of the undeniable successes of the ESM (and previously of the EFSF) that it was able to raise significant amounts of money at very favourable conditions (...)." ³⁵⁰ This is made possible by €80 billion that are subdivided in accordance to the ECB's capital key³⁵¹ and paid in by the Member States: "This capital is not destined to be passed on to the beneficiary Member States receiving financial assistance. Instead, the capital's purpose is to ensure an excellent rating for the ESM, which shall allow the ESM to raise money on the financial markets at affordable rates which can then be lent on to the beneficiary Member States."³⁵²

Those lower interest rates are automatically passed on to the beneficiary country according to the financing costs of the ESM, making negotiations on the financial terms of assistance unnecessary: "[F]rom a legal point of view, the Member States do not face each other as debtors and creditors. The significance in political terms of this feature should not be underestimated."³⁵³ The financial assistance by the ESM thus acts as a "last resort when the situation of a Member State has already so deteriorated to the extent that it has become impossible for national authorities to borrow directly from the financial markets at acceptable financial conditions".³⁵⁴ Despite Member State guarantees as high as €705 billion, the maximum credit volume of the ESM is capped at €500 billion.³⁵⁵

Decisions within the ESM are taken by its executive organ: the Board of Governors, which is composed of the finance ministers of the Eurozone.³⁵⁶ It takes the most important decisions regarding the ESM's capital structure, economic policy conditionality and also the ultimate decision whether or not to provide support.³⁵⁷ Those decisions are taken by mutual, unanimous agreement,³⁵⁸ whereas other decisions fall under qualified majority, where votes are weighted in accordance with the financial contribution of the ESM members.³⁵⁹ The Board of Directors acts a subsidiary organ, which is composed of "people of high competence in economic and financial matters"³⁶⁰ who shall ensure compliance with the foundational ESM Treaty and the by-laws adopted by its Board of Governors.³⁶¹

³⁴⁹ Forsthoff and Lauer (n 322) 884.

³⁵⁰ *ibid.*

³⁵¹ TESI art 11.

³⁵² Forsthoff and Lauer (n 322) 884.

³⁵³ *ibid* 885.

³⁵⁴ Martucci (n 265) 308.

³⁵⁵ Heinemann (n 340) 139.

³⁵⁶ TESI art 5.

³⁵⁷ *cf.* Martucci (n 265) 304.

³⁵⁸ *ibid* 305.

³⁵⁹ TESI art 4(7); Fabbrini, *Next Generation EU* (n 13) 44.

³⁶⁰ TESI art 6(1); Martucci (n 265) 305.

³⁶¹ TESI art 6(6).

The complete lack of democratic constraints in the decision-making process has led to severe legitimacy concerns: negotiations involving the ESM are made in an intergovernmental setting behind closed doors, and involving only national executives.³⁶² In general, there seemed to be "unease with the speed in which important developments took shape which deviated significantly from what was previously considered to be the common understanding of central aspects of the functioning of the EU in general and the Economic Union in particular."³⁶³

The creation of the ESM bore high political and economic costs and has led to severe distributive conflicts. The institution was "heavily criticized by many citizens for intervening massively into the economic policy of the beneficiary countries by imposing austerity, by others for being still too lenient."³⁶⁴ Some have argued that conditionality, as prescribed in a Memorandum of Understanding (MoU), "amounts to a sell-out of the political autonomy and responsibility of democratically legitimate institutions, an exchange of obedience for money".³⁶⁵ As illustrated by several judgements of the Portuguese Constitutional Court, the measures taken by national governments to enforce austerity in compliance with the ESM's MAP can indeed conflict with substantive constitutional guarantees in the field of social rights.³⁶⁶ Yet others have criticized the interplay between various actors, which would blur responsibilities and reduce accountability.³⁶⁷ In this context, it has also been highlighted that neither the Commission nor the EP ultimately participate in decisions under the ESM.³⁶⁸

Despite the widespread criticism, the ECJ has rejected all legal challenges and upheld the legality of the mechanism in a complex landmark-judgement: The *Pringle* case covers several issues that concern the ESM's "compatibility with EU law, implications for the Union legal system, institutional balance, national sovereignty and democratic accountability"³⁶⁹, as well as the previously mentioned use of the simplified revision procedure,³⁷⁰ that cannot be discussed in much detail within this research.

Put very simply, the ESM has been sanctioned as legal because of three main reasons. Firstly, the ECJ has found it to be a measure of economic policy, as "it is not the purpose of the ESM to maintain price stability, but rather to meet the financing requirements of ESM members".³⁷¹ This is relevant because the MS have a wider room for maneuver in economic policy (coordinating competence) than in monetary policy (exclusive EU competence).³⁷²

³⁶² Hinarejos (n 35) 594.

³⁶³ Forsthoff and Lauer (n 322) 882.

³⁶⁴ *ibid* 879.

³⁶⁵ Joerges (n 26).

³⁶⁶ Armstrong (n 28) 604–605.

³⁶⁷ *cf.* Forsthoff and Lauer (n 322) 911.

³⁶⁸ Lenaerts (n 34) 763.

³⁶⁹ Martucci (n 265) 294.

³⁷⁰ Armstrong (n 28) 605.

³⁷¹ C-370/12 *Pringle* (n 87) para 96.

³⁷² Palmstorfer (n 51) 774.

Secondly, the ESM has found to be compatible with the no bail-out clause contained in Art. 125 TFEU because assistance is dependent on three aspects: The supported Member State must remain liable to its creditors, assistance is subject to strict conditionality rules and is limited to cases where the entire EZ is at risk.³⁷³ This constitutes a "purposive and dynamic"³⁷⁴ reinterpretation of the no-bailout clause, as well as a shift from the market-based Maastricht paradigm³⁷⁵ which has been discussed in further detail in chapter 2. In a nutshell, in the eyes of the ECJ the deviation from the market principle is allowed as long as other means are used to guarantee sound budgetary policy.³⁷⁶ Thirdly, the use of EU institutions by the ESM has also been found to be legal, as the entrusted tasks have not been found to "alter the essential character" of the powers conferred to them under the EU treaties.³⁷⁷

A later judgment by the ECJ, which sought the partial annulment of the MoU concluded between Cyprus and the ESM as well as compensations, further clarified the role of the EU Charter of Fundamental Rights. Even though a violation was not found *in casu*,³⁷⁸ the Court determined that EU institutions are always subject to EU law and the Charter, even when acting under the ESM.³⁷⁹ This is significant because the conditionality attached to ESM aid "typically requires the receiving Member State to effect cutbacks that impact citizens' rights".³⁸⁰ The ECJ therefore "showed that it is sensitive to the problem of formally non-Union institutions such as the ESM performing de facto tasks of direct Union relevance and drawing upon the participation in its work of the Commission and the ECB".³⁸¹

The acceptance by the Member States of the reinterpreted no bail-out clause was "only possible because they were able, in return, to retain significant powers at the expense of the supranational element of the Community."³⁸² This is made possible by "strict" conditionality rules that are described as such even the ESM founding treaty.³⁸³ For *Martucci*, this is key to understand the instrument: "Conditionality is the heart of the ESM."³⁸⁴ This is more than a political decision or a "lack of solidarity",³⁸⁵ it is a legal requirement to ensure compliance with the no bail-out clause.

³⁷³ C-370/12 *Pringle* (n 87) paras 139–142; see also Rosas (n 25) 1400.

³⁷⁴ Hinarejos (n 35) 595.

³⁷⁵ Ioannidis, 'Europe's New Transformations: How the EU Economic Constitution Changed during the Eurozone Crisis' (n 16) 1258; as well as Fabbrini, *Next Generation EU* (n 13) 43.

³⁷⁶ C-370/12 *Pringle* (n 87) para 137.

³⁷⁷ *ibid* para 158; cf. *Martucci* (n 265) 303.

³⁷⁸ Joined Cases C-8/15 P to C-10/15 P *Ledra Advertising Ltd and Others v European Commission and European Central Bank (ECB)* [2016] EU:C:2016:701 [para 75].

³⁷⁹ *ibid* para 67.

³⁸⁰ Hinarejos (n 35) 597.

³⁸¹ Rosas (n 25) 1414.

³⁸² Ioannidis, 'Europe's New Transformations: How the EU Economic Constitution Changed during the Eurozone Crisis' (n 16) 1247 and 1266.

³⁸³ TESM art 3.

³⁸⁴ *Martucci* (n 265) 307.

³⁸⁵ cf. Francesco Martucci, 'Non-EU Legal Instruments (EFSF, ESM, and Fiscal Compact)', *The EU law of economic and monetary union* (Oxford University Press 2020) 309.

The MoU contains all relevant provisions regarding policy conditionality. It is negotiated by the "Troika" (European Commission and European Central Bank, together with the IMF) based on a mandate by the ESM Board of Governors.³⁸⁶ Despite the Commission's obligation to ensure compliance with EU law, this document is not considered as an EU legal act³⁸⁷ and only commits the ESM: "Therefore, the ECJ does not have jurisdiction to rule on the compatibility with EU law of the conditionality detailed by the MoU."³⁸⁸

The MoU is concluded only between the ESM and the recipient Member State, meaning that the troika institutions are not contracting parties. While some scholars see this document as a non-binding political commitment (i.e. soft law), others recognize the MoUs as "international law sources having binding force".³⁸⁹ The TESM itself leaves this question open: While the term "memorandum" is traditionally used for non-binding commitments, "the laborious approval process, the signature by signatories empowered to represent the parties legally, and the language used in the MoU can be seen as elements indicating that the MoU, or at least parts of it, should be considered as legally binding".³⁹⁰

The almost total lack of judicial remedies for the beneficiary combined with the ESM's decision-making procedure (see table 2 below) are the reason why financial assistance by the European Stability Mechanism comes with many strings attached. However, it is important to specify that a macroeconomic adjustment programme is required only for ESM loans.³⁹¹ The justiciability of MoUs in the ESM context has been clarified by the CJEU in *Ledra Advertising*. In this judgment, the court has "gone beyond the literal meaning of Article 13(3) ESM Treaty and broadened very significantly the duty to ensure consistency", developing a "duty for the Commission to ensure the compatibility of the MoU with EU law in general".³⁹²

The monitoring rules of the ESM were deemed necessary due to the moral hazard problem. The cheaper loans by the ESM "might encourage borrowers to take risks and maintain inefficient economic structures – which [could] ultimately lead to public debt problems."³⁹³ Therefore, the macroeconomic adjustment loans are conditional upon "budgetary restriction and structural reforms".³⁹⁴ For example, the respect of the "golden rule" of the SCG Treaty is one of the conditions meant to ensure sound fiscal policy.³⁹⁵ Moreover, the previously mentioned MAP contains a wide range of austerity measures impacting the economic and

³⁸⁶ TESM art 13(3) and 13(7).

³⁸⁷ Forsthoff and Lauer (n 322) 889.

³⁸⁸ Martucci (n 265) 308.

³⁸⁹ Baraggia (n 2) 1.

³⁹⁰ Forsthoff and Lauer (n 322) 896.

³⁹¹ TESM art 16(2).

³⁹² Forsthoff and Lauer (n 322) 888.

³⁹³ Ioannidis, 'Europe's New Transformations: How the EU Economic Constitution Changed during the Eurozone Crisis' (n 16) 1246, see also 1264.

³⁹⁴ Martucci (n 265) 309.

³⁹⁵ Fabbrini, 'The Fiscal Compact, the Golden Rule and the Paradox of European Federalism' (n 296) 37.

social situation of the recipient, according to the "severity of the weaknesses to be addressed and the financial assistance instrument chosen".³⁹⁶

The Troika is not only responsible for negotiating the MoU, but also for monitoring compliance with the conditionality attached to the financial assistance facility: "To the extent that the financial assistance is released in successive tranches, the disbursement of each of them is conditional on the achievements of clear and measurable macroeconomic performance and structural adjustment criteria, based on the economic programmes of the beneficiary countries."³⁹⁷ According to *Forsthoff and Lauer*, "[t]his cautious approach reflects the consideration that, in any event, the ESM has little means to 'enforce' MoU compliance and that any attempt to do so could be counterproductive"³⁹⁸ as it might negatively impact the collaboration. Despite those regular compliance reports by the Troika, the ultimate decision whether to continue, suspend or revoke financial assistance in case of non-compliance with the MAP is taken politically by the Eurogroup Finance Ministers,³⁹⁹ acting by mutual agreement as the ESM's Board of Governors (see table 2 below). As the threat to withdraw the positive incentive (cheap loans) in case of non-compliance acts as the main motivation, the ESM can be categorized as relying on ex post positive conditionality.

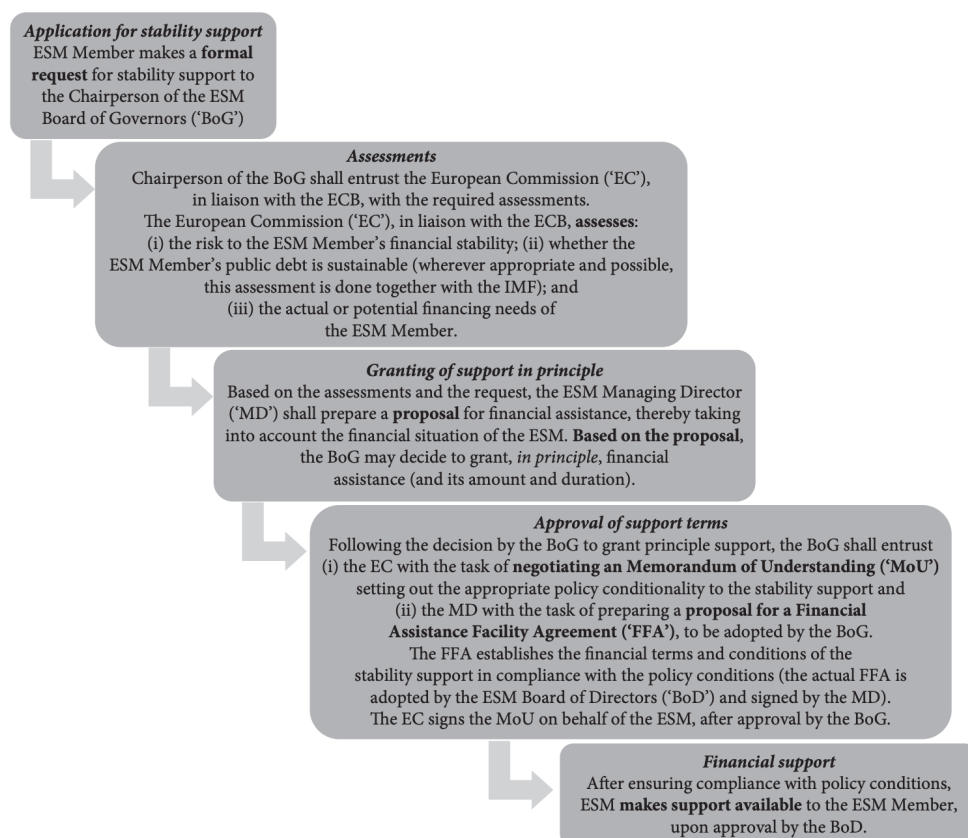


Table 2: Detailed outline of the ESM governance mechanism

³⁹⁶ Martucci (n 265) 308–309.

³⁹⁷ *ibid* 308.

³⁹⁸ Forsthoff and Lauer (n 322) 902.

³⁹⁹ cf. TESI art 13(7) and 16(5); see also Fabbrini, *Next Generation EU* (n 13) 44.

While a "communitarization" of the ESM is legally possible,⁴⁰⁰ it seems very unlikely in the medium term due to political constraints. Despite a Commission proposal to convert the ESM into a European Monetary fund⁴⁰¹ based on EU law, the ESM members have instead decided to "maintain and further develop the ESM on an intergovernmental basis".⁴⁰² Even though the text of the current amendment of the ESM has been approved by all members by signature in early 2021,⁴⁰³ its new provisions still have not entered into force as Italy's current far-right government has so far opposed ratification.⁴⁰⁴ The ESM has been attacked for years by Italian politicians from all parties such as Italy's current prime minister Giorgia Meloni, who has strongly opposed the reform previously while being leader of the opposition, claiming that it would play with Italy's future.⁴⁰⁵

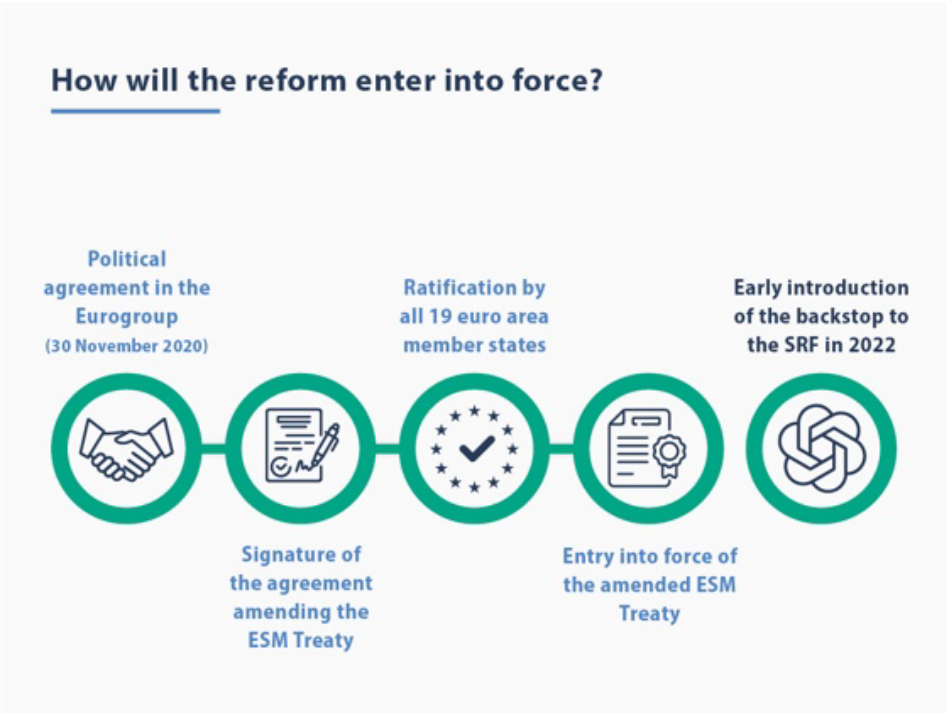


Illustration 3: Procedure for the ESM Treaty reform

The reform of the TESM foresees several amendments that aim at "strengthening of the ESM's role in the design, negotiation and monitoring of conditionality attached to ESM financial assistance"⁴⁰⁶ The biggest change in the implementation of conditionality is that the "joint responsibility of ESM and Commission for design and negotiation of the Memorandum of

⁴⁰⁰ Lenaerts (n 34) 753.
⁴⁰¹ Commission Proposal COM(2017) 827 final: On the establishment of the European Monetary Fund.
⁴⁰² Forsthoff and Lauer (n 322) 917.
⁴⁰³ NN, 'ESM Treaty – Amending Agreement (All Official Language Versions)' (*esm.europa.eu*, 2 March 2021) <<https://bit.ly/3WUOdnx>> accessed 1 January 2023.
⁴⁰⁴ Giuseppe Fonte and Alvisè Armellini, 'Italy Cautious on Ratification of Reformed Euro Zone Bailout Fund' (*reuters.com*, 14 December 2022) <<https://reut.rs/3GsYiBJ>> accessed 1 January 2023.
⁴⁰⁵ *ibid.*
⁴⁰⁶ Forsthoff and Lauer (n 322) 918.

Understanding⁴⁰⁷ is now formally acknowledged in the treaty text. Under the revised intergovernmental Treaty, the ESM would be empowered to co-negotiate the MoU and participate in its monitoring, domains that were previously reserved mainly to the Commission: "However, the ESM never acts alone and the ESM actions are always subject to a consistency check by the Commission."⁴⁰⁸ Furthermore, the surveillance powers of the ESM over national budgets would also be increased,⁴⁰⁹ introducing a new competence to carry out a "debt sustainability assessment" of the Member State requesting financial assistance.⁴¹⁰

Apart from this, the monitoring and negotiating procedure would remain largely unaffected: "At some point in the discussions, it appeared that a consensus was emerging that the IMF should no longer be on board. Still, in the revised ESM Treaty text, the role of the IMF is largely maintained".⁴¹¹ Likewise, the ECB's role, which had also been questioned, has also remained the same in the signed treaty text.⁴¹² The other main innovation that would be introduced by the amended TESM is the ability to provide financial assistance not only to ESM Member States (public actors), but also to significant EU banks (private actors) by acting as a backstop to the Single Resolution Fund.⁴¹³ Moreover, the ESM reform "streamlines the access to the ESM's precautionary credit line to ESM Members that, while needing financial assistance, are not yet in such dire straits as to have lost access to financing on the markets."⁴¹⁴

Despite much political and scholarly criticism as well as several legal challenges, the ESM has arguably "fundamentally strengthened the EU in the area of economic governance and enhanced the role of the EU institutions, in particular of the European Commission."⁴¹⁵ This instrument is based on strict rules, that are agreed upon and contained within the MoU, enforcing ex post positive conditionality. The ESM exemplarily shows the "departure from the idea that the financing of Eurozone Member States is solely governed by market logic and the acceptance of public assistance and cross-border public transfers".⁴¹⁶ However, as the current reform proposal shows, the ESM remains a highly controversial instrument that is in need of further adjustments.

⁴⁰⁷ *ibid.*

⁴⁰⁸ Andrea Westerhof Löfflerová, 'Reform of the European Stability Mechanism Signed: A Landmark Achievement Fully Respectful of EU Constitutional and Institutional Limits' (EU Law Live 2021) 16.

⁴⁰⁹ *cf.* Fabbrini, *EU Fiscal Capacity* (n 208) 17.

⁴¹⁰ Westerhof Löfflerová (n 408) 16.

⁴¹¹ Forsthoff and Lauer (n 322) 918.

⁴¹² *ibid* 918–919.

⁴¹³ *cf.* Fabbrini, *EU Fiscal Capacity* (n 208) 17.

⁴¹⁴ Westerhof Löfflerová (n 408) 13.

⁴¹⁵ *ibid* 22.

⁴¹⁶ Ioannidis, 'Europe's New Transformations: How the EU Economic Constitution Changed during the Eurozone Crisis' (n 16) 1239.

4. The Next Generation EU fund (NGEU)

The conditionality-based instruments that were analyzed so far have been – together with the measures taken by the ECB (see chapter 5) – sufficient to calm the financial markets in the context of the sovereign debt crisis. However, the measures adopted during the experimentation stage of EMU governance (2008-2019) "have not fundamentally altered the original asymmetry"⁴¹⁷ that characterized this policy field since its early days. In essence, conditionality was used by EU institutions as a tool to enforce fiscal rigor and austerity, whose rule-based approach was "experienced as a *diktat* from Northern to Southern countries".⁴¹⁸

To sum up the previous chapter, "the main strategy to address the euro-crisis was based on greater fiscal surveillance of Member States' budgets and on the award of financial assistance subject to strict conditionality".⁴¹⁹ The mutualization of sovereign debt in the form of "Eurobonds" issued by the European Commission had remained a "major taboo",⁴²⁰ as Northern European states were reluctant to pay the bill for what they perceived to be decades of misguided fiscal policy.⁴²¹

This chapter will attempt to explain why this perception changed in the context of the Covid-19 pandemic, how the EU's economic crisis response was structured and to what extent the EU has succeeded in establishing a conditionality-based fiscal capacity. But to begin with, it will first be necessary to describe how the idea of a fiscal capacity in the context of EMU developed and materialized.

4.1. Legal origins: Influence by previous proposals and instruments

The lack of a centralized fiscal capacity was one of the major structural weaknesses of EMU that had not been addressed by the EU institutions during the experimentation phase. The term "fiscal capacity" describes a budgetary instrument that is "funded through new resources, to be deployed by EU authorities to tackle slumps in the business cycle and stabilize the economy in cases of shocks".⁴²² While all proper federal states can dispose of such a counter-cyclical tool of economic policy, the idea of fiscal federalism has always been very controversial in the EU context.

Traditionally, the EU had been unable to mobilize resources of its own: The EMU system was "devoid of a fiscal pillar (...) – arguably the very essence of genuinely 'constitutional'

⁴¹⁷ Fabbrini, *EU Fiscal Capacity* (n 208) 16, see also Chapter 2 of this thesis.

⁴¹⁸ cf. Peter Lindseth and Cristina Fasone, 'The Eurozone Crisis, the Coronavirus Response, and the Limits of European Economic Governance', *The Idea of Economic Constitution in Europe* (Brill Nijhoff 2022) 524 (emphasis in the original); see also Fabbrini, *Next Generation EU* (n 13) 51.

⁴¹⁹ Fabbrini, *EU Fiscal Capacity* (n 208) 17.

⁴²⁰ cf. Stella Ladi and Dimitris Tsarouhas, 'EU Economic Governance and Covid-19: Policy Learning and Windows of Opportunity' [2020] 42 *Journal of European Integration* 1041, 1049.

⁴²¹ cf. Fabbrini, *Next Generation EU* (n 13) 51.

⁴²² Fabbrini, *EU Fiscal Capacity* (n 208) 9.

authority".⁴²³ Loans subject to strict conditionality rules were the only exception, under which high political and economic costs were imposed on the recipients. Up until the Covid-19 pandemic, the use of conditionality rules in the EMU framework was "based almost entirely on constraining Member States' power"⁴²⁴ in order to limit "negative spillover effects in the single market between different national economies".⁴²⁵

The idea of creating a fiscal capacity had been discussed already prior to the pandemic for about ten years. It was first proposed within the so-called Four Presidents' report,⁴²⁶ which was published by the then-Presidents of the European Council, Commission, ECB and Eurogroup. A similar publication (the so-called Five Presidents' report, also including the EP's then-President) was published three years later, further elaborating on the idea of a "euro area-wide fiscal stabilization function"⁴²⁷ called Budgetary Instrument for Convergence and Competitiveness (BICC). A high-level expert group chaired by the former Italian Prime Minister Mario Monti also supported the idea of a budget "to tackle the specific characteristics of a monetary union, such as the need for automatic stabilisers" as well as the creation of a budget authority to manage expenditures and revenues.⁴²⁸

The idea of creating a fiscal capacity has also been endorsed by several EU institutions, in particular by the European Commission, which on several occasions proposed its introduction in stages.⁴²⁹ Jean-Claude Juncker has also publicly supported the idea during his term as Commission President, most notably during his inaugural speech⁴³⁰ and within his 2017 State of the Union Address⁴³¹ in front of the European Parliament.

The EP has been perhaps the most fervent supporter of an EU fiscal capacity, referring to the concept as an "innovative idea" that is necessary to ensure "financial solidarity"⁴³², claiming that a genuine Economic and Monetary Union "cannot be limited to a system of rules but requires an increased budgetary capacity based on specific own-resources"⁴³³. The

⁴²³ Lindseth and Fasone (n 418) 526–527.

⁴²⁴ *ibid* 513.

⁴²⁵ D'Erman and Verdun (n 239) 8.

⁴²⁶ Herman Van Rompuy and others, 'Towards a Genuine Economic and Monetary Union', *President of the European Council final report* (2012) 5.

⁴²⁷ Jean-Claude Juncker and others, 'Completing Europe's Economic and Monetary Union', *President of the European Commission report* (2015) 14.

⁴²⁸ Mario Monti and others, 'Future Financing of the EU', *Final report and recommendations of the High Level Group on Own Resources* (2016) 67–69.

⁴²⁹ Commission Communication COM(2012) 777 final 'A blueprint for a Deep and Genuine Economic and Monetary Union: Lunching a European Debate'; Commission Communication COM(2017) 822 final 'New Budgetary Instruments for a Stable Euro Area within the Union Framework' 17.

⁴³⁰ Jean-Claude Juncker, 'A New Start for Europe: My Agenda for Jobs, Growth and Democratic Change – SPEECH/14/567' (Speech at the European Parliament, Strasbourg, 15 July 2014) <<https://bit.ly/3VZt3UB>> accessed 4 January 2023.

⁴³¹ Jean-Claude Juncker, 'State of the Union Address – SPEECH/17/3165' (Speech at the European Parliament, Strasbourg, 13 September 2017) <<https://bit.ly/3GDvJT4>> accessed 4 January 2023.

⁴³² EP Resolution 12 November 2012 (2012/2151) 'Recommendations to the Commission on the report of the Presidents of the European Council, the European Commission, the European Central Bank and the Eurogroup 'Towards a genuine Economic and Monetary Union' [2012] OJ C419/48 [para CR].

⁴³³ *ibid* para 11.

parliamentary groups also declared their majoritarian support for an EU fiscal capacity on three further occasions,⁴³⁴ as well as in the context of the negotiations for the new MFF.⁴³⁵ However, the three aforementioned actors (High-level Groups, Commission, EP) do not carry much political weight in the primarily intergovernmental EMU context. What is perhaps more surprising are the cautious steps that had been already made before the pandemic by the Euro Summit: This composition of the European Council decided to endorse the idea of a fiscal capacity in 2018, mandating the Eurogroup to "work on the design, modalities of implementation and timing".⁴³⁶ While the wording seemed hesitant at first, there appeared to be a green light concerning a basic compromise, as a 2019 statement of the body shows.⁴³⁷ Finally, the idea was also pushed by a Franco-German proposal based on the Meseberg declaration held by Angela Merkel and Emmanuel Macron in 2018.⁴³⁸ This is perhaps the most relevant indication that a common budgetary capacity based on own resources was not completely out of reach, despite strong opposition by the so-called "Hanseatic League", an informal coalition of fiscal conservative Northern European governments.⁴³⁹ It can therefore be argued that the pandemic was merely the last drop (or rather storm) to turn the tides in the political game by increasing the stakes at play.

The resulting agreement has its legal roots mainly in the Commission Proposal for a Reform Support Program (RSP): The draft RSP regulation did not only foresee the continuation of the SRSP (see chapter 3.2.) under an almost quadrupled budget,⁴⁴⁰ but also the introduction of a new Reform Delivery Tool (RDT). This conditionality-based instrument would have provided financial incentives for the voluntary implementation of reforms in Member States, containing €22 billion in funding.⁴⁴¹ This similar legislative initiative was derailed in favor of the pandemic assistance measures, which absorbed the proposed RDT entirely and could rely on much greater resources.⁴⁴²

⁴³⁴ EP Resolution 12 December 2013 (2012/2078) '*Constitutional problems of a multitier governance in the EU*' [2013] OJ C468/176 [para 2]; EP Resolution 24 June 2015 (2014/2145) '*Review of the economic governance framework: stocktaking and challenges*' [2015] OJ C407/86 [para 57(c)]; EP Resolution 16 February 2017 (2015/2344) '*Budgetary capacity for the euro area*' [2017] OJ C252/235 [para I(1i)].

⁴³⁵ EP Resolution 14 March 2018 (2017/2052) '*The next MFF: Preparing the Parliament's position on the MFF post-2020*' [2018] OJ C 162/51 [para 12].

⁴³⁶ Euro Summit statement 14 December 2018 – EURO 503/18.

⁴³⁷ cf. Euro Summit statement 21 June 2019 – EURO 502/19.

⁴³⁸ Bruno Le Maire and Peter Altmaier, 'Franco-German Proposal on the Architecture of a Eurozone Budget within the Framework of the European Union', *Proposal based on the Meseberg Declaration (version finale)* (2018) <<https://bit.ly/2BgURxl>> accessed 4 January 2023.

⁴³⁹ cf. Fabbrini, *EU Fiscal Capacity* (n 208) 26.

⁴⁴⁰ Commission Proposal COM(2018) 391 final: Proposal for a Regulation of the European Parliament and of the Council on the establishment of the Reform Support Programme art 7(2b).

⁴⁴¹ *ibid* art 7(2a).

⁴⁴² Agnieszka Widuto, 'Proposal for a Regulation on the Reform Support Programme 2021-2027: Legislative Train Schedule' (*europarl.europa.eu*, 22 November 2022) <<https://bit.ly/3VOU2Tv>> accessed 12 December 2022.

The legal drafting of the fiscal capacity in response to the pandemic was also clearly inspired by the European Semester (see chapter 3.3.). This was not an obvious choice,⁴⁴³ especially considering the "modest"⁴⁴⁴ compliance with the process. The ES was chosen mainly due to the fact that "the EU actors did not want to reinvent the wheel and the Semester was already doing what the Commission and the EU member states wanted to do going forward, namely provide annual assessments and recommendations and linking them back to previous CSRs"⁴⁴⁵ As a predictable and encompassing framework for the coordination of economic policies that incorporated both the domestic and the EU level, it was chosen as the main channel to distribute the funds, even if its original objective was quite different.⁴⁴⁶

It has been argued that the Semester may end up becoming more effective thanks to the new financial incentives⁴⁴⁷ or that it might even "fundamentally change in character from being a non-binding structure for policy coordination to a vehicle for the allocation of a major economic impetus which is to have more teeth".⁴⁴⁸ The two instruments have been found to be "mutually beneficial"⁴⁴⁹ in their implementation: "[T]he increases in the use of 'carrots' and 'sticks' might make the Semester more effective, as it becomes a 'harder mode of soft governance'".⁴⁵⁰

4.2. The pandemic's economic fallout as a trigger for integration

The uncontrolled spread of SARS-CoV-2 in February 2020 acted as an "institutional and political earthquake" in the EU: "The re-imposition of border controls, along with the fact that many Member States were understandably focused on the internal impact of the crisis and thus seemingly insensitive to the needs of a pan-European response, all helped to raise questions about the unity and integrity of the EU."⁴⁵¹ As the Member States were largely forced to impose lockdowns, the European economic system came to a halt: "production and supply chains went disrupted, while households and firms struggled to cope with the resulting loss of income and spending power."⁴⁵²

The result was the biggest economic shock after the Second World War, with Eurozone output falling in merely two quarters as much as it had risen over the last 15 years.⁴⁵³ As the ECB's former President Mario Draghi formulated it in a much-noted editorial to the Financial Times,

⁴⁴³ cf. D'Erman and Verdun (n 239) 8.

⁴⁴⁴ Vanhercke and Verdun (n 235) 207.

⁴⁴⁵ *ibid* 219.

⁴⁴⁶ cf. D'Erman and Verdun (n 239) 7; as well as Vanhercke and Verdun (n 235) 209 and 215.

⁴⁴⁷ Moschella (n 210) 8.

⁴⁴⁸ Vanhercke and Verdun (n 235) 217–218.

⁴⁴⁹ Moschella (n 210) 3.

⁴⁵⁰ Vanhercke and Verdun (n 235) 219.

⁴⁵¹ Lindseth and Fasone (n 418) 528.

⁴⁵² Moschella (n 210) 10.

⁴⁵³ Ladi and Tsarouhas (n 420) 1047.

the EU was facing a "human tragedy of potentially biblical proportions".⁴⁵⁴ The pandemic thus quickly grew into a systemic crisis that called for a "comprehensive response concerning all sectors of institutional, economic and social life".⁴⁵⁵

Due to the limited EU budget, the adopted measures to ensure the functioning of the internal market were initially "rather shy and disappointing".⁴⁵⁶ But, as so often in the EU context, the institutions managed to overcome the initial paralysis after some rounds of negotiation. "With a new EP in 2019, a new Commission firmly in place since December 2019 and withdrawal of the United Kingdom officially completed on 31 January 2020, the EU was better positioned to take more forceful action to face the pandemic crisis."⁴⁵⁷

Much like at the beginning of the sovereign debt crisis, the national governments initially reacted by drastically increasing public spending.⁴⁵⁸ Despite the similar point of departure, the EU "reacted in a markedly different way compared to the economic and financial upheavals of the previous decade"⁴⁵⁹ by adding flexibility in the light of the exceptional situation. One of the first measures of the EU was the first-ever activation of the SGP's general escape clause,⁴⁶⁰ temporarily suspending the obligations regarding national debt and deficit. The EU provisions covering state aid were also rendered more flexible to leave more discretion to national authorities.⁴⁶¹

The softening of several constraints seemed to suggest that the EU's principal approach in tackling the crisis was "creating favourable conditions for the Member States to make extraordinary expenses".⁴⁶² Apart from those historic decisions, at first there did not seem to be a profound reconsideration of the EU's economic governance rules in general and the use of conditionality specifically.

Most instruments providing immediate financial aid were loan-based, such as the ESM pandemic credit line (see chapter 3.5.). Despite not requiring a MAP as usual, the Member States requesting assistance under this facility would still be subject to enhanced monitoring

⁴⁵⁴ Mario Draghi, 'We Face a War against Coronavirus and Must Mobilise Accordingly.' (*ft.com*, 25 March 2020) <<https://on.ft.com/3CpVOT8>> accessed 4 January 2023.

⁴⁵⁵ Marco Dani and José Menéndez, 'Le Prime Risposte Dell'Unione Europea Alle Conseguenze Economiche Della Crisi CoViD-19' [2020] 1 *BioLaw Journal: Rivista di BioDiritto* 527, 527 (translated from Italian by the author).

⁴⁵⁶ José María Porrás Ramírez, 'EU Next Generation-Europe's Recovery and Resilience Plan: A Revolution in Economic Governance of EU?' [2021] 23 *Diritto pubblico comparato ed europeo* 821, 822; see also Dani and Menéndez (n 455) 528.

⁴⁵⁷ Vanhercke and Verdun (n 235) 206.

⁴⁵⁸ Ladi and Tsarouhas (n 420) 1046.

⁴⁵⁹ Rayo (n 14) 6.

⁴⁶⁰ Commission Proposal COM(2020) 123 final on the activation of the general escape clause of the Stability and Growth Pact 2; Katharina Pausch-Homblé, 'Statement of EU Ministers of Finance on the Stability and Growth Pact in Light of the COVID-19 Crisis' (*consilium.europa.eu*, 24 March 2020) <<https://bit.ly/3GMcRRX>> accessed 7 January 2023.

⁴⁶¹ cf. Federico Fabbrini, 'The Legal Architecture of the Economic Responses to COVID-19: EMU beyond the Pandemic' [2022] 60 *JCMS: Journal of Common Market Studies* 186, 189.

⁴⁶² Porrás Ramírez (n 456) 826.

in EU law under the European Semester.⁴⁶³ The ESM pandemic line was thus a "seemingly advantageous offer" that, however, did not "exclude the possibility of stricter conditionality at a later date".⁴⁶⁴

A similar loan-based instrument to mitigate the impact of the pandemic had been established by the European Investment Bank: The institution's Board of Directors introduced the European Guarantee Fund (EGF), which would raise up to €200 billion on the capital markets to provide support for sound private companies that had been affected by the pandemic.⁴⁶⁵ This loan-based instrument has confirmed the initial "preference for credit over non-repayable transfers"⁴⁶⁶ within the immediate crisis response.

The third relevant financial aid instrument introduced in the context of the pandemic was the Commission's creatively-named SURE initiative (instrument for Support to mitigate Unemployment Risks in an Emergency).⁴⁶⁷ This temporary facility allowed Member States to access loans at advantageous rates in order to finance short-time work support schemes.⁴⁶⁸ Its establishment had become necessary as the national unemployment insurance systems had come under heavy pressure caused by the nation-wide lockdowns.⁴⁶⁹ Unlike other EMU instruments, the SURE initiative does not rely on conditionality rules, however it is important to highlight that it has been conceived as a voluntary and complementary facility providing loans that increase sovereign debt and eventually have to be paid back.⁴⁷⁰

In essence, the EU's initial fiscal response to Covid-19 seemed more reactive to the immediate effect rather than proactive with regard to the longer-term economic effects.⁴⁷¹ To sum up, the EU's principal reaction consisted in the flexibilization of the SGP and state aid rules, as well as the launch of the EGF, the ESM pandemic credit line⁴⁷² and the SURE initiative (see illustration 4 on the next page for an overview). Those instruments all had one principal Achilles' heel: Due to their loan-based nature, "wealthier and more financially secure Member States were in a much better position to mobilize the resources needed to address the crisis"⁴⁷³.

⁴⁶³ 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 [2013] OJ L140/1 arts 2(3) and 3.

⁴⁶⁴ Dani and Menéndez (n 455) 534 (translated from Italian by the author).

⁴⁶⁵ cf. Rayo (n 14) 7; NN, 'European Guarantee Fund' (*EIB.org*) <<https://bit.ly/3VfpSlv>> accessed 28 November 2022.

⁴⁶⁶ Dani and Menéndez (n 455) 536 (translated from Italian by the author).

⁴⁶⁷ NN, 'SURE Initiative' (*eurofund.europa.eu*, 15 May 2020) <<https://bit.ly/3uimOje>> accessed 1 December 2022; for the legal base cf. TFEU (n 36) art 122(2).

⁴⁶⁸ cf. Porras Ramírez (n 456) 828.

⁴⁶⁹ cf. Fabbrini, 'The Legal Architecture of the Economic Responses to COVID-19: EMU beyond the Pandemic' (n 461) 189.

⁴⁷⁰ cf. Dani and Menéndez (n 455) 536.

⁴⁷¹ cf. Ladi and Tsarouhas (n 420) 1047.

⁴⁷² Ann.: Despite not being under EU law, this facility was introduced by the Eurogroup's ministers.

⁴⁷³ Lindseth and Fasone (n 418) 528.

Ultimately it became clear that the capacity of Northern European states "that had barely been affected by the recent past crises to provide assistance to their economies was notably greater than that which the southern European States, still convalescing from those, could carry out."⁴⁷⁴ Therefore, many observers had predicted that the aforementioned measures would magnify the significant economic divergences that already existed within the EU single market prior to the crisis.⁴⁷⁵

Facilitated by **flexible budgetary rules** and a **temporary framework for state aid**, member states could provide



The EU provides **additional support**:




-  **SURE (Instrument for temporary Support to mitigate Unemployment Risks in an Emergency)**
Up to € 100 billion in loans to secure jobs
-  **EGF (European Guarantee Fund of the European Investment Bank, EIB)**
To unlock up to € 200 billion in loans to support businesses
-  **ESM (European Stability Mechanism) Pandemic Crisis Support**
Up to € 240 billion in loans to euro area countries to support financing COVID-19 related health costs

Illustration 4: Early EU response measures to the Covid-19 pandemic

According to *Ladi and Tsarouhas*, the EU was soon facing a "critical juncture" regarding its EMU framework: "Policy instruments centred on loans and emergency liquidity provisions were inadequate to shield European economies, workers, households and businesses from the consequences of the pandemic. Piling up more debt without a change in approach led nowhere."⁴⁷⁶ Up until the pandemic, the EU had seemed "structurally unable to develop meaningful forms of transnational solidarity"⁴⁷⁷ in the context of EMU rules. But the pandemic seemed to have opened a "window of opportunity"⁴⁷⁸ for Southern Europe: "Business as usual was no longer an option: Covid-19 called for a response that would safeguard the Union's cohesion in the years to come."⁴⁷⁹

⁴⁷⁴ Porras Ramírez (n 456) 823.

⁴⁷⁵ cf. Dani and Menéndez (n 455) 530.

⁴⁷⁶ Ladi and Tsarouhas (n 420) 1050.

⁴⁷⁷ Dani and Menéndez (n 455) 527 (translated from Italian by the author).

⁴⁷⁸ Ladi and Tsarouhas (n 420) 1051.

⁴⁷⁹ *ibid* 1042.

4.3. The negotiation's result: The NGEU fund's dimension and structure

As described in the previous chapter, only few years after the economy started recovering from sovereign debt crisis, the EU was "called to tackle a new economic crisis which could prove to be even bigger and more unpredictable than the Euro area crisis".⁴⁸⁰ It soon became evident that the exogenous challenge posed by Covid-19 was huge and that a more ambitious reaction than the previously described measures would be necessary. The EU needed to address the asymmetric impact, as not all EU members could afford to "spend their way out of the crisis".⁴⁸¹ The Southern European Member States that had been most impacted by the pandemic soon "requested that their spending capacity to act should be matched to that of the Member States with greater spending potential".⁴⁸² To achieve this objective, they advocated for the launch of a new solidarity-based instrument that would allow for the internal distribution of resources: a new version of the Marshall Plan.⁴⁸³

For the first time in EU history, "aspirations about a transfer union seem[ed] to materialise building on a negative lesson from the Euro area crisis, which showed that loans alone were not enough to stabilise the crisis and created tensions between creditor and debtor countries".⁴⁸⁴ The proposal seemed unlikely at first, but "against the back-drop of negative public opinion towards the EU following the austerity years, the idea of adopting an EU instrument to alleviate the economic and social consequences of COVID-19 was widely supported by member states."⁴⁸⁵

Ultimately, as so often in the EU context, it was a Franco-German compromise that paved the way for intense negotiations.⁴⁸⁶ This initiative proposed a temporary recovery fund tied to the new MFF that would be financed by the issuance of common debt and disburse €500 billion in grants.⁴⁸⁷ This agreement surprised many observers and was interpreted as "a way to demonstrate political leadership in the EU, to revive the Franco-German alliance, and to signal their own political priorities".⁴⁸⁸

The Franco-German initiative was soon taken up by the European Commission and tabled as a legislative proposal, adding €250 billion in loans – increasing the total volume to €750 billion – and naming the instrument Next Generation EU fund (NGEU).⁴⁸⁹ Inevitably, the Commission proposal sparked a lively debate as soon as the Heads of State and Government met within an extraordinary meeting of the European Council in July 2020 to negotiate the details.

⁴⁸⁰ *ibid* 1045.

⁴⁸¹ *cf.* *ibid* 1046.

⁴⁸² Porras Ramírez (n 456) 826.

⁴⁸³ *cf.* *ibid* 830.

⁴⁸⁴ Ladi and Tsarouhas (n 420) 1049.

⁴⁸⁵ De la Porte and Heins (n 168) 137–138.

⁴⁸⁶ *cf.* D'Erman and Verdun (n 239) 10.

⁴⁸⁷ *cf.* Fabbrini, *Next Generation EU* (n 13) 67.

⁴⁸⁸ De la Porte and Heins (n 168) 138.

⁴⁸⁹ Commission Proposal COM(2020) 456 final: Europe's moment: Repair and Prepare for the Next Generation 2 and 4; see also Rayo (n 14) 12.

An informal ad-hoc coalition of fiscally conservative Member States called the "Frugal Four" emerged: Austria, Denmark, the Netherlands and Sweden were "unhappy with the idea that much discretion would go to the EU level without sufficient checks and balances (and indeed conditionality)".⁴⁹⁰ While Italy and Spain argued that the recovery fund should be made up of "grants with virtually no conditionality"⁴⁹¹, the Frugal Four suggested that the assistance should be disbursed as "repayable loans subject to conditionality"⁴⁹² in order to "secure that EU money would be spent (...) in the way intended by the Commission proposals."⁴⁹³

After five days of intense negotiations, the European Council ultimately found a compromise on the NGEU package as well as the jointly negotiated MFF: The proportion of the grants in relation to the total package would be reduced to 52% (see illustration 5 below) rather than the two thirds originally proposed by the Commission.⁴⁹⁴ Moreover, the Frugal Four would also be granted larger rebates from their contributions to the next EU budget to ensure the unanimous approval.⁴⁹⁵

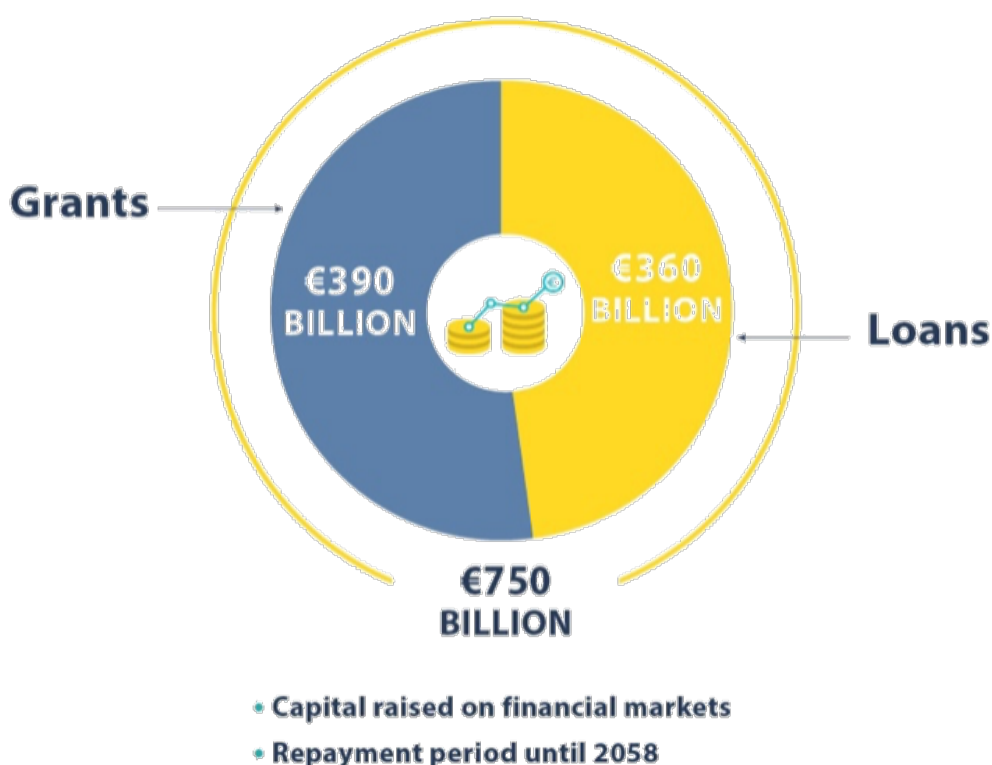


Illustration 5: Overall proportion of loans and grants in the Next Generation EU fund

⁴⁹⁰ Vanhercke and Verdun (n 235) 206.

⁴⁹¹ De la Porte and Heins (n 168) 138.

⁴⁹² Porras Ramírez (n 456) 831.

⁴⁹³ Ladi and Tsarouhas (n 420) 1048.

⁴⁹⁴ Conclusion EUCO 10/20 of the European Council Special Meeting July 2020 [para 1(A3)]; see also D'Erman and Verdun (n 239) 7.

⁴⁹⁵ EUCO 10/20 (n 494) para 152(Annex); see also Porras Ramírez (n 456) 838.

The entry into force of the recovery fund was further delayed in November 2020 by a veto of Hungary and Poland, who objected the plan to tie funds to the rule-of-law principle. Eventually, a compromise was found in December 2020, and the NGEU was unanimously adopted by the Council of the EU (see illustration 6 below for a more detailed timeline).⁴⁹⁶

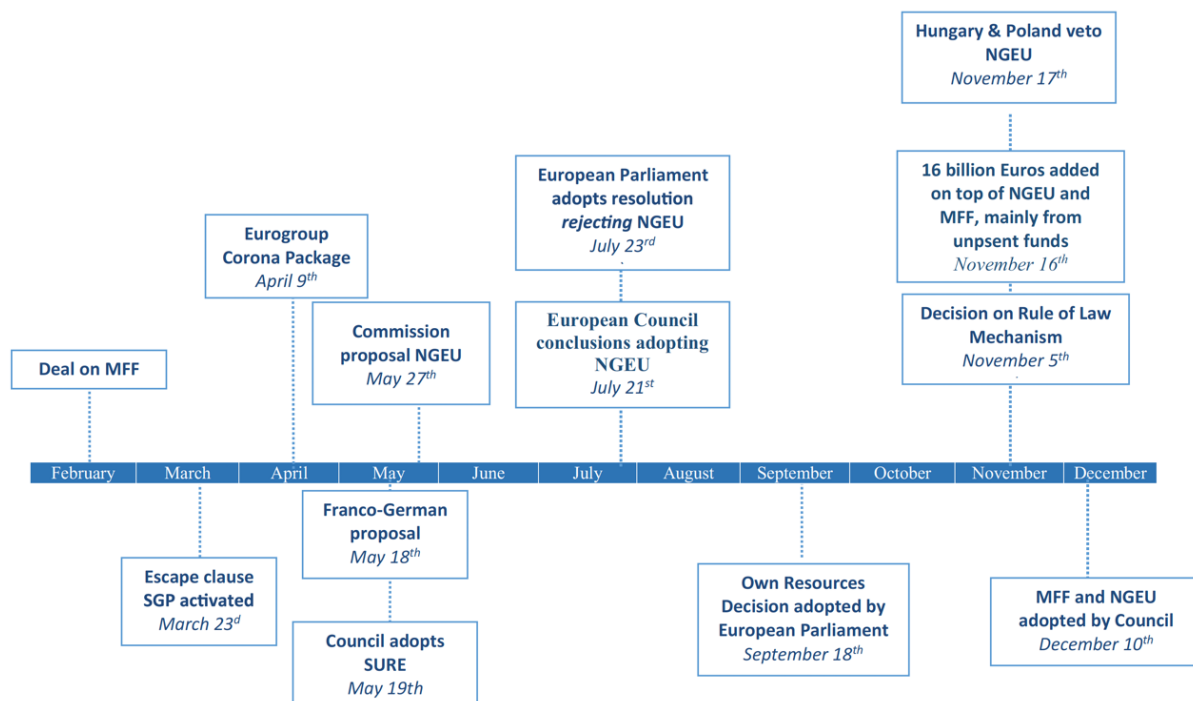


Illustration 6: Legislative timeline of NGEU adoption

The NGEU fund is more than a regular spending program, it can better be thought of as an "instrument to help economic recovery in a spirit of solidarity"⁴⁹⁷ that redistributes "funds from Member States with high per capita incomes to less prosperous countries"⁴⁹⁸. Its general objective is thus the promotion of economic convergence: "NGEU acts less as an insurance instrument to mitigate the consequences of the crisis and more like an extension of the EU budget (...)"⁴⁹⁹ According to its legislative text, its main objectives are to "restore employment and job creation", to support "reforms and investments" and to promote "just transition to a climate-neutral economy" as well as "research and innovation in response to the Covid-19 crisis".⁵⁰⁰

⁴⁹⁶ cf. De la Porte and Heins (n 168) 138.

⁴⁹⁷ Alberto de Gregorio Merino, 'The Recovery Plan: Solidarity and the Living Constitution' (EU Law Live 2021) 9.

⁴⁹⁸ Florian Dorn and Clemens Fuest, 'Next Generation EU: Chancen Und Risiken Des Europäischen Fonds Für Die Wirtschaftliche Erholung Nach Der Corona-Krise' [2021] 101 Wirtschaftsdienst 78, 80 (translated from German by the author).

⁴⁹⁹ *ibid* 81 (translated from German by the author).

⁵⁰⁰ Council Regulation (EU) No 2020/2094 of 14 December 2020 establishing a European Union Recovery Instrument to support the recovery in the aftermath of the COVID-19 crisis [2020] OJ L433I/23 art 1(2a, 2b, 2d, 2f).

The ultimate size of the NGEU fund was settled at €750 billion in 2018 prices. This is a "huge amount" in EU standards, especially considering that it is only marginally smaller than the long-term EU-budget (MFF)⁵⁰¹ and proportionally larger than the Covid-19 recovery funds adopted in the USA and China (see illustration 7 below). According to the new Own-Resources decision (ORD), those €750 billion are to be financed through the long-term issuance of debt in the markets by the Commission on behalf of the EU, which are to be paid off by the end of 2058.⁵⁰² While the issuance of common debt has already been used within the EU's financing strategy,⁵⁰³ it has never been employed in such a high volume: "The EU is set to become one of 'Europe's largest bond issuers' in the financial markets, most likely triggering a transformation of European capital markets."⁵⁰⁴

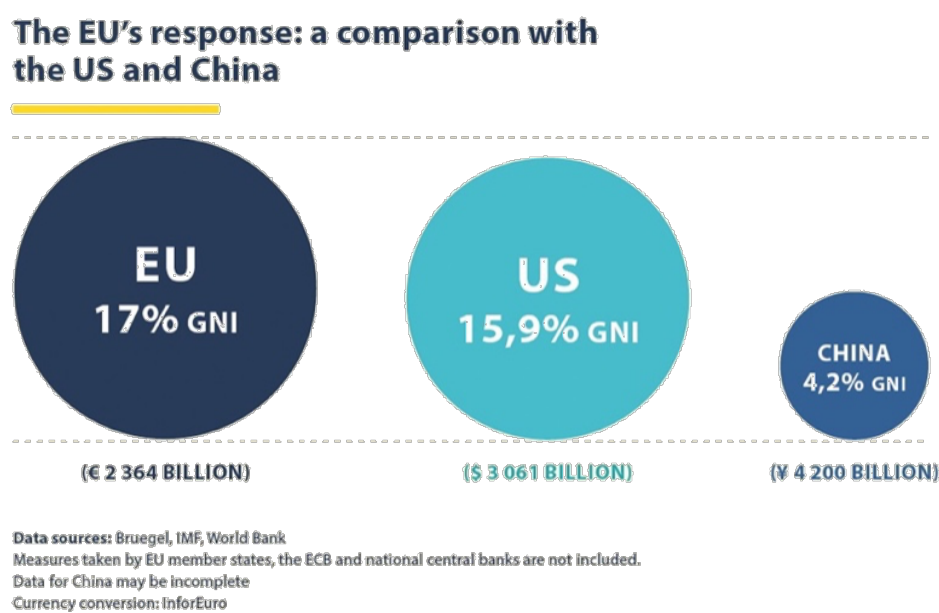


Illustration 7: NGEU in comparison with other recovery packages

In practice, this means that net-receiver countries such as Bulgaria and Croatia will receive financial contributions under the NGEU fund that are above 10% of GDP, or in the case of at least five other members between 5% and 10% of GDP.⁵⁰⁵ In total, annual public spending by the EU will increase from 1% of aggregate GDP to 1.7% of aggregate GDP: "NGEU thus represents a significant expansion of EU spending compared to pre-Covid crisis levels."⁵⁰⁶ The flipside of this aspect is that average public debt in the EU is predicted to rise from 95% to 100.5% of GDP in order to finance NGEU.⁵⁰⁷ This is because the debt that finances NGEU is primarily based on Member State guarantees.

⁵⁰¹ de Gregorio Merino (n 497) 4.

⁵⁰² Council Decision (EU, Euratom) 2020/2053 of 14 December 2020 on the system of own resources of the European Union and repealing Decision 2014/335/EU, Euratom [2020] OJ L 424/1 arts 5(1a) and 5(2); see also Rayo (n 14) 12.

⁵⁰³ de Gregorio Merino (n 497) 5.

⁵⁰⁴ Lindseth and Fasone (n 418) 531.

⁵⁰⁵ Vanhercke and Verdun (n 235) 214.

⁵⁰⁶ Dorn and Fuest (n 498) 78 (translated from German by the author).

⁵⁰⁷ *ibid* (translated from German by the author).

The reason for this is an obligation contained within the EU treaties: "As a difference to the national budgets, which can incur deficits (subject to the Stability and Growth Pact limitations and applicable national debt brakes), the EU budget must be in balance at the end of each year."⁵⁰⁸ Under the current Treaty framework, borrowing for spending can therefore never become a permanent feature of the EU budget: The NGEU fund is "designed to be budgetary neutral" and it thus contains a "large number of guarantees which make it compatible with the Treaties, be it the principle of budgetary balance, or be it the integrity of the own resources system". As a result, it is "far from constituting a genuine European Treasury with a vocation of permanence".⁵⁰⁹ Therefore, *Lindseth and Fasone* have emphasized that "it is important not to exaggerate too much the impact of the agreement on the EU's metabolic constitution".⁵¹⁰ As long as the EU is not granted the power to levy taxes, its ability to use debt to finance its spending will be severely limited.⁵¹¹ Under the current primary law framework, the EU still "lacks the autonomous democratic and constitutional legitimacy to such a demanding form of sovereign power".⁵¹² While a new tax based on non-recycled plastic waste has already been introduced at the beginning of 2021,⁵¹³ other new own resources such as a carbon border adjustment mechanism or a digital levy that were to be introduced⁵¹⁴ are delayed due to political controversies⁵¹⁵ and are lagging behind the legislative roadmap that was agreed in 2020⁵¹⁶. It is also important to consider that those proposed measures are strictly speaking not proper taxes that would go directly from the citizens to the EU budget, but rather automatic Member State contributions that are calculated according to preestablished parameters. To sum up, the EU has, in addition to its MFF, adopted €540 billion worth of loan-based safety nets (see chapter 4.2.), as well as the NGEU fund (€750 billion).⁵¹⁷

⁵⁰⁸ de Gregorio Merino (n 497) 6.

⁵⁰⁹ *ibid* 10.

⁵¹⁰ *Lindseth and Fasone* (n 418) 530.

⁵¹¹ Dorn and Fuest (n 498) 80 (translated from German by the author).

⁵¹² *Lindseth and Fasone* (n 418) 533.

⁵¹³ Porras Ramírez (n 456) 838.

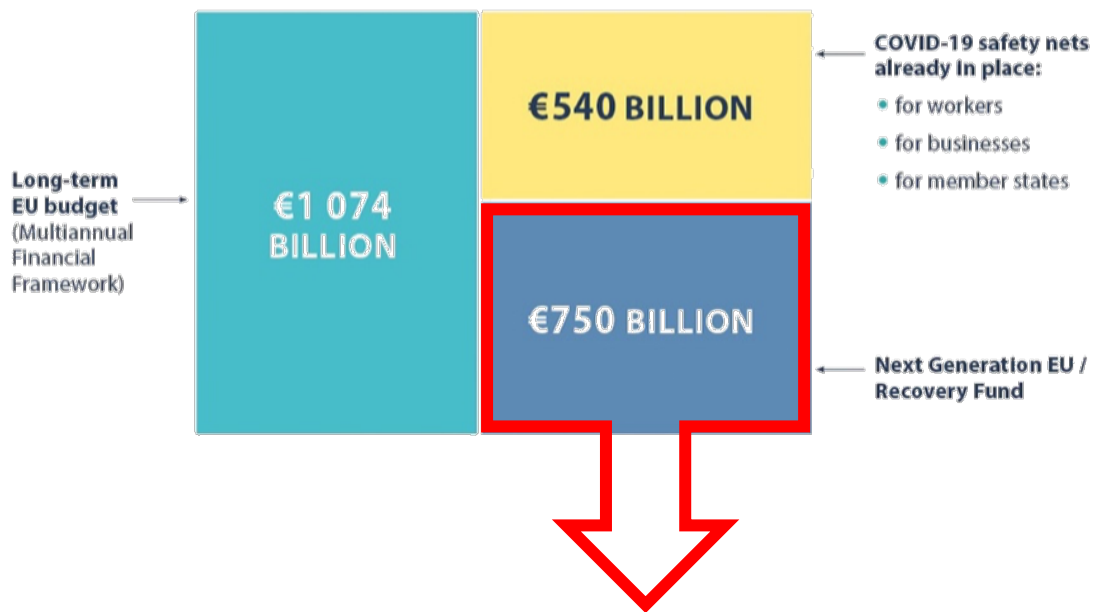
⁵¹⁴ EUCO 10/20 (n 494) paras 145–150.

⁵¹⁵ Federica Di Sario, 'More Fights Ahead for EU Carbon Border Tax' (*politico.eu*, 13 December 2022) <<https://politi.co/3WX07ha>> accessed 9 January 2023.

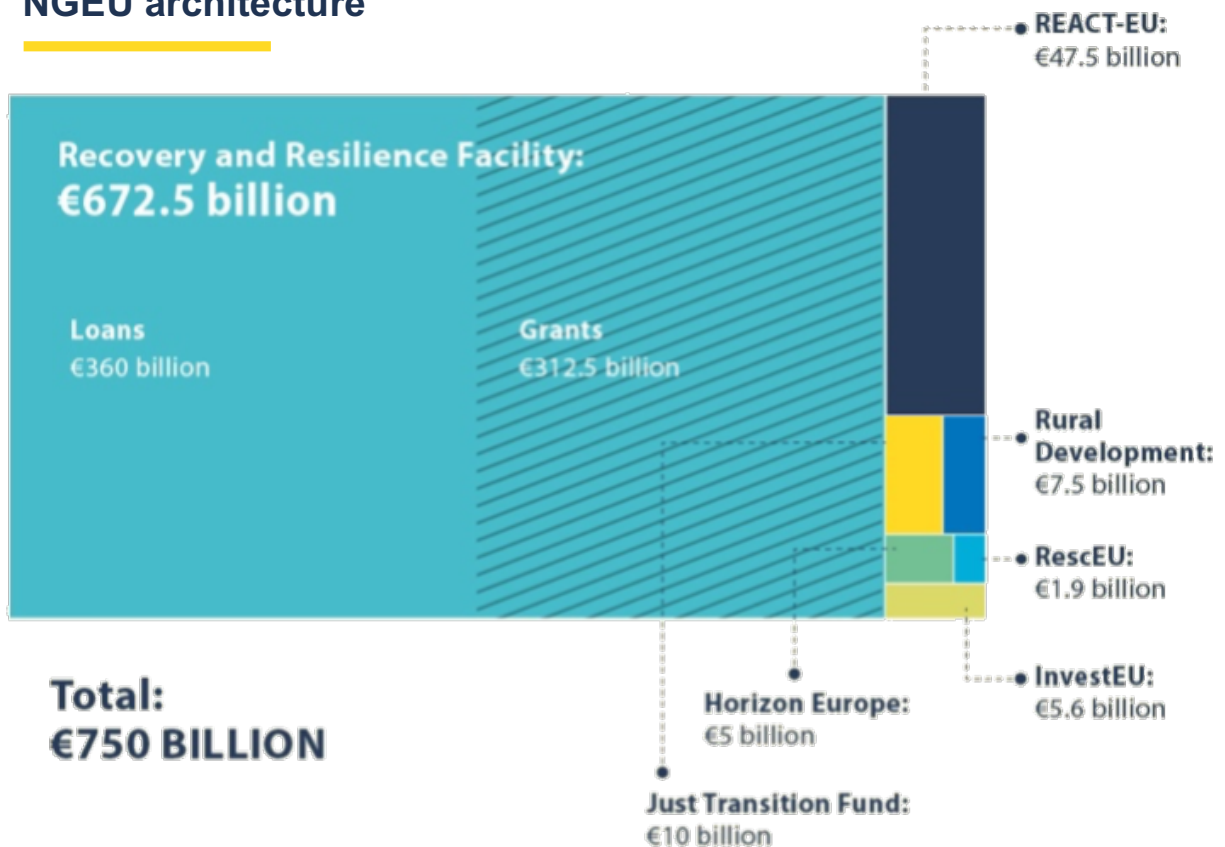
⁵¹⁶ Interinstitutional Agreement of 16 December 2020 between the European Parliament, the Council of the European Union and the European Commission on budgetary discipline, on cooperation in budgetary matters and on sound financial management, as well as on new own resources, including a roadmap towards the introduction of new own resources [2020] OJ L433/28.

⁵¹⁷ Fabbrini, *EU Fiscal Capacity* (n 208) 50.

Overall architecture



NGEU architecture



- **Legal commitments:** by 31 December 2023
- **Payments:** by 31 December 2026

Illustration 8: NGEU financial architecture

Now that the financial architecture of NGEU has been outlined, the focus will move on to the legal engineering of the fund. Unlike the response to the Eurozone crisis, the NGEU fund is built entirely on existing legal bases within the current EU treaty framework; it thus applies to the entire EU and not just the Eurozone.⁵¹⁸ Its legal architecture is "complex and based on different interrelated components"⁵¹⁹ (see table 3 on the next page).

De Gregorio Merino, the director of the legal service of the Council in economic and financial affairs, has accurately described the recovery fund as a "building of three floors".⁵²⁰ As already mentioned, the new ORD that was adopted by the Council empowers the Commission to borrow funds on the capital markets.⁵²¹ The ORD thus acts as the "top floor" and covers not only the overall volume of the EU's liabilities but also the financial conditions for repayment.⁵²² Staying in the same metaphor, the EU Recovery Instrument (EURI) Regulation acts as NGEU's "intermediate floor (...) which works as a 'control room', conduit or channel that allocates the proceeds of borrowings in the markets to different measures and programmes that it identifies".⁵²³ The legal foundation for the EURI Regulation is Art. 122 TFEU which is "seen as a counterweight or complement to the no-bailout clause"⁵²⁴ as it enables financial solidarity between the MS in cases of "natural disasters or exceptional occurrences".⁵²⁵ The EURI regulation has been described as "a bit of an empty shell",⁵²⁶ as its only purpose is the delegation of the funds raised to the programs of NGEU. It is a very compact legislative document as it only contains six articles,⁵²⁷ but it is still a "key element of the legal architecture of NGEU".⁵²⁸ As it was adopted by a SLP, the EP was sidelined in the adoption process. Finally, the "ground floor"⁵²⁹ of NGEU is made up of the different programs to which the resources are allocated: The RRF as well as six other minor cohesion programs, as illustrated on the bottom of the previous page. Each of those subcomponents of NGEU has its own "programming, eligibility and allocation criteria".⁵³⁰ It would go beyond the scope of this research to describe those criteria; therefore, the focus will lie on the Recovery and Resilience Facility.

⁵¹⁸ cf. *ibid* 68.

⁵¹⁹ Rayo (n 14) 12.

⁵²⁰ de Gregorio Merino (n 497) 4.

⁵²¹ Council Decision 2020/2053 (n 502) art 5(1a) and 5(2).

⁵²² cf. de Gregorio Merino (n 497) 4.

⁵²³ *ibid*.

⁵²⁴ Rayo (n 14) 13.

⁵²⁵ TFEU (n 36) art 122(2).

⁵²⁶ Paul Dermine, 'The EU's Response to the COVID-19 Crisis and the Trajectory of Fiscal Integration in Europe: Between Continuity and Rupture' [2020] 47 *Legal Issues of Economic Integration* 337, 342.

⁵²⁷ Regulation 2020/2094 (n 500) arts 1–6.

⁵²⁸ Bruno De Witte, 'The European Union's COVID-19 Recovery Plan: The Legal Engineering of an Economic Policy Shift' [2021] *Common Market Law Review* 635, 654.

⁵²⁹ de Gregorio Merino (n 497) 5.

⁵³⁰ *ibid*.

The RRF acts as "the cornerstone of the EU's socioeconomic strategy for tackling the consequences of the pandemic."⁵³¹ As already mentioned, this temporary ad-hoc instrument covers the biggest share of NGEU funds. It is thus indisputably "the most innovative and relevant mechanism of assistance"⁵³² in the recovery fund as well as the "legal engineering of an economic policy shift".⁵³³ While its conditionality rules will be detailed in the following chapter, it is now sufficient to briefly outline its legal base: The RRF relies on a Regulation that has been adopted by OLP.⁵³⁴ The EP was thus "in a better position to make its voice heard" during the adoption of this regulation, however *Fasone* has rightly pointed out that this does not compensate "the lack of [its] formal involvement on the EURI and the SURE Regulations" or its subsequent lack of decision-making powers in the disbursement of the RRF funds.⁵³⁵ The RRF regulation is based on Art. 175(3) TFEU, as it is a program to promote economic and social cohesion.

Furthermore, the legal architecture of NGEU is also influenced by the MFF regulation,⁵³⁶ as it maintains close ties to the long-term EU budget. Finally, NGEU funds are also subject to Regulation 2021/241⁵³⁷ that controversially introduced the respect for the rule of law as a precondition to access EU funds.

Legal act	Common Name	Legal Basis	Purpose
Council Regulation 2020/2094	EURI regulation	Art. 122 TFEU	Establishes NGEU and defines its size (= intermediate floor)
Council Regulation 2020/2093	MFF regulation	Art. 312 TFEU	Establishes the multiannual financial framework 2021-27 and defines its size
Council Decision 2020/2053	Own resources decision (ORD)	Art. 311 TFEU	Authorizes the funding of MFF and NGEU, issuance of common debt (= top floor)
Regulation 2021/241	RRF regulation	Art. 175 TFEU	Defines RRF conditionality and NGEU governance (= ground floor)
Regulation 2020/2091	Rule of Law regulation	Art. 322 TFEU	Sets respect for rule of law as a precondition to access EU funds
Interinstitutional agreement of 16 December 2020	Own resources IIA	Art. 295 TFEU	Roadmap for introduction of new EU taxes to repay NGEU's capital & interests

Table 3: Legal architecture of NGEU

⁵³¹ Rayo (n 14) 12.

⁵³² Porras Ramírez (n 456) 839.

⁵³³ *ibid.*

⁵³⁴ Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility [2021] OJ L57/17.

⁵³⁵ Cristina Fasone, 'Fighting Back? The Role of the European Parliament in the Adoption of Next Generation EU' [2022] 28 *The Journal of Legislative Studies* 368, 380.

⁵³⁶ Council Regulation (EU, Euratom) 2020/2093 of 17 December 2020 laying down the multiannual financial framework for the years 2021 to 2027 [2020] OJ L433/11.

⁵³⁷ Regulation 2021/241 (n 536).

4.4. Conditionality in the Recovery and Resilience Facility (RRF)

The principal reason why the European Council summit in July 2020 took five days to complete was the conundrum of "reconciling solidarity and responsibility in the Recovery and Resilience Facility".⁵³⁸ In the end, the conflict mainly came down to the design of conditionality rules within this instrument.⁵³⁹ While Northern European MS aimed at an "effective mechanism" based on the "successful implementation of economic reforms", the Southern European states like Italy feared that the RRF would become "a sort of 'Greek like troika' " that would entail a "strong interference in national economies".⁵⁴⁰ Ultimately, the European Council did find a compromise that reconciled the "everlasting tango" between solidarity and responsibility.⁵⁴¹ This subchapter will try to describe the facility's governance and impact, as well as categorize its use of conditionality rules.

As already mentioned, the general objective of the RRF is to "promote the Union's economic, social and territorial cohesion" in order to restore sustainable economic growth after the pandemic.⁵⁴² It is important to note that under the RRF regulation, funds are mostly allocated on the basis of various broad policy goals that are not strictly related to the pandemic, such as the transition to a digitalized and carbon-neutral economy: "These are no doubt all good causes and relevant for many EU horizontal objectives. However, they have little to do with alleviating the consequences of the pandemic, quite simply because they exist fully independent of the pandemic."⁵⁴³

As already lined out in the previous chapter, the RRF consists of both loans and grants: "While it may safely be predicted that the EUR 312.5 billion worth of *subsidies* will be very largely, and perhaps fully, taken up, it is not so obvious that the Member States will fully use the *loan* part [€360 billion] of the RRF."⁵⁴⁴ As of July 2022, only seven out of twenty-seven Member States have requested loans under the RRF,⁵⁴⁵ it thus seems that the grant-based part of the RRF has had the most economic impact. The allocation of grants under the RRF relies on a "complicated calculation method" that considers "the size of the member state, its macro-economic condition before the pandemic, and the impact that COVID-19 had on its economy"⁵⁴⁶ (see previous subchapter and illustration on the next page).

⁵³⁸ de Gregorio Merino (n 497) 11.

⁵³⁹ cf. De Witte (n 530) 675.

⁵⁴⁰ de Gregorio Merino (n 497) 11.

⁵⁴¹ *ibid.*

⁵⁴² Commission Proposal COM(2020) 408 final: Proposal for a Regulation of the European Parliament and the Council establishing a Recovery and Resilience Facility 4.

⁵⁴³ Leino-Sandberg and Ruffert (n 8) 446.

⁵⁴⁴ De Witte (n 530) 677 (emphasis in the original).

⁵⁴⁵ Fabbrini, *EU Fiscal Capacity* (n 208) 108.

⁵⁴⁶ Federico Fabbrini, 'Next Generation EU: Legal Structure and Constitutional Consequences' [2022] Cambridge Yearbook of European Legal Studies 1, 7; see also De Witte (n 530) 675.

Recovery and Resilience Facility: grants

Total grants: €312.5 billion

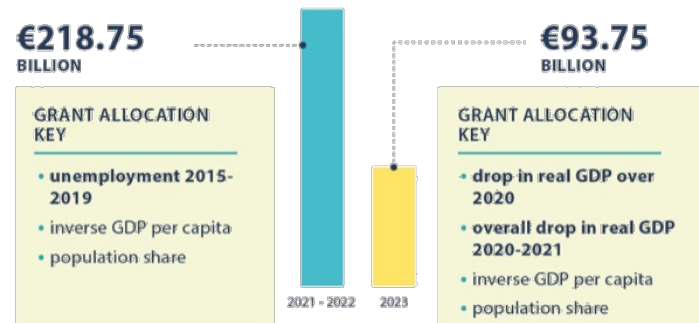


Illustration 9: Grant allocation key in the RRF

As pointed out by *Hartlieb and Morwinsky* in their policy brief for the German Konrad Adenauer foundation, those grants entail the "risk that the NGEU will create perverse incentives, especially for those Member States that hardly have any national debt leeway left".⁵⁴⁷ The scholars have therefore supported the use of spending conditionality rules and called for "clear and binding agreements on the repayment of the assumed debt".⁵⁴⁸ In practice, those negotiations regarding the payback have proven to be very difficult and characterized by the usual conflict between creditor and debtor countries.

While the NGEU fund is based on Art. 122(2) TFEU enabling temporary assistance measures in the event of a crisis, the RRF relies on Art. 175(3) TFEU (cohesion policy) even though the instrument in some respects is more similar to a measure of economic and fiscal policy.⁵⁴⁹ Both legal bases covering the NGEU and the RRF have been "discovered in recent years, particularly in the context of the euro crisis" and began to be used in a "vastly more ambitious" manner in the context of the pandemic.⁵⁵⁰ It has been argued that the RRF "embodies a much higher level of mutualization and risk-sharing between Member States" compared to the post-2008 context and that as a consequence, the EU's finances will be "closer to those of a State, than those of an international organization."⁵⁵¹ The RRF is not part of the MFF but has been legally classified as "assigned revenue" that will disappear upon termination of the NGEU program. Therefore, the continuation of the RRF after Covid-19 would "require either new borrowing or the creation of new sources of revenue above the current MFF", measures that both require unanimous consent by the Member States.⁵⁵²

⁵⁴⁷ Armin Hartlieb and Oliver Morwinsky, 'Für Ein Stabiles Europa von Morgen: Ein Rückzahlpakt Für Den Europäischen Rettungsfonds NGEU' (Konrad Adenauer Stiftung 2021) 448 2 (translated from German by the author).

⁵⁴⁸ *ibid* (translated from German by the author).

⁵⁴⁹ cf. Dermine (n 528) 344.

⁵⁵⁰ De Witte (n 530) 653.

⁵⁵¹ Dermine (n 528) 347.

⁵⁵² De Witte (n 530) 659.

Despite being based entirely on existing EU Treaty provisions, the RRF establishes an innovative solidarity-based system of economic governance.⁵⁵³ In the architecture of the RRF, the strategic objectives are defined by the EU in line with long-term political priorities.⁵⁵⁴ The overarching aim of the RRF is to make available new financial resources to the Member States, that will help to "build back better" the national economies for the EU's "Next Generation"⁵⁵⁵. In terms of *realpolitik*, the legal bases of the instrument are not politically significant, as the fund enjoys widespread support within the European Council. Therefore, questions surrounding its legality have not as prevalent as during the Eurozone crisis: "By the time the NGEU finds its way before the Court, its funding will already have been paid out and spent, with effects that cannot be undone."⁵⁵⁶

There is a decisive difference between the ESM and the RRF: In the first case, the instrument foresees an intergovernmental budgetary transfer from one group of Member States to another, giving each national government a right to veto its disbursement decision.⁵⁵⁷ The RRF on the other hand is based on supranational common resources that are raised on the financial markets and disbursed through the EU framework: "In NGEU, no Member State has more decision-making powers than the others, regardless of its size or economic might."⁵⁵⁸ This key difference diminishes the relevance of the no bail-out clause as well as the "legal need for strict conditionality" as established in the CJEU's *Pringle* judgement.⁵⁵⁹

However, this does not mean that fiscal prudence would "cease to exist", its previous strict and rule-based approach has instead been transformed into a hybrid enforcement based on a shared "discursive and policy space".⁵⁶⁰ Overall, it seems as if the prevalence of technocratic bodies such as the Troika has been overcome, making space for a more politicized implementation of conditionality.⁵⁶¹ Despite the more subtle enforcement mechanism, conditionality-based features are still predominant in the RRF's governance.⁵⁶²

As far as the implementation of conditionality is concerned, several scholars have argued that the Commission's role has been strengthened by the Recovery and Resilience Facility.⁵⁶³ Its tasks go beyond a bureaucratic administration of the instrument's governance: The Commission is also responsible for raising the NGEU resources on the capital markets and for

⁵⁵³ cf. Fabbrini, *EU Fiscal Capacity* (n 208) 71–72.

⁵⁵⁴ Regulation 2021/241 (n 536) art 3.

⁵⁵⁵ Fabbrini, 'Next Generation EU: Legal Structure and Constitutional Consequences' (n 548) 17–18.

⁵⁵⁶ Leino-Sandberg and Ruffert (n 8) 438.

⁵⁵⁷ Fabbrini, *EU Fiscal Capacity* (n 208) 63.

⁵⁵⁸ *ibid*; see also Fabbrini, 'Next Generation EU: Legal Structure and Constitutional Consequences' (n 548) 19.

⁵⁵⁹ Dermine (n 528) 348.

⁵⁶⁰ Ladi and Tsarouhas (n 420) 1051.

⁵⁶¹ cf. *ibid* 1050.

⁵⁶² cf. Dermine (n 528) 348.

⁵⁶³ Fabbrini, *EU Fiscal Capacity* (n 208) 75; Vanhercke and Verdun (n 235) 204; Leino-Sandberg and Ruffert (n 8) 454.

running a supranational economic policy.⁵⁶⁴ As it was pointedly put by *Fromage and Markakis*, it sits in the driver's seat of the RRF, together with the Council of the EU.⁵⁶⁵

The RRF's governance mechanism relies on a complex procedure based on the submission of National Recovery and Resilience Plans (NRRP) by the national governments,⁵⁶⁶ as defined by Chapter III of Regulation 2021/241. The right of initiative thus lies firmly in the hands of national administrations, as the European Union can only approve but not launch any projects.⁵⁶⁷

In order to be granted financial assistance, the national administrations must submit "duly reasoned and substantiated" roadmaps outlining the broad policy objectives, as well as "envisaged milestones, targets and an indicative timetable" concerning the implementation of reforms.⁵⁶⁸ The national capitals are also required to provide an estimated total cost of the reforms and investments, as well as an allocation to the various policy objectives. According to the legislative text, at least 37% of the requested funds must support the environmental transition, and at least 20% should be devoted to digitalization.⁵⁶⁹ The remaining 43% can be used more freely, as long as they can be somehow fitted into the broad policy objectives of the regulation. The national room for maneuver is thus considerably limited by a preestablished earmarking of funds,⁵⁷⁰ which is meant to influence national policies.

Following the submission of the NRRP, the Commission engages in "opaque and bilateral"⁵⁷¹ negotiations with the national governments: "Effectively, therefore, the NGEU transfers a great deal of budgetary powers from the legislature to the executive, at the EU level but likely also at the national level."⁵⁷²

The RRF then foresees a three-step process that leads to the disbursement of the funds: "1) approval of the NRRPs; 2) approval of compliance with the objectives set out in the plans; and 3) approval of payments".⁵⁷³ This very simplified version of the governance mechanism is checked by a "double filter"⁵⁷⁴ in each of its phases by both the supranational and the intergovernmental layer: "While the European Commission is responsible for evaluating the NRRPs and authorizing payments to beneficiary states, its actions are counter-checked by a triple intergovernmental control: the Council, responsible for approving the NRRPs [by means of a QMV implementing act] (phase 1); the Economic and Financial Committee (EFC), responsible for assessing compliance with the objectives (phase 2); and the comitology

⁵⁶⁴ Vanhercke and Verdun (n 235) 211.

⁵⁶⁵ cf. *Fromage and Markakis* (n 33) 8.

⁵⁶⁶ cf. *Moschella* (n 210) 9.

⁵⁶⁷ cf. *De Witte* (n 530) 675.

⁵⁶⁸ Regulation 2021/241 (n 536) art 18(4).

⁵⁶⁹ *ibid* art 16(2b); see also *De Witte* (n 530) 675.

⁵⁷⁰ cf. *Dermine* (n 528) 348.

⁵⁷¹ *Leino-Sandberg and Ruffert* (n 8) 455.

⁵⁷² *ibid*.

⁵⁷³ *Domínguez* (n 209) 26 (translated from Spanish by the author).

⁵⁷⁴ *ibid* 28 (translated from Spanish by the author).

committees for approving and implementing the payments linked to the mechanism (phase 3).⁵⁷⁵ This dual procedure (see illustration 10 below) has been interpreted as a clear sign that the Member States "want to keep the upper hand in the disbursement of the funds from the RRF".⁵⁷⁶ The main innovation of the RRF is the use of EU funds as a reward/carrot, in order to promote national reforms that are in line with EU strategic objectives⁵⁷⁷, as defined in the CSR of the ES: The RRF thus has a strong ex ante positive conditionality aspect, in that the policy guidance, negotiations and oversight occur before the disbursement of the funds.⁵⁷⁸

How does it work?

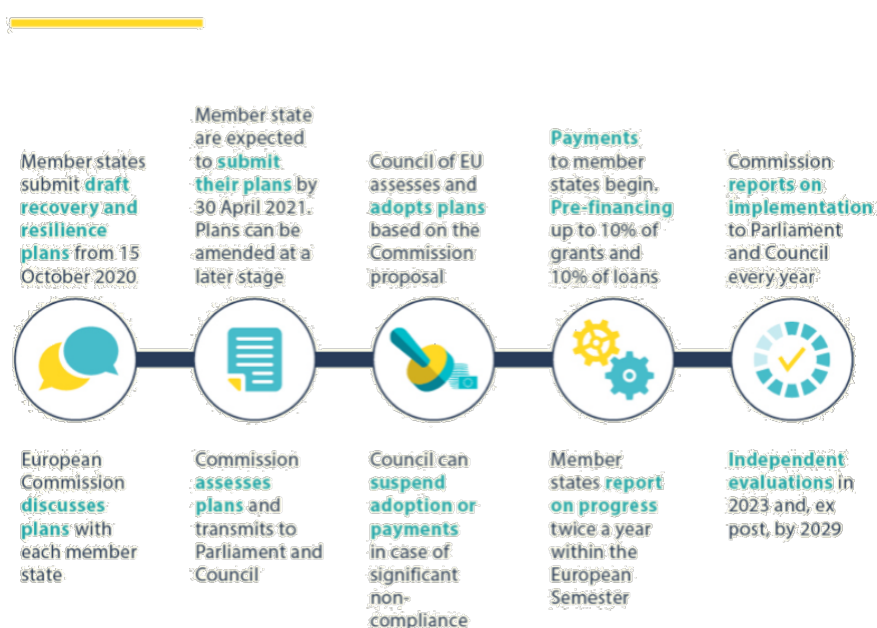


Illustration 10: Governance mechanism of the RRF

However, there is also an ex post positive conditionality aspect to the RRF that should not be overlooked. To be precise, the Commission continues its monitoring of the relevant milestones and targets even after the first disbursements of the funds: Further implementing decisions releasing additional funds can be taken by the Council only the Commission's assessment of the reform progress is positive.⁵⁷⁹ Yet, such a negative assessment by the EC is unlikely in practice in view of the "enormous pressure from the member states to disburse the money without delay".⁵⁸⁰ Moreover, the financial assistance can also theoretically be suspended by the Council upon a Commission proposal, if the Council has determined a violation of the SGP's excessive deficit rule by a Member State.⁵⁸¹ This link to the pre-existing EMU rules on sound economic governance is mainly declaratory and unlikely to ever be implemented.

⁵⁷⁵ *ibid* 27 (translated from Spanish by the author).

⁵⁷⁶ Fromage and Markakis (n 33) 8.

⁵⁷⁷ Fabbrini, 'Next Generation EU: Legal Structure and Constitutional Consequences' (n 548) 6.

⁵⁷⁸ *cf.* De Witte (n 530) 676; as well as Dermine (n 528) 348.

⁵⁷⁹ Regulation 2021/241 (n 536) art 24(6).

⁵⁸⁰ Vanhercke and Verdun (n 235) 211.

⁵⁸¹ Regulation 2021/241 (n 536) art 10.

There are two further aspects that enforce conditionality rules ex post in the RRF. The first of those legal features is the so-called "emergency brake". This control mechanism relies on a provision contained in the regulation's recital and not on substantive legal provisions, meaning that its "legal efficacy is dubious".⁵⁸² The emergency mechanism is thus a collaboration-based political mechanism,⁵⁸³ which has as its main purpose to "reassure the frugal member states of Northern Europe that NGEU funds would be used wisely and prudently".⁵⁸⁴

The Preamble of the RRF Regulation states that if "one or more Member States consider that there are serious deviations from the satisfactory fulfilment of the relevant milestones and targets, they may request the President of the European Council to refer the matter to the next European Council".⁵⁸⁵ The emergency brake can also be pulled by the EFC, in case that either the milestones or targets of the NRRP have not been met.⁵⁸⁶ As a result of this procedure, the disbursement of funds can be slowed down by up to three months.⁵⁸⁷ Ultimately however, this provision "cannot prevent the Commission from ultimately going ahead with the payments",⁵⁸⁸ as the European Council formally cannot block an implementing decision.

Finally, the abovementioned Rule of Law Conditionality Regulation also comes into play as an ex post conditionality mechanism: In situations where the breach of the rule of law principle contained in Art. 2 TEU has a "sufficiently direct" impact on the sound financial management of the EU budget,⁵⁸⁹ the Commission can decide to suspend EU funds⁵⁹⁰ such as the loans and grants disbursed by the RRF. As all legal challenges of this regulation were rejected as unfounded by the ECJ in two separate rulings,⁵⁹¹ the mechanism has now been applied by the Commission against Hungary: Currently, the €5.8 billion in grants designated for the Hungarian government under the RRF are being held back by the EU until the concerns over judicial independence are addressed by Budapest.⁵⁹²

To sum up, the RRF can be best categorized as "sticks and carrots" conditionality. Even though the ex ante aspect is predominant, the Rule of Law regulation, the emergency brake mechanism, the link to the SGP, the disbursement in tranches and more general rules of transparency and good governance act as ex post safeguards.

⁵⁸² Fabbrini, 'Next Generation EU: Legal Structure and Constitutional Consequences' (n 548) 9.

⁵⁸³ de Gregorio Merino (n 497) 12.

⁵⁸⁴ Fabbrini, 'Next Generation EU: Legal Structure and Constitutional Consequences' (n 548) 9.

⁵⁸⁵ Regulation 2021/241 (n 536) recital 52.

⁵⁸⁶ *ibid.*

⁵⁸⁷ Vanhercke and Verdun (n 235) 210.

⁵⁸⁸ de Gregorio Merino (n 497) 12.

⁵⁸⁹ Regulation 2020/2092 (n 31) art 4(1).

⁵⁹⁰ *ibid* art 5(a,i).

⁵⁹¹ Case C-156/21 *Hungary v European Parliament and Council of the European Union* [2022] EU:C:2022:97 [paras 153, 180, 197, 289, 295, 304, 318, 334, 346, 360]; Case C-157/21 *Republic of Poland v European Parliament and Council of the European Union* [2022] EU:C:2022:98 [paras 189, 229, 242, 252, 272, 310, 345, 363].

⁵⁹² Kate Abnett and Jan Strupczewski, 'EU Holds Back All of Hungary's Cohesion Funds over Rights Concerns' (*reuters.com*, 22 December 2022) <<https://reut.rs/3wjJOE6>> accessed 22 January 2023.

Finally, it is important to point out that the prerogatives of the EP are very limited in the context of the RRF. The EP does not have any decision-making powers concerning the governance of the RRF, such as the drafting or approval of the NRRPs: "It could not, for example, veto the approval of a plan or the disbursement of funds to a Member State because it is displeased with the relevant milestones and targets set or with their unsatisfactory fulfilment."⁵⁹³ This lack of involvement "sits uneasily with the fact that EURI actually created that 'shadow budget' whose amount vastly exceeds the EU's annual budget"⁵⁹⁴. The EU is thus facing the usual "dilemma between efficiency and legitimacy" as greater involvement of the EP in the implementation of conditionality "slows down the procedure but gives it greater democratic legitimacy".⁵⁹⁵

However, scholars have still observed a "slow empowerment of the EP"⁵⁹⁶ in the field of EMU compared to the response to the Eurozone crisis: "the EP was in a better position to make its voice heard."⁵⁹⁷ This is because the European Parliament has successfully used its veto power for the adoption of the MFF to increase its leverage in the NGEU context.⁵⁹⁸ While the EP ultimately cannot formally constrain the Commission, it can use political blame to exert public pressure.⁵⁹⁹ All in all, the EP was successful in getting "most of the concessions it wanted on the substance of the proposals or on specific themes (e.g. enhanced protection of social rights, green transition, the EU added value), but not really on decision-making powers".⁶⁰⁰

To sum up, conditionality in the Recovery and Resilience Facility has been applied in a medium way. While the interference is nowhere near as far-reaching as under the ESM, the Member States are incentivized to fulfill objectives as defined by the EU, thus giving up yet another part of their budgetary autonomy. While most ex post surveillance mechanisms are mainly declaratory, the Rule of law regulation has proven its teeth in practice against Hungary. The RRF conditionality can therefore best be described as incentive-based sticks and carrots. It has been argued that the RRF represents a "learning" from the experimentation period in that rule-based economic governance is increasingly replaced by a hybrid approach.⁶⁰¹ Through its extensive reliance on conditionality, the RRF also acts as a "powerful incentive to give additional bite to the EU's economic governance".⁶⁰²

⁵⁹³ Fromage and Markakis (n 33) 8.

⁵⁹⁴ De Witte (n 530) 668.

⁵⁹⁵ Domínguez (n 209) 20 (translated from Spanish by the author).

⁵⁹⁶ Fromage and Markakis (n 33) 13.

⁵⁹⁷ Fasone (n 537) 380.

⁵⁹⁸ cf. De Witte (n 530) 669.

⁵⁹⁹ Fromage and Markakis (n 33) 8.

⁶⁰⁰ Fasone (n 537) 380.

⁶⁰¹ cf. Stella Ladi and Dimitris Tsarouhas, 'EU Economic Governance and Covid-19: Policy Learning and Windows of Opportunity' [2020] 42 Journal of European Integration 1041, 1049.

⁶⁰² Dermine (n 528) 349; see also Moschella (n 210) 9.

5. Conditionality-based monetary instruments

An analysis of the implementation and enforcement of conditionality in EMU law would not be complete without also considering the monetary instruments launched by the European Central Bank since the beginning of the Eurozone crisis: "the ECB's conditionality contributed to drive Euro area crisis countries to adopt urgent and crucial reforms or even to seek EU/IMF financial assistance."⁶⁰³ By linking the eligibility for its purchasing programs to compliance with the macroeconomic adjustment programs, the ECB "almost acted as an enforcer of the Troika's conditionality".⁶⁰⁴ This characteristic has never been observed in other central banks and is therefore quite controversial, as some see it as "a true political action departing from the standards of neutrality and independence that central banks should meet."⁶⁰⁵

During the Eurozone crisis and also the Covid-19 pandemic, the European Central Bank was confronted with "new challenges, which were not anticipated in its mandate".⁶⁰⁶ Rather than having to keep down inflation, the ECB had to mitigate the effects of a deflationary recession: "This inversion, however, has occurred without any concurrent political, legal, or constitutional change."⁶⁰⁷ As a consequence, the ECB's legal mandate did not provide any clear guidance on how the governors had to respond: "These authorization gaps have forced, and continue to force, the ECB's Governing Council to agree to policies that are not clearly authorized by its mandate, which in turn open these policies up to legal challenge."⁶⁰⁸

Ultimately, those legal gaps and lack of political reform will have forced the European Central Bank to stretch its mandate (see chapter 5.1.) to the outer limits: "With financial markets in free fall, the ECB, like other major central banks, became the lender of last resort of private financial institutions through massive refinancing operations, turning it into a market-maker."⁶⁰⁹

This far-reaching interference in national fiscal sovereignty was "justified in terms of *raison d'euro*: the need to safeguard the EMU and its stability – perceived as a supreme good – made extreme measures not only necessary, but almost inevitable."⁶¹⁰ The ECB was thus facing a choice between a "strict interpretation of its mandate or safeguarding the euro."⁶¹¹ Due to the incomplete and asymmetrical nature of EMU, the ECB decided to "develop new tools to plug gaps in the system",⁶¹² leading to a de facto compensation for the lack of fiscal integration.⁶¹³

⁶⁰³ Viterbo (n 17) 504.

⁶⁰⁴ *ibid* 508.

⁶⁰⁵ *ibid* 530.

⁶⁰⁶ de Boer and Van't Klooster (n 26) 1690.

⁶⁰⁷ Dani and others (n 41) 318.

⁶⁰⁸ de Boer and Van't Klooster (n 26) 1703.

⁶⁰⁹ Dani and others (n 41) 316.

⁶¹⁰ Viterbo (n 17) 502 (emphasis in the original).

⁶¹¹ AM Mooij, 'The Role of the European Central Bank in Response to COVID19. An Evaluation of Its Mandate' [2022] *Journal of European Integration* 1, 2.

⁶¹² Alicia Hinarejos, 'On the ECB's New Transmission Protection Instrument and the Role of Courts' [2022] *European law review* 435.

⁶¹³ cf. Kerstin Bernoth and others, 'Activation of New ECB Emergency Program TPI Not Required so Far' [2022] *12 DIW Weekly Report* 249, 256.

Conditionality became the distinctive characteristic of all monetary instruments as a way to bridge the gap between legal norms and economic necessities. To analyze its enforcement and implementation, the categories of the classification conducted by this research need to be slightly adjusted. Instead of differentiating between ex ante and ex post as well as between positive and negative conditionality, the category "typology" will describe whether the monetary instrument is "quantitative" or "selective". This distinction makes a relevant difference in the implementation, as conditionality is usually less effective when it applies to the entire Eurozone rather than individual Member States.

Moreover, the category "enforcement" will subdivide the monetary instruments into implicit and explicit mechanisms.⁶¹⁴ While conditionality was usually formalized in the context of the previously discussed fiscal instruments, this characteristic is not strictly "necessary for conditionality to be operational and effective in influencing a party's behaviour".⁶¹⁵ Conditionality can also be based on a "tacit understanding of benefits and sanctions, outside the confines of written law" and be equally effective.⁶¹⁶ This enforcement mechanism is usually based on a "clear power asymmetry" and therefore mostly found in the context of interstate relations rather than supranational institutions, which usually operate based on binding legal provisions and the principle of conferral.⁶¹⁷

Finally, the category "application" will remain unchanged in its differentiation between "soft", "medium" and "strict" instruments. The categorization of the ECB instruments will in this case mostly depend on the fiscal instruments they are linked to (see previous two sections) as well as on implications caused by the other two categories. As usual, the research will disregard instruments targeting private legal persons (such as the CSPP) and focus on the impact on national fiscal policy.

Due to the very recent developments in the field of monetary policy, this section cannot always provide a comprehensive picture, as many questions remain open regarding the legality and implementation of certain instruments (see chapters 5.3. and 5.4.). Since the Russian invasion of Ukraine, inflation has been soaring in the Eurozone with implications that are not fully predictable for the ECB's monetary policy. The unprecedented rise in the price levels has forced the Central Bank to wind down its quantitative easing programs and to raise interest rates to cool the economy.⁶¹⁸ It is clear that the third major economic recession in the ECB's short existence will further delay the "return to normal in EMU rules and governance" for a few more years.⁶¹⁹

⁶¹⁴ Viterbo (n 17) 504.

⁶¹⁵ Sacchi (n 29) 78.

⁶¹⁶ Viterbo (n 17) 504.

⁶¹⁷ *ibid.*

⁶¹⁸ Fabbrini, *EU Fiscal Capacity* (n 208) 138.

⁶¹⁹ Fabbrini, 'The Legal Architecture of the Economic Responses to COVID-19: EMU beyond the Pandemic' (n 461) 195.

5.1. The ECB's mandate

For the members of the Eurozone, monetary policy is an exclusive competence of the Union⁶²⁰ conducted by the European Central Bank (ECB) in Frankfurt. This EU institution is designed to be fully independent⁶²¹ and protected from any form of political interference. Its lack of democratic legitimation is justified by the institution's technocratic character: "The ECB is expected to exercise its mandate in a clearly defined and restricted sphere on the grounds of cumulated technical knowledge in the conduct of monetary policy".⁶²² Despite this legal obligation, the ECB has been polemically described as "the only agency engaged in economic policy worthy of the name" since it is said to be the only EU body enjoying "real authority and clout as a federal institution"⁶²³ in the field of EMU.

The ECB's primary objective is maintaining price stability⁶²⁴ within the single currency area: "The primacy of price stability means two things: that it constitutes the ECB's primary focus and that, in the event of conflict with other objectives, it takes precedence."⁶²⁵ All measures taken by the ECB must therefore be "necessary to preserve (...) the singleness and effectiveness of monetary policy".⁶²⁶ As it is not expressly defined by the TFEU, the CJEU has recognized that the ECB has a "wide scope of discretion to define price stability" and that defining inflation rates at levels close to 2% is a "valid exercise of the ECB's discretion".⁶²⁷ Moreover, the institution shall also "support the general economic policies in the Union".⁶²⁸ This second provision of the same Treaty article is often referred to as the ECB's "secondary objective", as it is "hierarchically subordinate"⁶²⁹: "Under certain conditions, the ECB may also take measures which make an indirect contribution to the primary objective by fostering the preconditions which are necessary to achieve its price stability objective."⁶³⁰ The CJEU has ruled in its landmark judgment *Gauweiler* that measures adopted by the ECB aiming to preserving the monetary transmission mechanism "may be regarded as pertaining to the primary objective".⁶³¹

⁶²⁰ TFEU (n 36) art 3(1c).

⁶²¹ cf. *ibid* art 130.

⁶²² Dani and others (n 41) 315.

⁶²³ Adam Tooze, 'The Death of the Central Bank Myth' (*ForeignPolicy.com*, 13 May 2020) <<https://bit.ly/3Cg6oMw>> accessed 3 January 2023.

⁶²⁴ TFEU (n 36) art 127(1).

⁶²⁵ Michael Ioannidis, Sarah Jane Hlášková and Chiara Zilioli, 'The Mandate of the ECB: Legal Considerations in the ECB's Monetary Policy Strategy Review' [2021] ECB Occasional Paper 8.

⁶²⁶ *ibid* 10.

⁶²⁷ Case C-493/17 *Heinrich Weiss and Others* [2018] EU:C:2018:1000 [54–57].

⁶²⁸ TFEU (n 36) art 127(1); see also TEU (n 70) art 3.

⁶²⁹ Michael Ioannidis, 'The European Central Bank' in Fabian Amtenbrink, Christoph Herrmann and René Repasi (eds), *The EU Law of Economic and Monetary Union* (Oxford University Press 2020) 371.

⁶³⁰ Ioannidis, Hlášková and Zilioli (n 627) 9.

⁶³¹ C-62/14 *Gauweiler* (n 90) para 50.

The ECB must exercise its supportive role in economic policy cautiously without disturbing the institutional balance or interfering with the responsibilities of other EU institutions.⁶³² So far, the ECB has never relied on its secondary objective as an exclusive legal basis for its monetary policy measures,⁶³³ as it cannot exercise exclusive competence based on this provision. This reflects the original imbalance that has characterized EMU ever since the Maastricht Treaty (see chapter 2).

The original intention behind this separation of monetary and economic policy was to "guarantee that economic issues remain firmly in the hands of democratically legitimated bodies."⁶³⁴ In *Weiss* however, the CJEU departed from the pre-financial crisis understanding of EMU law, stating that "the authors of the Treaties did not intend to make an absolute separation between economic and monetary policies".⁶³⁵ In the same judgment, the Court also reiterated that "in order to exert an influence on inflation rates, the ESCB necessarily has to adopt measures that have certain effects on the real economy, which might also be sought – to different ends – in the context of economic policy".⁶³⁶ As long as those indirect effects on factors such as employment or economic growth are not the primary objective of the monetary policy measure and are necessary to maintain price stability, they are covered by the ECB's mandate.⁶³⁷ This mandate can be best thought of as the "outer limits of its competence to act".⁶³⁸

As an EU institution, the ECB is also constrained by the general pillars of EU law such as the principles of conferral, institutional balance, proportionality, non-discrimination and an open market economy.⁶³⁹ Moreover, it is expressly forbidden to the ECB to purchase sovereign debt directly⁶⁴⁰ from the Member States: "[T]his 'monetary no bail-out clause' was also introduced into EU law by the Treaty of Maastricht in order to safeguard the market-based paradigm (...)."⁶⁴¹ As described in chapter 2, this provision's objective was to ensure that governments would not have an incentive to issue more debt than appropriate (the moral hazard problem). Much like in *Pringle*, the CJEU offered a purposive and dynamic interpretation of Article 123(1) TFEU, based on the premise that the "meta-objective of sound budgetary policies" can also be served by "public discipline through conditionality" instead of by a market mechanism.⁶⁴²

⁶³² cf. Michael Ioannidis and Chiara Zilioli, 'Climate Change and the Mandate of the ECB: Potential and Limits of Monetary Contribution to European Green Policies' [2022] 59 Common Market Law Review 363, 369–370.

⁶³³ cf. Ioannidis, Hlášková and Zilioli (n 627) 13.

⁶³⁴ Dani and others (n 41) 315.

⁶³⁵ Case C-493/17 *Weiss* (n 629) para 60.

⁶³⁶ *ibid* para 66.

⁶³⁷ cf. Ioannidis, Hlášková and Zilioli (n 627) 12.

⁶³⁸ *ibid* 6.

⁶³⁹ cf. Ioannidis, 'The European Central Bank' (n 631) 370–373.

⁶⁴⁰ TFEU (n 36) art 123(1).

⁶⁴¹ Ioannidis, 'Europe's New Transformations: How the EU Economic Constitution Changed during the Eurozone Crisis' (n 16) 1252.

⁶⁴² *ibid* 1262.

5.2. Monetary response to the Eurozone crisis and conditionality

Many scholars have acknowledged the decisive role that the ECB's commitment to do "whatever it takes to save the euro"⁶⁴³ has played in responding to the Eurozone crisis.⁶⁴⁴ Put very simply, the main issue that the ECB was facing concerned the spread of interest rates on sovereign debt: "[I]nvestors can sell the bonds of a given country to buy bonds of a more credible country (e.g. Germany) denominated in the same currency. This happened during the Euro area crisis and signified the skyrocketing of borrowing costs in the bailed-out countries and their rapid decline in Germany and other countries."⁶⁴⁵

By adopting several groundbreaking unconventional monetary policies, the ECB began "navigating unexplored waters" in order to calm the panic on the sovereign bonds market.⁶⁴⁶ *Lindseth and Fasone* have linked this controversial strategy to a major deficiency that had characterized the EU's metabolic constitution up until the NGEU fund: "The ECB has been forced to stretch the limits of its mandate in this way, however, precisely because of the lack of a fiscal capacity at the supranational level, justifying its efforts as a means of saving the EMU, albeit without a specific mandate and clear accountability limits."⁶⁴⁷ *Dani et al* have instead seen the "radical independence of the ECB"⁶⁴⁸ as the principal reason for the legal uncertainty surrounding the ECB's unconventional monetary policy.

Whatever the legal reason, the ECB vastly expanded its mandate during the experimentation phase of conditionality: "The functional need to avoid the disorganized unraveling of the eurozone has led to a gradual and problematic mutation of the role of the ECB."⁶⁴⁹ Due to the conditionality-based monetary instruments that will be outlined in the following subchapters, the ECB controversially became the largest creditor in the Eurozone.⁶⁵⁰ For the CJEU, the use of conditionality is seen as a necessary "instrument to ensure that the two separate measures, of monetary policy and economic policy, work in the same direction"⁶⁵¹ As part of the Troika, the ECB went beyond traditional central banking tasks: Not only did it participate in the negotiations of the MoU, it also played a major role in monitoring the compliance with policy conditionality, despite being nominally being only an "expert advisor and without decision-making authority".⁶⁵²

⁶⁴³ UKTI UK Trade & Investment, 'Global Investment Conference - Mario Draghi, President of the European Central Bank' (*youtube.com*, 26 July 2012) <<https://bit.ly/3kJqJDS>> accessed 24 January 2023 TC 07:11.

⁶⁴⁴ cf. Fabbrini, *EU Fiscal Capacity* (n 208) 43; Griller and Lentsch (n 68) 3; Dani and others (n 41) 320; as well as Ioannidis, 'The European Central Bank' (n 631) 354.

⁶⁴⁵ Ladi and Tsarouhas (n 420) 1046.

⁶⁴⁶ cf. de Boer and Van't Klooster (n 26) 1691.

⁶⁴⁷ Lindseth and Fasone (n 418) 522.

⁶⁴⁸ Dani and others (n 41) 315.

⁶⁴⁹ *ibid.*

⁶⁵⁰ cf. Griller and Lentsch (n 68) 3.

⁶⁵¹ Zilioli (n 15) 181.

⁶⁵² *ibid* 181, cf. also 177-178.

5.2.1. Securities Markets Program (SMP)

This bond-purchasing program was implemented by the ECB in May 2010 as part of a larger package to address the diverging yields on sovereign bonds: "The Eurosystem argued that monetary policy impulses were not transmitted through financial markets and banks to the real economy, because the disruptions in the sovereign bond markets affected financial market pricing and the behaviour of banks. Critically, the SMP was to restore the monetary policy transmission mechanism by supporting the government bond markets of the troubled Member States [through purchases by the ECB]."⁶⁵³ Bond purchases under the SMP occurred in "two big waves, one in the first half of 2010 and the other in the second half of 2011".⁶⁵⁴ There were only five countries targeted by the SMP: Greece, Ireland, Portugal and later also Spain and Italy.⁶⁵⁵ This makes this bond-purchasing program a selective instrument.

The SMP marks the first time that the Central Bank went beyond its traditional strategy of influencing interests through the policy rate. The SMP can thus be considered as the ECB's first large-scale implementation of unconventional monetary policy.⁶⁵⁶ To be compatible with the monetary financing prohibition,⁶⁵⁷ the Governing Council decided to conduct the purchases of bonds issued by public entities on the secondary market.⁶⁵⁸ The ECB decision covering the SMP relied on the first indent of Article 127(2) TFEU ("defining and implementing monetary policy") as its legal base, not mentioning the Bank's secondary objective. The SMP had been conceived as a temporary, crisis-related instrument. Therefore, it was terminated after just two years in operation at the announcement of the OMT program.⁶⁵⁹

As the application of the minimum credit rating threshold⁶⁶⁰ had been suspended following the approval of the Troika's economic adjustment programs,⁶⁶¹ all public bonds issued in Eurozone Member States⁶⁶² were deemed eligible for the SMP: "In spite of their downgrading by credit rating agencies, sovereign bonds of these countries were considered eligible as collateral, provided that they complied with EU/IMF adjustment programmes."⁶⁶³

⁶⁵³ Klaus Tuori, 'Monetary Policy (Objectives and Instruments)' in Fabian Amtenbrink, Christoph Herrmann and René Repasi (eds), *The EU Law of Economic and Monetary Union* (Oxford University Press 2020) 658; see also NN, 'Asset Purchase Programmes' (*ecb.europa.eu*) <<https://bit.ly/3EML41L>> accessed 30 November 2022.

⁶⁵⁴ Ioannidis, 'Europe's New Transformations: How the EU Economic Constitution Changed during the Eurozone Crisis' (n 16) 1255.

⁶⁵⁵ NN, 'History of SMP Holdings per Issuer' (*ecb.europa.eu*, 17 February 2022) <<https://bit.ly/3wpMQBU>> accessed 24 January 2023.

⁶⁵⁶ cf. Tuori (n 655) 658–663 for more nuance.

⁶⁵⁷ TFEU (n 36) art 123(1).

⁶⁵⁸ Decision 2010/281/EU of the European Central Bank of 14 May 2010 establishing a securities markets programme [2010] OJ L124/8 1(a); see also Zilioli (n 15) 177.

⁶⁵⁹ NN, 'Technical Features of Outright Monetary Transactions' (*ecb.europa.eu*, 6 September 2012) <<https://bit.ly/2VV3dmD>> accessed 29 November 2022.

⁶⁶⁰ cf. Decision 2010/281/EU (n 660) art 3.

⁶⁶¹ NN, 'ECB Announces Change in Eligibility of Debt Instruments Issued or Guaranteed by the Greek Government' (*ecb.europa.eu*, 3 May 2010) <<https://bit.ly/3Xy1Vxf>> accessed 24 January 2023.

⁶⁶² Decision 2010/281/EU (n 660) art 2(a) and 2(b,i).

⁶⁶³ Viterbo (n 17) 508; cf. Decision 2010/281/EU (n 660) recital 4.

Despite being based upon a legally binding act,⁶⁶⁴ the Securities Markets Program relied upon implicit conditionality. This is because the scope of conditionality was not formalized in any official document,⁶⁶⁵ much unlike later ECB bond-purchasing programs or financial assistance by the ESM. The SMP purchases were instead tied to "self-styled conditions that took the form of reform requests addressed informally".⁶⁶⁶ Despite not being formalized, the conditions imposed informally in the SMP context were "nonetheless stringent and pervasive, as the ECB was setting the policy agenda, alternatives and instruments to be adopted in exchange for its support."⁶⁶⁷

Those requests took the form of confidential letters sent by Jean-Claude Trichet and Mario Draghi to the national governments, which recommended fiscal discipline and austerity measures liberalizing the labor market and welfare state.⁶⁶⁸ Even though these letters never expressly mentioned the SMP, the "sequence of events is rather eloquent."⁶⁶⁹

The publication of those confidential letters soon led to the accusation that the ECB had overstepped its mandate: "It was claimed right from the outset that the SMP amounted to the prohibited monetary financing of governments."⁶⁷⁰ Moreover, some economists claimed there was not sufficient evidence supporting the SMP's proportionality: "The link between the proper functioning of national financial markets and domestic government bonds is not clear."⁶⁷¹

The SMP relied on market discipline as its "key operating mechanism", as Member States who would not comply with the implicit conditions risked facing "severe and, at some points, almost unsustainable market conditions" which could ultimately lead to a further loss of budgetary sovereignty or even a default in the worst case.⁶⁷²

Considering the urgency at the time of its adoption, the SMP was clearly focused on extinguishing the fire on the financial markets: Due to the implicit and informal nature of conditionality, the application proved to be soft in practice compared to the following monetary instruments. In a nutshell, the SMP was hurriedly implemented as an extraordinary measure: "Despite their positive effects in reducing sovereign spreads, the SMP actions, in part because of the pre-limited extent of the programme, did not prove sufficient to contain the crisis."⁶⁷³

⁶⁶⁴ Jacopo Alberti, 'Challenging the Evolution of the EMU: The Justiciability of Soft Law Measures Enacted by the ECB against the Financial Crisis before the European Courts' in Albertina Albers-Llorens and others (eds), *Yearbook of European Law*, vol 37 (Oxford Academic 2018) 631.

⁶⁶⁵ cf. Viterbo (n 17) 504.

⁶⁶⁶ Ioannidis, 'Europe's New Transformations: How the EU Economic Constitution Changed during the Eurozone Crisis' (n 16) 1267.

⁶⁶⁷ Sacchi (n 29) 7.

⁶⁶⁸ cf. *ibid* 6; as well as Ioannidis, 'Europe's New Transformations: How the EU Economic Constitution Changed during the Eurozone Crisis' (n 16) 1267.

⁶⁶⁹ Sacchi (n 29) 7.

⁶⁷⁰ Tuori (n 655) 662.

⁶⁷¹ *ibid* 663.

⁶⁷² Sacchi (n 29) 4–5; see also Viterbo (n 17) 505.

⁶⁷³ Ioannidis, 'Europe's New Transformations: How the EU Economic Constitution Changed during the Eurozone Crisis' (n 16) 1255.

5.2.2. Outright Monetary Transactions (OMTs)

At the peak of the European sovereign debt crisis in September 2012, the ECB established its Outright Monetary Transactions (OMT) program. The Bank announced that if a Member State was having liquidity problems and private investors would not buy its bonds, the ECB would step in and buy these state securities on the secondary market as a lender of last resort.⁶⁷⁴ The basic premise of the OMT program is thus very similar to the Securities Markets Program that it replaced: Both programs are selective in their typology as they both target individual Member States and do not cover the entire Eurozone.⁶⁷⁵ This is because the issue tackled by the SMP and the OMT was localized since "the monetary policy transmission mechanism was disrupted in some countries, but not in others."⁶⁷⁶

There are however also several differences between the OMT and the SMP: Unlike its predecessor, the program is not covered by a formal and binding decision by the ECB's Governing Council. The OMT is instead based on a short press release,⁶⁷⁷ which is a "much softer act"⁶⁷⁸ in legal terms. Furthermore, as the OMT program does not feature a predefined limit of the bond purchases' volume, the ECB consequently purposely showcased its readiness to conduct unlimited purchases as long as the eligibility criteria were met.⁶⁷⁹

The enforcement as well as the content of those requirements are the most fundamental innovations by the OMT program. For the first time, bonds issued by countries in financial difficulty required "strict and effective conditionality" attached to an appropriate financial assistance program such as the ESM to be eligible for purchase: "The Governing Council will consider Outright Monetary Transactions to the extent that they are warranted from a monetary policy perspective *as long as programme conditionality is fully respected*, and terminate them once their objectives are achieved or when there is non-compliance with the macroeconomic adjustment or precautionary programme."⁶⁸⁰

This first explicit reference to policy conditionality has led the German Federal Constitutional Court to argue that the OMT program is an instrument of economic policy.⁶⁸¹ As the decisions regarding the start, continuation, and suspension of bond purchases are taken by the Governing Council "in full discretion",⁶⁸² concerns began to emerge regarding the ECB's democratic accountability and its interference in national budgetary sovereignty.⁶⁸³

⁶⁷⁴ Hinarejos (n 35) 592–593.

⁶⁷⁵ cf. Zilioli (n 15) 174.

⁶⁷⁶ *ibid* 175.

⁶⁷⁷ NN, 'Technical Features of Outright Monetary Transactions' (n 661).

⁶⁷⁸ Alberti (n 666) 631.

⁶⁷⁹ cf. (n 26) 1705; and Ioannidis, 'Europe's New Transformations: How the EU Economic Constitution Changed during the Eurozone Crisis' (n 16) 1255.

⁶⁸⁰ NN, 'Technical Features of Outright Monetary Transactions' (n 661) (emphasis added by the author).

⁶⁸¹ Baraggia (n 2) 2.

⁶⁸² NN, 'Technical Features of Outright Monetary Transactions' (n 661).

⁶⁸³ cf. Viterbo (n 17) 501.

In contrast to the SMP, the OMT program was never actually activated by the ECB, as its "mere existence had a strong effect on the markets"⁶⁸⁴, in particular on the yields of sovereign bonds. Despite its non-implementation and the lack of a challengeable binding decision, the OMT program became subject to a legal challenge by a group of fiscally conservative German activists.

In its landmark judgement *Gauweiler*, the ECJ received for the first time a preliminary question by the German Federal Constitutional Court. While a "clash was ultimately avoided", the two courts had come very close to an open confrontation.⁶⁸⁵ The ECB had defended the OMT program by arguing that it was covered by its mandate as "large spreads between the Member States undermined its ability to shape financial market conditions across the euro area."⁶⁸⁶

In its judgement, the CJEU agreed with this position, ruling that the OMT was fully compatible with primary EU law⁶⁸⁷ and that the ECB had "acted in pursuit of its objectives and fully within its competences".⁶⁸⁸ The ECJ in fact welcomed the OMT's explicit reference to program conditionality as a positive factor decreasing the moral hazard and promoting sound budgetary policies.⁶⁸⁹ The Luxembourg Court also found the OMT's conditionality to be a sufficient safeguard to ensure that the instrument would not have an effect equivalent to a direct purchase as prohibited by Art. 123(1) TFEU.⁶⁹⁰

To sum up, the OMT program is a selective bond-purchasing program that relies explicitly on compliance with policy conditionality. As it is linked to the harsh austerity measures of the ESM financial assistance program (see chapter 3.5.), the application of the OMT program can be classified as strict. In fact, the press release by the ECB itself acknowledges the obligatory presence of "strict and effective"⁶⁹¹ conditionality measures.

5.2.3. Public Sector Purchasing Program (PSPP)

While the SMP and especially OMT succeeded in absorbing the biggest shocks of the sovereign debt crisis, the economy of the Eurozone had remained fragile due to strong deflationary tendencies.⁶⁹² In this context, the ECB launched the PSPP in 2015 to support economic growth by expanding its balance sheet (quantitative easing).⁶⁹³ In a similar manner as was announced three years earlier in OMT, the ECB started to purchase large quantities of

⁶⁸⁴ Hinarejos (n 35) 593.

⁶⁸⁵ *ibid* 609.

⁶⁸⁶ de Boer and Van't Klooster (n 26) 1705.

⁶⁸⁷ C-62/14 *Gauweiler* (n 90) para 58.

⁶⁸⁸ Zilioli (n 15) 172.

⁶⁸⁹ Baraggia (n 2) 2.

⁶⁹⁰ C-62/14 *Gauweiler* (n 90) para 108; see also Ioannidis, 'Europe's New Transformations: How the EU Economic Constitution Changed during the Eurozone Crisis' (n 16) 1261.

⁶⁹¹ NN, 'Technical Features of Outright Monetary Transactions' (n 661).

⁶⁹² cf. Tuori (n 655) 675.

⁶⁹³ Fabbrini, *EU Fiscal Capacity* (n 208) 44.

Member State sovereign bonds on the secondary markets.⁶⁹⁴ Until December 2022, the ECB has purchased bonds in the total rounded value of €2.742.802.000.000⁶⁹⁵ under the PSPP, which amounts to over 20% of the Eurozone's GDP.⁶⁹⁶

The ECB's Governing Council launched the PSPP because the bank could no longer set lower interests to kickstart the economy: "This so-called lower zero bound constitutes a technical limit of the interest rate tool, because the interest rate on bank notes is by definition 0 percent. Moving short-term interest rates on central bank deposits even lower would incentivize financial institutions to reallocate their portfolio towards bank notes."⁶⁹⁷ While the pursuit of the pre-crisis inflation target by all means caused notable controversy within the ECB's decision-making organ, the ECB was indeed "able to bring down interest rates in financial markets without needing to lower its deposit rate further."⁶⁹⁸

The first major difference compared to its predecessors is that the PSPP is not targeted but quantitative: "Its objective is to target the low inflation, which is not a localized issue but affects the whole euro area. This is why the bond-buying is addressing the government bonds of all the euro area Member States."⁶⁹⁹ Despite relying on the same legal base as its predecessors,⁷⁰⁰ the PSPP does not primarily focus on restoring the monetary policy transmission mechanism, it rather aims at "facilitating credit provision, stimulating economic activities and contributing to keep inflation rates close to 2 per cent in the whole Euro area".⁷⁰¹ Just as the OMT program, the PSPP relies on explicit conditionality. In that, *Tuori* has argued that the ECB "took into account the failures of the SMP" in the design of the PSPP: "The discretionary and unclear nature of the SMP made it ineffective in signalling monetary policy commitment (...)."⁷⁰² The ECB decision's explicit reference to conditionality⁷⁰³ is meant to ensure that the purchases are compatible with the Treaty's monetary financing prohibition and also to reduce the financial risk of the operations.⁷⁰⁴ Bonds issued by Member States that are under a financial assistance program are eligible only if the MoU are successfully implemented.⁷⁰⁵ Based on this provision, the ECB excluded "Greek bonds and, until recently, also Cypriot debt" from the PSPP.⁷⁰⁶

⁶⁹⁴ Hinarejos (n 35) 593.

⁶⁹⁵ NN, 'History of Cumulative Purchase Breakdowns under the PSPP' (*ecb.europa.eu*, 1 April 2023) <<https://bit.ly/3R6BiND>> accessed 26 January 2023.

⁶⁹⁶ Dani and others (n 41) 310.

⁶⁹⁷ de Boer and Van't Klooster (n 26) 1706.

⁶⁹⁸ *ibid.*

⁶⁹⁹ Zilioli (n 15) 175.

⁷⁰⁰ cf. *Tuori* (n 655) 679.

⁷⁰¹ *Viterbo* (n 17) 527.

⁷⁰² *Tuori* (n 655) 679.

⁷⁰³ Decision 2015/774/EU of the European Central Bank of 4 March 2015 on a secondary markets public sector asset purchase programme [2015] OJ L 121/20 3(2d).

⁷⁰⁴ cf. *Viterbo* (n 17) 528.

⁷⁰⁵ cf. *Tuori* (n 655) 677.

⁷⁰⁶ Ioannidis, 'Europe's New Transformations: How the EU Economic Constitution Changed during the Eurozone Crisis' (n 16) 1267.

The PSPP is implemented in a decentralized manner, as 80% of the asset purchases are delegated to the national central banks according to their share in the ECB capital key.⁷⁰⁷ This design has several advantages: The flexibility granted to the national central banks ultimately leads to greater risk-sharing. Moreover, the structure has been selected as a "concession to the worries that the PSPP could turn into fiscal transfer mechanism between the Member States."⁷⁰⁸ The undifferentiated application of the quantitative easing program combined with the decentralized implementation mean that the PSPP is less effective as an enforcer of conditionality than the OMT. Considering that the purchases are still directly linked to the Troika conditionality, the application of the PSPP can be best described as medium.

Just as the OMT program, the PSPP was very controversially upheld as legal by the CJEU, as it was found to be a measure of monetary policy covered by the ECB's primary objective.⁷⁰⁹ The Luxembourg court has been accused of having "turned crisis law into the new normal"⁷¹⁰, causing a problem of democratic accountability: "The ECB is now free to do 'whatever it takes' no longer only in exceptional situations (...), but as long as it can demonstrate to judicial satisfaction that it has conducted a sound proportionality analysis."⁷¹¹ As a result, the Eurosystem has been found to have "replaced private investors as creditors of the Member States" through central bank money in the long term.⁷¹² According to the ECJ, those economic effects are not decisive as long as the primary objective remains price stability, since the Treaties lack a precise definition of monetary policy.⁷¹³

In the spring of 2020, the German Federal Constitutional Court took the unprecedented step of declaring this ECJ judgement "inapplicable in Germany" and the PSPP itself "illegal" by referring to the principles of conferral and democratic legitimation.⁷¹⁴ This ultra vires declaration and non-compliance with the judgement were highly criticized, as it was found to be "an illegal breach of the principle of the supremacy of EU law" and thus a threat to the EU legal order.⁷¹⁵ The ECB simply decided to disregard the German ruling, arguing that "state courts cannot bind federal authorities" and that the PSPP is "valid for EU purposes".⁷¹⁶ Ironically, it has been argued that "the German Constitutional Court judgment and the constitutional and institutional tensions it gave rise to, may have largely contributed to the German willingness towards the NGEU."⁷¹⁷

⁷⁰⁷ NN, 'Public Sector Purchase Programme (PSPP) - Q&A' (*ecb.europa.eu*, 24 June 2022) <<https://bit.ly/3DiNMfq>> accessed 26 January 2023 [para 3.1.1. and 3.1.2].

⁷⁰⁸ Tuori (n 655) 678.

⁷⁰⁹ cf. Case C-493/17 *Weiss* (n 629) paras 54 and 57.

⁷¹⁰ Dani and others (n 41) 317.

⁷¹¹ *ibid* 321.

⁷¹² Tuori (n 655) 686.

⁷¹³ Case C-493/17 *Weiss* (n 629) 50.

⁷¹⁴ Rosas (n 25) 1403.

⁷¹⁵ Fabbrini, *EU Fiscal Capacity* (n 208) 45; see also de Boer and Van't Klooster (n 26) 1710.

⁷¹⁶ Dani and others (n 41) 324.

⁷¹⁷ de Gregorio Merino (n 500) 4.

5.3. Conditionality in the Pandemic Emergency Purchasing Program

Just as the Eurozone economy started to cool down and recover from the sovereign debt crisis, the ECB had to counter the biggest recession (see chapter 4.2.) it had ever faced in its short existence. In the context of the Covid-19 pandemic the ECB "proved once again its centrality in EMU"⁷¹⁸ by providing "the most powerful response to the economic uncertainties"⁷¹⁹ in early 2020: The Pandemic Emergency Purchasing Program (PEPP). As usual, the Governing Council took its decisions "in an entirely supranational mode, without the formal participation of representatives of the Member States".⁷²⁰ This allowed for a much quicker response compared to the lengthy negotiations regarding the NGEU fund (see chapter 4.3.) that took almost an entire year to complete.

Learning from its mistakes in the Eurozone crisis, the ECB "after a brief hesitation, has acted quickly"⁷²¹ to avoid an increasing spread on the yields of government bonds, stabilize the financial markets and support the economic recovery. "The aim of the PEPP is primarily to restore monetary transmission channels. However, it also aims to mitigate the economic consequences of the pandemic. Demonstrating the ECB's readiness to support economic recovery. This is a transformation from its originally narrow mandate."⁷²² Just as in the Eurozone crisis, the ECB's competences were pushed to their outer limits by PEPP.⁷²³

The Central Bank set out to reassure the financial markets by "directly purchasing assets at (sic!) countries on the periphery of the Euro area, which are subject to high pressure by financial markets"⁷²⁴ The PEPP is a temporary QE program covering both public and private debt that was expanded twice to reach the overall volume of €1.850 billion.⁷²⁵ It is therefore a quantitative program, as the PEPP's principal aim is to mitigate the economic crisis by facilitating additional borrowings across the Eurozone, being therefore "less intertwined with specific government budgets" than OMT.⁷²⁶

As its name already suggests, the PEPP is very similar to its predecessor the PSPP. The main difference is that unlike PSPP, the PEPP has not been established to fight deflation. Moreover, the ECB is authorized to buy public bonds "without having to adhere to the member states' capital key allocation, so as to maximize its impact in supporting those Euro Area Member States most affected by the pandemic and its consequences".⁷²⁷

⁷¹⁸ Fabbrini, *EU Fiscal Capacity* (n 208) 44.

⁷¹⁹ *ibid* 43.

⁷²⁰ De Witte (n 530) 667.

⁷²¹ Ladi and Tsarouhas (n 420) 1046.

⁷²² Mooij (n 613) 8.

⁷²³ Lindseth and Fasone (n 418) 530; see also de Boer and Van't Klooster (n 26) 1707.

⁷²⁴ Ladi and Tsarouhas (n 420) 1047.

⁷²⁵ NN, 'Pandemic Emergency Purchase Programme' ([ecb.europa.eu](https://www.ecb.europa.eu)) <<https://bit.ly/3ONVqTq>> accessed 30 November 2022; Fabbrini, *EU Fiscal Capacity* (n 208) 44.

⁷²⁶ Mooij (n 613) 9; see also De Witte (n 530) 638–639.

⁷²⁷ Fabbrini, 'The Legal Architecture of the Economic Responses to COVID-19: EMU beyond the Pandemic' (n 461) 190.

This characteristic is legally very relevant and is much more than a technicality as the purchases under the PEPP "seem in favor of debtor nations"⁷²⁸ In its typology, the PEPP thus combines elements of the OMT and the PSPP "in ways that are difficult to disentangle".⁷²⁹

As the PEPP was conceived as a crisis response measure designed to stimulate the economy suffering from an unprecedented recession, the application of conditionality is very soft compared to its predecessors: "[W]hile the availability of OMT emergency lending is subject to an ESM programme, the PEPP is to be used entirely at the discretion of the ECB's Executive Board."⁷³⁰ Unlike previous purchasing programs, the ECB has granted national central banks the authorization to buy Greek sovereign bonds at negative rates: "The inclusion of the Hellenic bonds demonstrates the growing reach of the ECB's programme. (...) The ECB most likely decided to include these bonds because COVID19 is the cause of the economic fallout, rather than deficits in government budgets."⁷³¹

The great flexibility of the PEPP is also due to the lack of a ceiling to the purchase of public debt per issuer.⁷³² Crucially, the program also comes without any explicit reference to policy conditionality in its legal act.⁷³³ This structure based on implicit conditionality thus seems to be a step backwards in terms of transparency and predictability that can in some respect be compared to the SMP.

This is perhaps caused to the fact that PEPP was conceived as a time-limited measure meant to be phased out as soon the pandemic subsided.⁷³⁴ Despite this, the PEPP "likely violates Article 123 of the Treaty on the Functioning of the European Union (TFEU), as inferred from the PSPP ruling"⁷³⁵. As the ECB has "acquired close to 70% of the of the public debt issued by Member States"⁷³⁶ without notable restraints since the launch of the program, it could be seen as direct monetary financing. Due to this "particularly precarious legal terrain"⁷³⁷ the outcome of the legal challenges of PEPP that have been announced by the German far-right Alternative für Deutschland and the Eurosceptic lawyer Peter Gauweiler⁷³⁸ is far from certain. To sum up, the PEPP is a quantitative easing program that does not target individual Eurozone members. The Governing Council enjoys an almost unprecedented level of flexibility due to the implicit nature of conditionality, the lack of purchase ceilings and the suspended bond rating eligibility criteria. Therefore, conditionality is applied in a very soft manner in the PEPP.

⁷²⁸ Mooij (n 613) 9.

⁷²⁹ de Boer and Van't Klooster (n 26) 1707.

⁷³⁰ Ladi and Tsarouhas (n 420) 1047.

⁷³¹ Mooij (n 613) 8.

⁷³² Dani and others (n 41) 314.

⁷³³ Decision 2020/188/EU of the European Central Bank of 3 February 2020 on a secondary markets public sector asset purchase programme (recast) [2020] OJ L 39/12; cf. Dani and Menéndez (n 455) 532.

⁷³⁴ cf. Dani and Menéndez (n 455) 532; and Ladi and Tsarouhas (n 420) 1047.

⁷³⁵ Dani and others (n 41) 314.

⁷³⁶ *ibid.*

⁷³⁷ Dani and Menéndez (n 455) 532.

⁷³⁸ de Boer and Van't Klooster (n 26) 1708.

5.4. Conditionality in the Transmission Protection Instrument (TPI)

Since the summer of 2021, inflation has been sharply increasing in the Eurozone. To respond to the continuously rising prices, the European Central Bank began to signal a normalization of its monetary policy at the end of 2021.⁷³⁹ Especially since the start of the Russian invasion of Ukraine in early 2022 and the consequent use of energy blackmail as a political weapon, the cost of living saw a significant increase in the entire EU. To curb inflation, the European Central Bank decided to ramp up the key interest rates⁷⁴⁰ and to gradually discontinue the asset purchases that were conducted as part of the PSPP and the PEPP.⁷⁴¹

These policies combined with the economic downturn led to an increase in the yields of sovereign bonds across the Eurozone.⁷⁴² Highly indebted Eurozone members such as Italy, Greece, Portugal and Spain soon began facing higher borrowing costs compared to Germany, leading to an increased spread of yields and a fragmentation of the Eurozone bond market.⁷⁴³ Despite not being nearly as dramatic as in the Eurozone crisis, the ECB decided to "root-out the possibility that its forthcoming rate hikes prompt sudden and unwarranted spread for some member states"⁷⁴⁴.

For this reason, the European Central Bank launched the Transmission Protection Instrument: "Through the TPI, primarily public sector purchases can be conducted for countries with high yields."⁷⁴⁵ As usual, those purchases would be undertaken on the secondary bond market⁷⁴⁶ to be compatible with Art. 123(1) TFEU. The declared goal of the TPI is to ensure an even monetary transmission across the common currency area.⁷⁴⁷ The European Central Bank sets out to reach this objective by means of selective public and private bond purchases from countries whose interest rate increases are not considered to be justified by macroeconomic fundamentals.⁷⁴⁸ Those unlimited purchases are meant to reduce the risk that "panicky market sell-offs put a wedge into domestic financing costs in different member states", which could for example lead to a scenario that sees "inflationary outcomes in Germany and deflationary ones in Italy".⁷⁴⁹

⁷³⁹ Bernoth and others (n 615) 250.

⁷⁴⁰ NN, 'Monetary Policy Decisions' (*ecb.europa.eu*, 27 October 2022) <<https://bit.ly/3WHLLQI>> accessed 27 January 2023.

⁷⁴¹ NN, 'History of Cumulative Purchase Breakdowns under the PSPP' (n 697); NN, 'History of Monthly Net Purchases under the PEPP' (*ecb.europa.eu*, 11 August 2022) <<https://bit.ly/3HggBnj>> accessed 26 January 2023.

⁷⁴² 'ECB Financial Stability Review, November 2022' (*ecb.europa.eu*, November 2022) 9 <<https://bit.ly/3Hkd79U>>.

⁷⁴³ cf. Bernoth and others (n 615) 250.

⁷⁴⁴ Nils Redeker, 'Wielding the Big Gun—What the ECB's New Bond Purchasing Program Means for EU Governance' [2022] Hertie School - Jacques Delors Centre 2.

⁷⁴⁵ Mooij (n 613) 9.

⁷⁴⁶ cf. Hinarejos (n 614).

⁷⁴⁷ cf. Anna Peychev, 'Disorder and Discipline: The ECB's Transmission Protection Instrument' [2022] 2022 European Papers-A Journal on Law and Integration 739, 745.

⁷⁴⁸ cf. Bernoth and others (n 615) 250–251; and Mooij (n 613) 9.

⁷⁴⁹ Redeker (n 746) 1.

The objective of the ECB's most recent instrument is therefore very similar to the OMT program (see chapter 5.2.2.): "Both programs aim to safeguard the singleness of monetary policy by counteracting distortions in the monetary policy transmission resulting from rising yield spreads of government bonds of certain Member States."⁷⁵⁰ Despite this overlap, the ECB's Governing Council has assured that OMT remains operational.⁷⁵¹ This has led to notable confusion among scholars as well as market participants.⁷⁵² The interplay between the two instruments has been discussed by *Peychev* who hypothesized that "the OMT remains in place as a last line of defence, even if all other ECB programmes in place are designed to make it useless."⁷⁵³ Much like the Outright Monetary Transaction program, the TPI does not (yet?) rely on a binding legal act, but only on a Press Release by the Governing Council. Despite its announcement in July 2022, it has still not been activated, meaning that no second market purchase has been made. This has led to speculations that much like in the case of OMT, its proclamation might be sufficient: "The Bank seems fairly confident that the mere announcement of its intentions will be enough to bully markets (...)."⁷⁵⁴

A further similarity (see table below for a side-by-side comparison) is that both monetary instruments contain an explicit reference to conditionality.⁷⁵⁵ Unlike the OMT, which is tied to compliance with the ESM, the TPI is linked to the EU law mechanisms of fiscal and economic governance.⁷⁵⁶ There are four non-binding criteria which "serve as input into the ECB's Governing Council's decision-making"⁷⁵⁷ concerning bond eligibility: Compliance with the EU fiscal framework, absence of severe macroeconomic imbalances, fiscal sustainability as well as sound and sustainable macroeconomic policies.⁷⁵⁸

	OMT (2012)	TPI (2022)
Selectivity	Secondary market purchases of government bonds of selected member states	Secondary market purchases of securities issued in jurisdictions experiencing a deterioration in financing conditions not warranted by country-specific fundamentals
Eligibility/Conditionality	Strict and effective conditionality attached to an appropriate European Financial Stability Facility/European Stability Mechanism (EFSF/ESM) program	Four criteria that function as "inputs" for an assessment: Compliance with the EU fiscal framework, no macroeconomic imbalances, fiscal sustainability, and sound and sustainable macroeconomic policies
Limits on purchases	No ex ante quantitative limits are set on the size of the purchases	No ex ante quantitative limits are set on the size of the purchases; volume depends on severity of risks facing monetary policy transmission

Table 4: Side-by-side comparison of OMT and TPI

⁷⁵⁰ Bernoth and others (n 615) 253.

⁷⁵¹ cf. NN, 'The Transmission Protection Instrument (Press Release)' (*ecb.europa.eu*, 21 July 2022) <<https://bit.ly/3H1Km3e>> accessed 1 December 2022.

⁷⁵² Bernoth and others (n 615) 256.

⁷⁵³ *Peychev* (n 749) 747.

⁷⁵⁴ *ibid*; see also Bernoth and others (n 615) 251.

⁷⁵⁵ cf. Mooij (n 613) 9.

⁷⁵⁶ Hinarejos (n 614).

⁷⁵⁷ Redeker (n 746) 3; see also *Peychev* (n 749) 745.

⁷⁵⁸ NN, 'The Transmission Protection Instrument' (n 753).

Those criteria encompass practically all aspects of EU economic governance and have therefore been criticized for being too vague and flexible: "The TPI's eligibility criteria are much less demanding than the criteria of OMT and serve only as a decision-making aid for the Governing Council. Thus, the ECB has complete discretion in weighing and evaluating these criteria."⁷⁵⁹ According to *Peychev*, the TPI eligibility criteria contained in the press release "seem far removed from the toxic demands of the days of ESM austerity and are instead found with (sic!) the edifice of European economic governance constructed after the crisis – the European Semester".⁷⁶⁰ Just as the ES, the application of conditionality in the TPI can therefore best be classified as medium.

The TPI eligibility criteria as described by the press release are meant to "reflect member states' broader willingness to cooperate within the EU processes", which is admittedly a "very broad criterion and a very political one."⁷⁶¹ This puts the European Central Bank in an uneasy position, where it could become the ultimate monitor of compliance with EMU rules, a situation that "may expose the ECB to political pressure and threaten its independence."⁷⁶²

Considering the rather limited effectiveness of EU fiscal and economic coordination, a withdrawal of (potential) TPI purchases seems far-fetched. For instance, the MIP referenced by the press release has "so far gained little traction in the EU's economic governance framework" and has up to now never been activated due to the high political thresholds.⁷⁶³ The Excessive Deficit Procedure⁷⁶⁴ on the other hand has been more effective in practice, but to be excluded from access to the TPI, a "failure to take action" would also have to be declared under the SGP,⁷⁶⁵ a process that also comes with high political thresholds (see chapter 3.1.). Finally, the TPI's last criterion regarding "sound and sustainable macroeconomic policies" is perhaps the most relevant innovation: "According to the communication, this means adhering to the commitments set out in the [RRF's] NRRPs and following the Commission's fiscal CSRs. This adds to the existing trend of equipping the European Semester with some real incentives, but also raises questions concerning the definition of compliance in this area."⁷⁶⁶

There are indeed many open questions regarding the TPI: Could the instrument's softer application of conditionality be used as "a way for Member States to circumvent the much harder OMT conditionality"?⁷⁶⁷ Would the TPI also be implemented in a decentralized way, with the national central banks having to carry losses according to the capital key?⁷⁶⁸

⁷⁵⁹ Bernoth and others (n 615) 253; see also Redeker (n 746) 8.

⁷⁶⁰ *Peychev* (n 749) 745.

⁷⁶¹ Redeker (n 746) 8.

⁷⁶² Bernoth and others (n 615) 255.

⁷⁶³ Redeker (n 746) 4.

⁷⁶⁴ cf. Protocol No. 12 (n 116).

⁷⁶⁵ TFEU (n 36) art 126(11).

⁷⁶⁶ Redeker (n 746) 6.

⁷⁶⁷ Bernoth and others (n 615) 256.

⁷⁶⁸ *ibid* 255.

As Redeker has highlighted, "important questions remain on what counts as compliance" as both the RRF and the ES lack "formal procedures that could establish broad non-compliance".⁷⁶⁹ The TPI press release also remains (deliberately?) vague regarding the final implementation: "The ECB should explain and substantiate its method, benchmark, criteria, and assessment process, as such an assessment is decisive for ensuring that the ECB is not overstressing its mandate."⁷⁷⁰

As with all other instruments of unconventional monetary policy, the TPI "will provide yet another instalment in the (at times heated) conversation between the national court and the Court of Justice of the EU."⁷⁷¹ Even though the TPI has not yet been activated, Markus Kerber, a Eurosceptic German attorney, has announced in July 2022 his plans to file a constitutional complaint against the ECB's newest monetary instrument.⁷⁷² There are also several scholars who doubt the legality of the TPI: "While it has its supporters, critics doubt that further asset purchases are the right way forward from an economic perspective with inflation on the rise and the TPI being questioned on legal grounds."⁷⁷³

According to a narrow interpretation of the ECB mandate, the TPI "can be interpreted as another form of self-empowerment" by the Central Bank.⁷⁷⁴ Yet, there are several safeguards embedded: The ECB can only activate the TPI if it is "strictly necessary to support the effective transmission of monetary policy", also it can only address "unwarranted and disorderly spreads" that are not caused by a changing economic outlook or political insecurity.⁷⁷⁵ However, it must be considered that the current economic context is radically different compared to the previous decade: "This puts a heightened burden of justification on the ECB to explain how further asset purchases – an expansionary monetary policy as such – fit within the overall monetary policy stance of fighting inflation."⁷⁷⁶ According to Mooij, it is therefore "difficult to see what the exact aim is of this programme" as "countries without excessive deficits should not be faced with high interest rates levels" in the first place.⁷⁷⁷

Out of all previously described instruments, the TPI will likely have the most profound impact on the EMU framework: "By linking bond purchases to member states following the EU's economic governance framework, the central bank has potentially increased the size of the gun the Commission and the Council can wield to incentivize compliance."⁷⁷⁸

⁷⁶⁹ Redeker (n 746) 7.

⁷⁷⁰ Bernoth and others (n 615) 255.

⁷⁷¹ Hinarejos (n 614).

⁷⁷² cf. Frank Siebelt, 'ECB Nemesis Kerber Weighs Action against New Debt Shield' (*reuters.com*, 29 July 2022) <<https://reut.rs/3EOWHyQ>> accessed 11 October 2022.

⁷⁷³ Bernoth and others (n 615) 251.

⁷⁷⁴ Mooij (n 613) 10.

⁷⁷⁵ Nils Redeker, 'Wielding the Big Gun—What the ECB's New Bond Purchasing Program Means for EU Governance' [2022] Hertie School - Jacques Delors Centre 2.

⁷⁷⁶ Bernoth and others (n 615) 255.

⁷⁷⁷ Mooij (n 613) 10.

⁷⁷⁸ Redeker (n 746) 1.

This will have relevant effects on the implementation of conditionality within the Recovery and Resilience Facility (see chapter 4.4.), as the TPI "raises the stakes for member states to follow their agreed reform and investment plans [NRRPs]" as non-compliance with the objectives could now also exclude Member States from bond purchases.⁷⁷⁹ By introducing an "incentive that has no clear expiration date", the TPI also means that "the European Semester cannot be turned back to a technocratic paper pusher anymore".⁷⁸⁰ *Redeker* therefore predicts a higher degree of compliance with the country-specific recommendations (CSR) than in the previous decade: "[T]he Commission until now had neither a real stick nor a carrot to encourage member states to heed its advice. The fact that compliance is now relevant for TPI access could change that. The TPI decision could thus intensify a trend toward stronger economic coordination that already started with the [NGEU] recovery instrument."⁷⁸¹

However, the author has also warned that TPI is "likely to heighten existing deficiencies in EU economic governance."⁷⁸² This is because the "bigger gun" introduced by TPI paradoxically makes it "much harder to pull the trigger": "If the Commission and the Council declare member states to have broken the rules, they could now effectively bar them from a critical instrument. This raises the stakes for doing so significantly."⁷⁸³ In a worst-case scenario, this could "further undermine the credibility of the framework and leave the ECB without meaningful political parameters on when to intervene."⁷⁸⁴

The political implications of TPI could also be significant as "it is unlikely that the ECB would declare a breach of this criterion without a clear political signal from the Council and the Commission",⁷⁸⁵ leading to a further politicization of EMU governance. TPI could also lead to some spill-over effects and trigger further supranational integration: "One question was always what carrots the EU can put on the table in exchange for reform implementation in the likely case that it has less money to offer after NextGenEU. At least for highly indebted member states, TPI access will be part of the answer."⁷⁸⁶

To sum up, the Transmission Protection Instrument is the newest kit in the ECB's toolbox. This selective bond-purchasing program contains an explicit reference to conditionality which creates for the first time ever a direct link between the fiscal and monetary instruments that were discussed in this thesis, such as the SGP, the RRF and the European Semester. Its application of conditionality can be best categorized as medium, but many questions remain open concerning its precise implementation and ultimate legality.

⁷⁷⁹ *ibid* 6.

⁷⁸⁰ *ibid* 8.

⁷⁸¹ *ibid* 7.

⁷⁸² *ibid* 2.

⁷⁸³ *ibid* 1.

⁷⁸⁴ *ibid* 2.

⁷⁸⁵ *ibid* 8.

⁷⁸⁶ *ibid* 9.

6. Outlook

The Economic and Monetary Union is a work in progress. Due to the constant evolution of this policy field it makes sense to dedicate a few final considerations to possible future developments and implications: "While in the short-term conditionality may prove an effective governance tool to promote compliance and advance broader EU interests at the national level, in the long-term it is worth reflecting upon the cost of a generalised conditionality culture inside the EU and its potential impact on a reformed Europe of tomorrow."⁷⁸⁷

Conditionality certainly has led to a shift in the institutional power balance of the EU. This is especially true for the subsequent reforms of the Stability and Growth Pact (see chapter 3.3.) leading to the introduction of the European Semester: "That reform has reinforced the role of the Commission in the economic governance of the EU in the hope that, unlike the Council (which has been perceived as responding too much to political, rather than legal or economic, criteria), would exercise the task of economic surveillance in a technical, non-political manner. However, the opposite became true: as the task remained political, the Commission as a technical institution was politicised."⁷⁸⁸

The Recovery and Resilience Facility has further increased the powers of the EC, giving it "the authority and means to steer the EU economy".⁷⁸⁹ Scholars have warned that this shift in the power balance could undermine "the nonbinding nature of EU recommendations on economic policies"⁷⁹⁰ (see chapter 3.2.), a trend that could be further magnified by the ECB's Transmission Protection Instrument. As outlined in chapter 5.2., the European Central Bank is also constantly being accused of overstepping its monetary policy mandate.

The increasing reliance on conditionality in both fiscal and monetary instruments could ultimately entail that "the initial normative standard of pure solidarity between the EU and Member States is now effectively changing towards a de facto conditional solidarity"⁷⁹¹, thus made dependent on continuous compliance with EU law. According to *Vita*, the observed spread of EU conditionality "points towards deeper transformations within the EU, with potential strong implications for the relationship between the EU, its Member States and the EU citizens".⁷⁹² *Leino-Sandberg and Saarenheimo* also believe that the widespread use of conditionality could have "consequences on the democratic nature and political content of economic policy decision-making in the euro area."⁷⁹³

⁷⁸⁷ *Vita*, 'Revisiting the Dominant Discourse on Conditionality in the EU: The Case of EU Spending Conditionality' (n 3) 120.

⁷⁸⁸ *Westerhof Löfflerová* (n 408) 15.

⁷⁸⁹ *Fabbrini*, 'Next Generation EU: Legal Structure and Constitutional Consequences' (n 548) 14.

⁷⁹⁰ *Leino-Sandberg and Saarenheimo* (n 9) 15.

⁷⁹¹ *Vita*, 'Revisiting the Dominant Discourse on Conditionality in the EU: The Case of EU Spending Conditionality' (n 3) 137.

⁷⁹² *ibid* 118.

⁷⁹³ *Leino-Sandberg and Saarenheimo* (n 9) 15.

Open questions also remain concerning the Next Generation EU fund, notably the issue whether this temporary crisis response measure represents a genuine fiscal capacity or even a "Hamiltonian moment", in the sense that it could lead to a further federalization in the field of taxation. *Porras Ramirez* supports the claim that NGEU represents a "genuine fiscal capacity" due to the unprecedented common issuance of debt,⁷⁹⁴ *Fabbrini* went even further by arguing that the EU is approaching a "fiscal union"⁷⁹⁵ with NGEU.

Other scholars have been more reserved: *Lindseth and Fasone* believe that "in terms of the EU's metabolic constitution, Next Generation EU still did not cross the crucial Rubicon, that of a proposed Europeanization of taxation authority to accompany the increased borrowing under the MFF" and that therefore the Member States have financed NGEU "through their own fiscal capacities, whether directly or indirectly."⁷⁹⁶ Once again, it is important to highlight that the EU Recovery Instrument has been conceived as a temporary measure: "Eventually, no doubt, any EU borrowing beyond the short-term and limited scale of Next Generation EU will need to be accompanied by autonomous taxing authority, which in turn would require treaty change",⁷⁹⁷ a process bound to be accompanied by considerable political conflict.

Under the existing treaty framework, any further issuance of common debt requires unanimous consent, which is a high hurdle: "Whether it can be overcome is likely to depend, among other things, on the perceived success of NGEU spending. In particular, the net contributors to NGEU will be reluctant to repeat a joint debt financing operation if it turns out that the NGEU has not contributed to making net recipients more resilient and less dependent on external support."⁷⁹⁸ As long as the EU does not have the power to levy taxes, its ability to use debt to finance its spending is therefore bound to remain "severely limited"⁷⁹⁹ without a profound overhaul of the Treaties in the field of taxation.⁸⁰⁰

As already described (see chapters 2. and 5.2.), the EMU provisions are characterized by an embedded asymmetry and were designed to "prevent a crisis, but not to manage one".⁸⁰¹ Therefore, a dynamic and purposive reinterpretation by the CJEU had become necessary in both fiscal and monetary policy, stretching their scope to the outmost. This has provoked several unconventional and controversial measures by the European Central Bank: "until the EU or Member States conduct a more coordinated economic policy, these new ECB tools are permanent."⁸⁰²

⁷⁹⁴ *Porras Ramirez* (n 456) 851.

⁷⁹⁵ *Fabbrini*, 'Next Generation EU: Legal Structure and Constitutional Consequences' (n 548) 14.

⁷⁹⁶ *Lindseth and Fasone* (n 418) 530.

⁷⁹⁷ *ibid* 531.

⁷⁹⁸ *Dorn and Fuest* (n 498) 80 (translated from German by the author).

⁷⁹⁹ *ibid* (translated from German by the author).

⁸⁰⁰ cf. *Porras Ramirez* (n 456) 851; *Fabbrini*, *EU Fiscal Capacity* (n 208) 142.

⁸⁰¹ *Hinarejos* (n 35) 597.

⁸⁰² *Mooij* (n 613) 2.

This development, combined with a strong reliance on intergovernmental procedures that were sometimes even adopted outside the scope of EU law altogether have "brought the legitimacy and effectiveness of the collective European response into question".⁸⁰³ This trend is especially worrying as the integration has not been accompanied by a proportionate increase of the EP prerogatives. While Fromage and Markakis have observed a "slow empowerment of the EP"⁸⁰⁴ in the field of EMU, its powers were only strengthened to a "limited extent".⁸⁰⁵ In order to "compensate for the loss of national and especially parliamentary sovereignty"⁸⁰⁶ that conditionality by definition entails, an increased involvement of the European Parliament is necessary.

The EP is still far too often relegated to an advisory role or even entirely bypassed in the legislative adoption. According to *Fabbrini*, "the EU must reform its governance system as way to legitimate the consolidation of a centralized fiscal capacity"⁸⁰⁷ by enhancing the role of the EP through passerelle clauses or a full Treaty amendment. This could contribute to making the enforcement of conditionality more transparent thus ultimately more democratic.⁸⁰⁸ Calls have already emerged in the context of the war in Ukraine to convert NGEU into a permanent fiscal capacity capable of absorbing economic shocks.⁸⁰⁹ It remains to be seen, whether the political circumstances allow for this consequential step, and whether the Treaties are amended accordingly. Giving the EU more powers in the field of taxation, combined with a stronger voice of the EP could ultimately herald a new era of conditionality: The final Consolidation Phase, as has been observed in the USA. At this point, it is impossible to predict if and at which pace the EU would ever reach this phase, however the preceding research seems to suggest that further integration in the field of EMU remains very likely.

⁸⁰³ Lindseth and Fasone (n 418) 513.

⁸⁰⁴ Fromage and Markakis (n 33) 13.

⁸⁰⁵ *ibid* 4–5.

⁸⁰⁶ *cf. ibid* 14.

⁸⁰⁷ *Fabbrini, EU Fiscal Capacity* (n 208) 141.

⁸⁰⁸ *cf. Vita, 'The Rise of Spending Conditionality in the EU: What Can EU Learn from the US Conditional Spending Doctrine and Policies?'* (n 33) 35.

⁸⁰⁹ *Fabbrini, EU Fiscal Capacity* (n 208) 3.

7. Conclusion

Conditionality can be a useful tool to promote reforms and economic growth in Member States with a weak institutional capacity. However, conditionality has its adversaries as it can ultimately lead to an erosion of national sovereignty without an adequate compensation in accountability on the European level. Whether good or bad, it is undeniable that conditionality has been extended to cover the entire EMU legal framework since the introduction of the common currency.

Nowadays, conditionality is not only a much more common phenomenon in fiscal and monetary EU policy than in the early days, but it has also been used in great plurality. Almost all parameter values of the four predefined characteristics (typology, implementation, enforcement and application) have been observed throughout the research. The high influence of conditionality on EMU law can thus be observed both quantitatively and qualitatively relating to its functional use. It seems as if EU action in this policy field has been characterized by a trial-and-error approach: Keep and enforce what works, pigeonhole what was impractical.

Despite this expansion of conditionality, fiscal and economic policy has remained firmly in the hands of national administrations. However, their power is being incrementally restricted by increasing regulatory constraints imposed at the supranational level. As compliance with European law is ultimately voluntary, the EU cannot efficiently use coercion against its own Member States. The flagrant failure of conditionality in the Development Phase (1997-2009) has shown that negative conditionality based on sanctions is not an effective enforcement mechanism in the EU context.

This is because the damage caused by a strict application might be greater for the standing of the European Union than the impact on the respective Member State. As the Stability and Growth Pact has shown, the deterrent effect of negative conditionality also seems modest. Therefore, it can be concluded that sanctions are an inherently inadequate instrument for the context of the Economic and Monetary Union. This is because a strict enforcement of (particularly negative) conditionality puts the cooperative relationship between the EU and its Member States at risk. The effectiveness of the fiscal instruments seems equally high for ex ante and ex post typology, with a slight advantage for instruments combining both.

The European Union thus has the most impact on national budgets when it uses "carrots" rather than "sticks". Ultimately, the EU framework is geared towards preventing breaches from occurring in the first place through communication and cooperation. However, the research also shows that purely cooperative forums risk being dismissed as a talking shop. Therefore, the EU seems to obtain the best results when it combines rule-based and cooperation-based enforcement into a hybrid accountability framework. This seems to be a major learning after the Experimentation Phase (2009-2019): After several controversial measures, the European Union seems to have now reached a level playing field between creditor and debtor nations.

This is best exemplified by the Next Generation EU fund, an instrument that has heralded the new and ongoing era of conditionality: The Expansion Phase (2020 until present). This instrument shows that ambitious action within the EU framework is not only legally possible but also politically feasible if the circumstances are contributive. The Recovery and Resilience Facility relies on the most elaborate and balanced conditionality mechanism that the EU has ever implemented. Its novel combination of proactive and retroactive incentive-based conditionality not only helped to successfully overcome the pandemic's economic fallout. The instrument has also restored the faith in the EU's potential for solidarity rather than frugal austerity. It is also bound to affect other EMU instruments due to its direct linkage to the European Semester. This goes to show how in EMU law, there is substantial overlap between the respective instruments: All conditionality-based fiscal tools are interlocked.

The bond-purchasing programs that have been introduced by the European Central Bank also have a big impact on the implementation of conditionality in EMU law. It seems as if the Governing Council often resorts to temporary instruments with a soft application and a merely implicit reference to conditionality in the immediate aftermath of an economic shock. Those programs are then phased out and replaced by stricter programs with an explicit reference to conditionality. While this leads to greater transparency and accountability, important questions remain surrounding the compatibility with the monetary financing prohibition contained in the Treaties. Conditionality is also used as a tool to guarantee the instruments' legality in front of the CJEU.

The research has shown that selective bond purchasing programs such as SMP, OMT and TPI have a far greater impact on national fiscal policy than the quantitative easing tools. Those selective programs have the potential to act as the ultimate enforcer of policy conditionality which has been previously agreed on in political negotiations. While initially, the programs were not linked to the EMU governance mechanisms but rather to intergovernmental agreements adopted in the context of the Troika, the Transmission Protection Instrument seems to have brought a paradigm shift: The fiscal and monetary instruments now seem closer than ever.

Yet, many questions regarding the legality and legitimacy of this development persist. The structure and identity of EMU law seems to be once again at stake. It has already been substantially altered by the substitution of the market-based Maastricht paradigm with a post-crisis institutionalized enforcement. Once again, this development has can have both positive and negative implications. In the end, the debate regarding the use of conditionality in EMU law illustrates the constant tension between solidarity and responsibility that has characterized the European Union since its very foundation. If well implemented, conditionality has the potential to act as a mediator between those two poles: Ideally, it could ease the transition into a more integrated and resilient economic union.

Research outcome: Taxonomy table of conditionality in EMU

Fiscal Instruments	Typology	Implementation	Enforcement	Application	Notes
<i>Stability and Growth Pact</i>	ex post negative	5 QMV votes in the Council upon Commission proposal	rule-based	soft, then medium	Coercive measures only for EZ-countries (Art. 139(2b)). 3 secondary law reforms
<i>Soft Law measures</i>	ex ante positive	Encouragement by the Commission and peer pressure in the Council	cooperation-based	soft	informal standard-setting, legal effects only through back door, political benefits
<i>European Semester</i>	sticks-and-carrots	EC reviews policies, drafts CSR and proposes sanctions. Conclusions adopted by Council, endorsed by EUCO	hybrid	medium	minor EP involvement within the Economic dialogue. NGEU funds as new incentive to comply. sanctions as last resort
<i>Fiscal Compact</i>	ex post negative	ratified by all EU Member States through "binding and permanent" provisions. Ratification can be challenged at CJEU.	rule-based	soft	penalty payments only with respect to Art. 3(2) TSCG, judicial enforcement (Art. 273 TFEU) similar to infringement procedure
<i>European Stability Mechanism</i>	ex post positive	Loans are granted in exchange for implementation of MAP. MoU is negotiated by the Commission and approved by ESM	rule-based	strict	mobilizes resources on capital market and grants financial assistance against strict conditionality. legality confirmed in Pringle
<i>Recovery and Resilience Facility</i>	sticks-and-carrots	common resources are raised on the financial markets and disbursed through the EU framework. Member States submit NRRPs, approved by QMV in Council.	hybrid	medium	Based on Art. 175(3) TFEU, classified as "assigned revenue". Payments can be suspended in case of EDP or deviation from objectives (emergency brake)
Monetary Instruments	Typology	Implementation	Enforcement	Application	Notes
<i>Securities Markets Program</i>	selective	informal, self-styled conditions in form of reform requests by ECB	implicit	soft	based on ECB Decision 2010/281/EU. market mechanism as relevant contributor
<i>Outright Monetary Transactions</i>	selective	conditional upon respect of MAP within the EFSF/ESM program	explicit	strict	only announced, never implemented. Legality confirmed in <i>Gauweiler</i>
<i>Public Sector Purchasing Program</i>	quantitative	only for countries with a minimum credit quality rating level 3 or participation in EU financial assistance program	explicit	medium	Decision 2015/774: all euro-denominated public debt securities are eligible for purchases on secondary market
<i>Pandemic Emergency Purchasing Program</i>	quantitative	both private and public sector securities, same eligibility as in previous programs	implicit	soft	waiver has been granted for securities issued by Greek government
<i>Transmission Protection Instrument</i>	selective	compliance with EU fiscal rules; absence of MIP or EDP, compliance with macroeconomic commitments under RRF and fulfillment of CSR by Commission in the European Semester	explicit	medium	effort to use the EU's mechanisms of fiscal and economic governance as assessed by the Commission and the Council. move away from link to ESM conditionality

Development phase (1997-2009)

Fiscal Instruments	Typology	Enforcement	Application
<i>Stability and Growth Pact</i>	ex post negative	rule-based	soft
<i>Soft Law measures</i>	ex ante positive	cooperation-based	soft

Experimentation phase (2010-2019)

Fiscal Instruments	Typology	Enforcement	Application
<i>Stability and Growth Pact</i>	ex-post negative	rule-based	medium
<i>Soft Law measures</i>	ex-ante positive	cooperation-based	soft
<i>European Semester</i>	sticks-and-carrots	hybrid	medium
<i>Fiscal Compact</i>	ex-post negative	rule-based	soft
<i>European Stability Mechanism</i>	ex-post positive	rule-based	strict
Monetary Instruments	Typology	Enforcement	Application
<i>Securities Markets Program</i>	selective	implicit	soft
<i>Outright Monetary Transactions</i>	selective	explicit	strict
<i>Public Sector Purchasing Program</i>	quantitative	explicit	medium

Expansion phase (2020-2023)

Fiscal Instruments	Typology	Enforcement	Application
<i>Stability and Growth Pact</i>	ex-post negative	rule-based	medium
<i>Soft Law measures</i>	ex-ante positive	cooperation-based	soft
<i>European Semester</i>	sticks-and-carrots	hybrid	medium
<i>Fiscal Compact</i>	ex-post negative	rule-based	soft
<i>European Stability Mechanism</i>	ex-post positive	rule-based	strict
<i>Recovery and Resilience Facility</i>	sticks-and-carrots	hybrid	medium
Monetary Instruments	Typology	Enforcement	Application
<i>Securities Markets Program</i>	selective	implicit	soft
<i>Outright Monetary Transactions</i>	selective	explicit	strict
<i>Public Sector Purchasing Program</i>	quantitative	explicit	medium
<i>Pandemic Emergency Purchasing Program</i>	quantitative	explicit	soft
<i>Transmission Protection Instrument</i>	selective	explicit	medium

Glossary of acronyms

ASGS: Annual Sustainable Growth Strategy

Yearly publication by the European Commission, containing general guidelines to boost growth and employment. This document "identifies the key reform priorities for the EU and offers general policy guidance to the member states for the coming year".⁸¹⁰ The publication of the ASGS marks the start of the European Semester.

BICC: Budgetary Instrument for Convergence and Competitiveness

Early proposal for a Eurozone fiscal capacity contained in the so-called Five Presidents' Report and the Eurogroup. The instrument would consist of grants and be part of the Multiannual Financial Framework. Despite an agreement on a basic compromise, an adoption now seems unlikely since the adoption of NGEU.⁸¹¹

CJEU: Court of Justice of the European Union

Institution of the European Union based in Luxembourg (LU). Consists of the European Court of Justice, the General Court and specialized courts. Observes the correct implementation and application of the EU treaties through preliminary rulings and binding judgements.⁸¹²

CSR: Country-Specific Recommendation

Recommendations published by the European Commission as part of the European Semester at the end of the Spring package. Those proposals are then endorsed by the European Council and adopted by the Council of the EU in July.⁸¹³ The CSR are a functional equivalent of the EAR, but for each individual member of the Eurozone.⁸¹⁴

DBP: Draft Budgetary Plan

Part of the European Semester and the SGP's preventive arm, established by the two-pack legislation.⁸¹⁵ Each year, each Eurozone member must submit a draft budgetary plan to the European Commission to ensure respect for the common rules and a coordinated economic policy. Then, the Commission publishes individual reports assessing the national budgets' compliance with EU rules.⁸¹⁶

⁸¹⁰ Verdun and Zeitlin (n 211) 138.

⁸¹¹ cf. Fabbrini, *EU Fiscal Capacity* (n 208) 27 and 59.

⁸¹² TEU (n 70) art 19.

⁸¹³ TFEU (n 36) art 121(3); as well as NN, 'The Autumn Package Explained' (n 222).

⁸¹⁴ cf. Flynn (n 176) 855.

⁸¹⁵ Regulation 472/2013 (n 463).

⁸¹⁶ cf. *ibid* art 19.

EAR: Euro Area Recommendation

*After the publication of the Annual Sustainable Growth Strategy, the European Commission proposes specific collective recommendations for the entire euro area, which are discussed by the European Council and approved by the Council in the spring.*⁸¹⁷

EC: European Commission

*Institution of the European Union based in Brussels (BE). It fulfills technocratic, legislative, and executive functions. It has been established to "promote the general interest of the Union". The Commission has the power to propose legislation and ensure external representation.*⁸¹⁸

ECB: European Central Bank

*Institution of the European Union based in Frankfurt am Main (DE). Its primary objective is to maintain price stability.⁸¹⁹ Beyond that, its four basic tasks are to define and implement the monetary policy of the Union, to conduct foreign-exchange operations, to manage foreign reserves and to promote the smooth operation of payment systems.⁸²⁰ It has the exclusive power to authorize the issue of euro banknotes and coins.*⁸²¹

ECJ: European Court of Justice

*One of two parts of the Court of Justice of the European (CJEU). As the supreme court in EU law, its function is to interpret the EU treaties and legislation and to ensure their uniform application across all Member States.⁸²² This term is used to distinguish the sub-entity from the lower-ranking General Court, whose decisions can be appealed to the ECJ.*⁸²³

ECOFIN: Economic and Financial Affairs Council

*Configuration of the Council of the European Union, made up of the economic and finance ministers from all Member States. Its meetings take place at least once a month. It is responsible for economic policy, taxation matters, financial markets and capital movements. It also prepares the EU's annual budget and takes care of the legal and practical aspects of the euro.*⁸²⁴

⁸¹⁷ cf. TFEU (n 36) art 121(2).

⁸¹⁸ TEU (n 70) art 17.

⁸¹⁹ TFEU (n 36) art 127(1).

⁸²⁰ *ibid* art 127(2).

⁸²¹ *ibid* art 128.

⁸²² *ibid* arts 260 and 263.

⁸²³ *ibid* art 256(1).

⁸²⁴ NN, 'Economic and Financial Affairs Council Configuration (Ecofin)' (*consilium.europa.eu*, 1 January 2022) <<https://bit.ly/2PSTGw8>> accessed 27 November 2022.

EDP: Excessive Deficit Procedure

Action launched by the European Commission against any Member State that exceeds the budgetary deficit ceiling imposed by the Stability and Growth Pact.⁸²⁵ The procedure entails several steps, potentially culminating in sanctions, to encourage a Member State to get its budget deficit under control.⁸²⁶

EFC: Economic and Financial Committee

Advisory body of the EU that provides opinions at request. Under the RRF, the EFC is also responsible for assessing compliance with the NRRP objectives.⁸²⁷

EFSF: European Financial Stability Facility

Conditionality-based instrument that was established in 2010 in Luxembourg (LU) outside the scope of EU law. It has been used as a temporary crisis resolution mechanism by the countries of the Eurozone. The EFSF has provided financial assistance to Ireland, Portugal and Greece. These loans were financed via bonds and other debt instruments on capital markets. Since the creation of the ensuing permanent European Stability Mechanism, the EFSF only rolls over outstanding bonds and does not provide any further financial assistance.⁸²⁸

EFSM: European Financial Stabilization Mechanism

An emergency funding program established in 2010, which relies upon funds raised on the financial markets using the budget of the European Union as collateral. It is based on EU law and aims at preserving financial stability by providing conditionality-based financial assistance to Member States in economic difficulty.⁸²⁹ The EFSM remains operational, even though the intergovernmental ESM now fulfils a similar function.⁸³⁰

EGF: European Guarantee Fund

An investment fund by the EIB, designed to help EU businesses recover from the COVID-19 pandemic. The fund is composed of €22 billion in Member State contributions as well as €188 billion in private investments. The EGF provides financing for sound private companies.⁸³¹

⁸²⁵ NN, 'Excessive Deficit Procedure (EDP)' (*ec.europa.eu*, 4 March 2019) <<https://bit.ly/3ODYQbx>> accessed 27 November 2022.

⁸²⁶ TFEU (n 36) art 126.

⁸²⁷ cf. Domínguez (n 209) 27.

⁸²⁸ NN, 'Before the ESM' (*esm.europa.eu*, 24 May 2016) <<https://bit.ly/3AOiETA>> accessed 27 November 2022.

⁸²⁹ Regulation 407/2010 (n 326).

⁸³⁰ cf. NN, 'European Financial Stabilisation Mechanism (EFSM)' (*ec.europa.eu*) <<https://bit.ly/3UeJOtM>> accessed 27 November 2022.

⁸³¹ NN, 'European Guarantee Fund' (n 465).

EIB: European Investment Bank

A multilateral development bank owned by the EU's Member States.⁸³² The EIB has its premises in Luxembourg (LU) and acts as the long-term lending arm of the European Union: "The EIB raises substantial volumes of funds on the capital markets which it lends on favourable terms to projects furthering EU policy objectives."⁸³³ Its purpose is to promote a "balanced and steady development of the internal market in the interest of the Union" on a "non-profit making basis".⁸³⁴

EMU: Economic and Monetary Union

The EMU involves the coordination of national economic and fiscal policies, a common monetary policy, and a common currency, the euro.⁸³⁵ Its legal origins lie in the Maastricht treaty, which was signed in 1992.⁸³⁶ Since then, its completion is a core aim of the European Union.⁸³⁷ While monetary policy is an exclusive EU competence, economic policies rely on coordination only.⁸³⁸

EP: European Parliament

Institution of the European Union based in Brussels (BE) and Strasbourg (FR). It is composed of 751 politicians who represent the interests of the Union's citizens. Its members are elected for a five-year term by direct universal suffrage. Jointly with the Council, the European Parliament exercises legislative and budgetary functions.⁸³⁹

ESCB: European System of Central Banks

The ESCB is made up of the ECB and the national central banks of all EU Member States whether they have adopted the euro or not.⁸⁴⁰ It has the same functions and objectives as the ECB,⁸⁴¹ by whose Governing Council it is led.⁸⁴² Due to the slow expansion of the Eurozone, in practice it is less relevant than the ECB's Eurosystem.

⁸³² TFEU (n 36) art 308.

⁸³³ NN, 'Eurostat Glossary: European Investment Bank (EIB)' (*ec.europa.eu*, 17 July 2013) <<https://bit.ly/3gD99jk>> accessed 27 November 2022.

⁸³⁴ TFEU (n 36) art 309.

⁸³⁵ cf. *ibid* arts 119(1) and 119(2).

⁸³⁶ NN, 'What Is the Economic and Monetary Union? (EMU)' (*ec.europa.eu*) <<https://bit.ly/3EOW5zC>> accessed 27 November 2022.

⁸³⁷ TEU (n 70) art 3(4).

⁸³⁸ TFEU (n 36) art 3(1c) and 5(1).

⁸³⁹ TEU (n 70) art 14.

⁸⁴⁰ NN, 'ECB, ESCB and the Eurosystem' (*ecb.europa.eu*, 25 June 2015) <<https://bit.ly/2ZzhtD1>> accessed 28 November 2022.

⁸⁴¹ cf. TFEU (n 36) art 127.

⁸⁴² *ibid* art 129.

ESM: European Stability Mechanism

Intergovernmental organization based in Luxembourg (LU), which does not operate under EU law. The countries of the Eurozone are its members and shareholders. The ESM provides financial assistance programs for Eurozone states in financial difficulty, with a maximum lending capacity of €500 billion.⁸⁴³ Those programs are financed through the issuance of debt securities that are backed by "a strong capital base, provided by the euro area Member States".⁸⁴⁴ Its compatibility with the EU treaties has been confirmed by the ECJ in the Pringle case, due to the fund's reliance on strict conditionality.⁸⁴⁵ The ESM shall be activated only if "indispensable to safeguard the stability of the euro area as a whole"⁸⁴⁶ assuming the functions of the previously adopted EFSM and EFSF.

EUCO: European Council

Institution of the European Union based in Brussels (BE). It consists of the Heads of State or Government who convene at summits at least twice every six months. Its task is not to exercise legislative functions but to "define the general political directions and priorities" of the European Union.⁸⁴⁷

EURI European Union Recovery Instrument

The "control room"⁸⁴⁸ of the Next Generation EU fund that allocates the financial market borrowings by the European Commission to the different measures and programmes of NGEU, such as the Recovery and Resilience Facility.⁸⁴⁹

EZ: Eurozone

Group of 20 Member States that have fully implemented all stages of the Economic and Monetary Union by adopting the euro as their primary currency and sole legal tender. All other EU states (except for Denmark) are obliged to join the EZ once they meet the convergence criteria.⁸⁵⁰ While four microstates are also part of the EZ because of monetary agreements, they do not participate in decisions regarding monetary policy. Two states (Montenegro and Kosovo⁸⁵¹) have also adopted the euro unilaterally, but they are not considered as part of the EZ.

⁸⁴³ NN, 'Who We Are' (*esm.europa.eu*, 18 March 2016) <<https://bit.ly/3OFTHQe>> accessed 28 November 2022.

⁸⁴⁴ NN, 'Financing the ESM & EFSF' (*esm.europa.eu*, 16 November 2021) <<https://bit.ly/3OJEHkj>> accessed 28 November 2022.

⁸⁴⁵ C-370/12 *Pringle* (n 87) para 137.

⁸⁴⁶ TFEU (n 36) art 136(3).

⁸⁴⁷ TEU (n 70) art 15.

⁸⁴⁸ de Gregorio Merino (n 497) 4.

⁸⁴⁹ cf. Regulation 2020/2094 (n 500).

⁸⁵⁰ TFEU (n 36) art 139.

⁸⁵¹ Ann.: The Republic of Kosovo is only partially recognized as a sovereign state.

IMF: International Monetary Fund

Financial agency of the United Nations, based in Washington DC (USA).⁸⁵² As a global lender of last resort, the IMF gathers funding through membership quotas and loans. Those funds can be borrowed by countries experiencing balance of payments problems.⁸⁵³ Similarly to the ESM, the IMF relies on very strict conditionality provisions.

IFI: Independent Fiscal Institution

Non-partisan public bodies promoting sustainable public finances. IFIs fulfil their mandate by "monitoring compliance with fiscal rules, production or endorsement of macroeconomic forecasts for the budget, and/or advising the government on fiscal policy matters".⁸⁵⁴ Their role has been specified and strengthened by the EU's new fiscal governance framework.⁸⁵⁵

MAP: Macroeconomic Adjustment Programme

Reform program containing austerity measures necessary to access ESM assistance.

MFF: Multiannual Financial Framework

Seven-year framework regulating the maximum amount of spendings in the EU budget. It is laid down in a special legislative procedure which foresees a unanimous vote in the Council of the EU and the consent of the European Parliament.⁸⁵⁶ The current MFF covers the period from 2021 until 2027, granting €1074.3 billion worth of funding.⁸⁵⁷

MIP: Macroeconomic Imbalance Procedure

Surveillance mechanism that aims to identify and correct potential macroeconomic risks early on, thus preventing the emergence of harmful macroeconomic imbalances by monitoring Member States' economic policies.⁸⁵⁸ Established by the six-pack regulations as part of the European Semester.⁸⁵⁹

⁸⁵² NN, 'What Is the IMF?' (*imf.org*, 4 January 2022) <<https://bit.ly/3AOAO7L>> accessed 27 November 2022.

⁸⁵³ cf. NN, 'IMF Lending' (*imf.org*, 22 February 2021) <<https://bit.ly/2Pr462x>> accessed 27 November 2022.

⁸⁵⁴ NN, 'Independent Fiscal Institutions' (*ec.europa.eu*) <<https://bit.ly/3F8DWhv>> accessed 28 November 2022.

⁸⁵⁵ cf. Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States [2011] OJ L306/41; and Regulation 473/2013 (n 221).

⁸⁵⁶ TFEU (n 36) art 312(2) and art 312(3).

⁸⁵⁷ NN, 'Long-Term EU Budget 2021-2027 and Recovery Package' (*consilium.europa.eu*, 25 October 2022) <<https://bit.ly/3u3bqHD>> accessed 26 November 2022.

⁸⁵⁸ NN, 'Macroeconomic Imbalance Procedure (MIP) - Eurostat' (*ec.europa.eu*) <<https://bit.ly/3u9jfMe>> accessed 28 November 2022.

⁸⁵⁹ Regulation (EU) No 1174/2011 of the European and of the Council of 16 November 2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro area [2011] OJ

MoU: Memorandum of Understanding

In the context of the ESM treaty, a MoU is to be negotiated between the Member seeking financial aid and the Board of Governors. This document shall detail the conditionality attached to the financial assistance facility: "The content of the MoU shall reflect the severity of the weaknesses to be addressed and the financial assistance instrument chosen."⁸⁶⁰

MS: Member States

Contracting parties, who have established among themselves the European Union. By conferring sovereign competences to a supranational institution, they strive to "attain common objectives" and reach an "ever closer union among the peoples of Europe".⁸⁶¹ As the "masters of the Treaties", the Member States can modify the TEU and TFEU (primary law) through the ordinary and simplified treaty revision procedures.⁸⁶²

MTO: Medium-term budgetary Objectives

Budgetary target that is established as part of the Stability and Growth Pact's preventive arm. MTOs are updated every three years and serve as benchmarks for the European Semester. Unless the Council of the European Union votes for a derogation acting upon a Commission proposal, a significant deviation from the MTOs will trigger the Excessive Deficit Procedure.⁸⁶³

NGEU: Next Generation EU fund

A temporary conditionality-based instrument designed to boost the economy after the Covid-19 pandemic. After its longest-ever negotiations, the European Council settled on €390 billion in grants and €360 billion in loans.⁸⁶⁴ For the first time ever, the European Commission was authorized to borrow €750 billion on the capital markets on behalf of the Union.⁸⁶⁵ The largest part of the NGEU fund is the Recovery and Resilience Facility (RRF), but the NGEU also contains six other funds supporting common objectives.⁸⁶⁶

L306/8; and Regulation (EU) No 1176/2011 of the European and of the Council of 16 November 2011 amending Council Regulation (EC) No 1466/97 on the prevention and correction of macroeconomic imbalances [2011] OJ L306/25.

⁸⁶⁰ TESI art 13(3).

⁸⁶¹ TEU (n 70) art 1.

⁸⁶² *ibid* art 48.

⁸⁶³ NN, 'Medium-Term Budgetary Objectives (MTOs)' (ec.europa.eu) <<https://bit.ly/3ELozdj>> accessed 28 November 2022.

⁸⁶⁴ Ann.: Those figures are indexed to inflation: €806.9 billion in 2022.

⁸⁶⁵ NN, 'Long-Term EU Budget 2021-2027 and Recovery Package' (n 876).

⁸⁶⁶ NN, 'EU's next Long-Term Budget & Next Generation EU: Key Facts and Figures' (commission.europa.eu, 11 November 2020) 2 <<https://bit.ly/3XNAAHz>> accessed 29 November 2022.

NRRP: National Recovery and Resilience Plans

*To receive funds under the Recovery and Resilience Facility, Member States need to present National Recovery and Resilience Plans outlining how they are going to invest the funds. Moreover, those plans need to meet several milestones and targets, that are assessed by the Commission before any money from the RRF can flow.*⁸⁶⁷

OLP: Ordinary Legislative Procedure

*Since the Lisbon Treaty, the OLP is the main decision-making procedure for adopting EU legislation, such as directives and regulations. After having received a proposal by the Commission, the Council of the EU and the European Parliament jointly act as equal co-legislators.*⁸⁶⁸

OMC: Open Method of Coordination

*Procedure to adopt non-binding soft law measures. The OMC "aims to spread best practice and achieve convergence towards Union goals in those policy areas in which the Member States are the primary actors".*⁸⁶⁹

OMT: Outright Monetary Transaction

*Exceptional bond-purchasing program tied to ESM/EFSS conditionalities announced by the ECB in 2012 to calm the markets during the Eurozone crisis.*⁸⁷⁰ *The aim of the OMT program was to maintain "an appropriate monetary policy transmission".*⁸⁷¹ *The program has only been announced but it was never implemented in practice.*⁸⁷²

ORD: Own Resources Decision

*Council decision adopted with a special legislative procedure requiring constitutional ratification.*⁸⁷³ *It spells out the different sources of revenue for the European Union that are beyond Member State control.*⁸⁷⁴ *The new ORD has added a new "uniform call rate to the weight of plastic packaging waste generated in each Member State that is not recycled"*⁸⁷⁵ *as well as the authorization for the Commission to borrow funds on capital markets to finance the NGEU's RRF.*⁸⁷⁶

⁸⁶⁷ NN, 'Recovery Plan for Europe' (ec.europa.eu) <<https://bit.ly/3ASysoB>> accessed 29 November 2022.

⁸⁶⁸ TFEU (n 36) art 289; as well as *ibid* art 294.

⁸⁶⁹ Flynn (n 176) 851.

⁸⁷⁰ cf. Mario Draghi, 'Introductory Statement to the Press Conference (with Q&A)' (ecb.europa.eu, 2 August 2012) <<https://bit.ly/3AUOqyn>> accessed 29 November 2022.

⁸⁷¹ NN, 'Technical Features of Outright Monetary Transactions' (n 661).

⁸⁷² Rosas (n 25) 1401.

⁸⁷³ cf. NN, 'Long-Term EU Budget 2021-2027 and Recovery Package' (n 876).

⁸⁷⁴ Council Decision (EU, Euratom) 2014/335 of 26 May 2014 on the system of own resources of the European Union [2014] OJ L 168/105 2(1).

⁸⁷⁵ Council Decision 2020/2053 (n 502) art 2(1c).

⁸⁷⁶ cf. *ibid* art 5.

PEPP: Pandemic Emergency Purchasing Program

Temporary unconventional monetary policy measure initiated by the ECB in March 2020 to counter the effects of the Covid-19 pandemic. Like the PSPP, this program relies on large-scale asset purchases (quantitative easing). However, this program also involves securities from the private sector. The objective of the Governing Council is to "counter the serious risks to the monetary policy transmission mechanism" posed by Covid-19 by injecting a total of €1.85 billion in the Eurozone.⁸⁷⁷

PSPP: Public Sector Purchasing Program

One of several asset purchasing programs launched by the ECB's Eurosystem during the Eurozone crisis, relying on unconventional monetary policy and quantitative easing (large-scale net purchases of public securities).⁸⁷⁸ It has been sanctioned as legal by the ECJ in the Weiss judgement,⁸⁷⁹ emphasizing its sufficient reliance on conditionality.⁸⁸⁰ This judgment has been rejected as being "ultra vires" by the German Constitutional Court.⁸⁸¹

QE: Quantitative Easing

Large-scale asset purchases by a Central Bank, used to support economic growth and increase inflation during an economic recession. The bond-purchases on the secondary market are supposed to increase their price and injects money in the banking system. Ideally, this should lead to the fall of interest rates, making loans cheaper. This would ultimately boost consumption and investment, leading into a phase of economic growth with normal levels of inflation.⁸⁸²

QMV: Qualified Majority Voting

Standard voting procedure in the Council of the European Union.⁸⁸³ A qualified majority is defined as "55% of the members of the Council, comprising at least fifteen of them and representing Member States comprising at least 65% of the population of the Union".⁸⁸⁴ In practice, decisions are still mostly taken by consensus. Constructive abstention is possible.⁸⁸⁵

⁸⁷⁷ cf. NN, 'Pandemic Emergency Purchase Programme' (n 727).

⁸⁷⁸ cf. Decision 2015/774/EU (n 705) art 3.

⁸⁷⁹ cf. Case C-493/17 Weiss (n 629) paras 147, 149 and 154.

⁸⁸⁰ *ibid* para 137.

⁸⁸¹ cf. de Boer and Van't Klooster (n 26) 36.

⁸⁸² cf. NN, 'How Quantitative Easing Works' (*ecb.europa.eu*, 25 August 2021) <<https://bit.ly/3gKQ8vq>> accessed 30 November 2022.

⁸⁸³ TEU (n 70) art 16(3).

⁸⁸⁴ *ibid* art 16(4).

⁸⁸⁵ TFEU (n 36) art 238(4).

RDT: Reform Delivery Tool

Proposed conditionality-based fiscal instrument providing financial incentives for the voluntary implementation of reforms in Member States, containing €22 billion in funding.⁸⁸⁶ Never implemented relevant inspiration for the RRF mechanism.

RQMV: Reverse Qualified Majority Voting

New voting procedure introduced by the six-pack legislation in the context of the EU's economic governance. In order to strengthen the effectiveness of the Stability and Growth Pact, the adoption of sanctions or fines now automatically enters into force following a decision by the Commission, unless the Council decides by a qualified majority vote to reject the decision within 10 days.⁸⁸⁷ This reversal of the usual procedure is meant to prevent bending the rules for political reasons.

RRF: Recovery and Resilience Facility

Central part of the Next Generation EU fund, composed of €360 billion in loans and €312.5 billion in grants.⁸⁸⁸ Following a historical decision, these funds will be borrowed on capital markets on behalf of the EU by the European Commission. In order to access the funds of the RRF, the Member States must submit National Recovery and Resilience Plans (NRRP) setting out a "reform and investment agenda" until the end of April 2021.⁸⁸⁹ Those plans are then assessed by the Commission.⁸⁹⁰

RSP: Reform Support Programme

Conditionality-based fiscal instrument proposed by the Commission, combining the RDT and the SRSP into a single legal framework.⁸⁹¹ Ultimately replaced by NGEU.

TSCG: Treaty on Stability, Coordination and Governance

Also known as the Fiscal Compact. Intergovernmental treaty outside the framework of EU law meant to increase budgetary discipline and economic cooperation on the national level.⁸⁹² It creates an obligation for the Member States to implement rules on budgetary discipline into national law,⁸⁹³ enhancing the effectiveness of the Stability and Growth Pact and the European Semester. The SCG Treaty has been ratified by all current EU Member States.⁸⁹⁴

⁸⁸⁶ Commission Proposal COM(2018) 391 (Draft RSP Regulation) (n 440) art 7(2a).

⁸⁸⁷ Regulation 1173/2011 (n 165) art 4(2), 5(2) and 6(2).

⁸⁸⁸ NN, 'Long-Term EU Budget 2021-2027 and Recovery Package' (n 876).

⁸⁸⁹ Regulation 2021/241 (n 536) art 17(1) and 18(3).

⁸⁹⁰ *ibid* art 19(1).

⁸⁹¹ Commission Proposal COM(2018) 391 (Draft RSP Regulation) (n 440).

⁸⁹² TSCG art 1(1).

⁸⁹³ *ibid* art 3(1b).

⁸⁹⁴ NN, 'Treaty on Stability, Coordination and Governance in the Economic and Monetary Union.' (n 269).

SGP: Stability and Growth Pact

A set of EU rules designed to ensure that countries in the European Union pursue sound public finances and coordinate their fiscal policies.⁸⁹⁵ It consists of a preventive and a corrective arm. The preventive arm is meant to "ensure sound budgetary policies over the medium term by setting parameters for Member States' fiscal planning and policies during normal economic times".⁸⁹⁶ The corrective arm on the other hand is meant to provoke "appropriate policy responses" in case an excessive deficit has emerged.⁸⁹⁷

SLP: Special Legislative Procedures

This term refers to all deviations from the ordinary legislative procedure that are provided by the treaties.⁸⁹⁸ There is no uniform special legislative procedure, it is instead a residual category for all exceptional legislative adoption mechanisms. The role of the European Parliament is often reduced, requiring only its consent⁸⁹⁹ or consultation⁹⁰⁰.

SMP: Securities Markets Programme

First unconventional monetary policy measure announced by the ECB to "address the malfunctioning of securities markets and restore an appropriate monetary policy transmission mechanism".⁹⁰¹ The temporary program was terminated at the announcement of the OMT program.⁹⁰²

SRF: Single Resolution Fund

An emergency fund to bail out banks facing default in times of crisis. The SRF is financed by obligatory contributions by the banks in the Eurozone to stabilize the financial system. Following the treaty amendment, the ESM will also be able to provide assistance to significant EU banks by acting as a backstop to the SRF.⁹⁰³

SRSP: Structural Reform Support Programme

Instrument for voluntary technical assistance that was meant to improve institutional and administrative capacities.⁹⁰⁴ The SRSP was supplied with € 222.8 millions.⁹⁰⁵

⁸⁹⁵ NN, 'Stability and Growth Pact' (n 103).

⁸⁹⁶ NN, 'The Preventive Arm' (n 105).

⁸⁹⁷ NN, 'The Corrective Arm/Excessive Deficit Procedure' (n 106).

⁸⁹⁸ TFEU (n 36) art 289(2).

⁸⁹⁹ cf. ibid art 312(2).

⁹⁰⁰ cf. ibid art 103.

⁹⁰¹ Decision 2010/281/EU (n 660) para recital 3.

⁹⁰² NN, 'Technical Features of Outright Monetary Transactions' (n 661).

⁹⁰³ cf. Fabbrini, *EU Fiscal Capacity* (n 208) 17.

⁹⁰⁴ Flynn (n 176) 872.

⁹⁰⁵ Regulation 2018/1671 (n 201) art art 1(3a).

SURE: Instrument for Support to mitigate Unemployment Risks in an Emergency

Temporary financial instrument presented by the European Commission at the height of the Covid-19 pandemic in 2020.⁹⁰⁶ Its objective is to allow Member States to "access loans at advantageous rates to finance a system of short-time work (STW) or support for the self-employed".⁹⁰⁷ Unlike other internal EU instruments impacting national budgets, the SURE initiative does not rely on conditionality rules.

TEU: Treaty on European Union

Intergovernmental Treaty signed and ratified by the EU's 27 Member States, establishing "among themselves" the European Union to attain common objectives.⁹⁰⁸ The 55 articles of the TEU cover the general aims of the EU and have the same legal value as other sources of primary law in the EU, such as the TFEU.⁹⁰⁹ Since two landmark judgements by the CJEU, both primary and secondary EU law enjoys supremacy over national law⁹¹⁰ and can have direct effect for individuals.⁹¹¹

TESM: Treaty establishing the European Stability Mechanism

Intergovernmental Treaty establishing the ESM. Not part of EU law.

TFEU: Treaty on the Functioning of the European Union

Just as the TEU, the TFEU is part of the EU's body of primary law. This treaty goes into more detail regarding procedural rules of legislating. Therefore, this treaty is much longer, being composed of 358 articles. Both treaties have remained practically identical since the entry into force of the Lisbon Treaty in 2009.⁹¹²

TPI: Transmission Protection Instrument

The ECB's most recent unconventional monetary policy instrument. The ECB claims that the TPI is "necessary to support the effective transmission of monetary policy",⁹¹³ yet the outcome of a legal challenge at the CJEU⁹¹⁴ is still uncertain. Bonds are only eligible for TPI if the Member States comply with the European Semester and their commitments under the Recovery and Resilience facility.⁹¹⁵

⁹⁰⁶ NN, 'EU Financial Assistance: SURE' (ec.europa.eu) <<https://bit.ly/3EVDaTO>> accessed 1 December 2022.

⁹⁰⁷ NN, 'SURE Initiative' (n 467).

⁹⁰⁸ TEU (n 70) art 1.

⁹⁰⁹ *ibid.*

⁹¹⁰ Case 6-64 *Flaminio Costa v ENEL* [1964] EU:C:1964:66 p 600 (para 4).

⁹¹¹ Case 26-62 *NV Algemene Transport- en Expeditie Onderneming van Gend & Loos v Nederlandse Administratie der Belastingen* [1963] EU:C:1963:1 p 16 (para 1).

⁹¹² Ann.: The only relevant exception being the insertion of Art. 136(3) by means of the simplified revision procedure, allowing for the establishment of a stability mechanism.

⁹¹³ NN, 'The Transmission Protection Instrument' (n 753).

⁹¹⁴ Siebelt (n 774).

⁹¹⁵ NN, 'The Transmission Protection Instrument' (n 753).

TSCG: Treaty on Stability, Cooperation and Governance

Intergovernmental Treaty signed by all current EU Member States. The signatories are bound to implement rules on budgetary discipline into national law.⁹¹⁶ More specifically, they need to institutionalize the so-called Golden Rule, a "lower limit of a structural deficit of 0.5 % of the gross domestic product at market prices"⁹¹⁷. Beyond this, it has been argued that "the Treaty did not add much that is 'new' in terms of economic or fiscal integration".⁹¹⁸ Therefore, the TSCG has been described as a primarily political commitment and as "an attempt to show leadership and appease investors".⁹¹⁹

TSI: Technical Support Instrument

Successor of the SRSP. The new name reflects the extended scope of the objectives pursuant the jointly adopted RFF.⁹²⁰ Apart from those changes, the legal structure of the TSI has remained essentially identical to the SRSP.⁹²¹ The instrument now also received a larger financial envelope, containing a budget of €864 billion.⁹²²

⁹¹⁶ Hinarejos (n 35) 600; and Armstrong (n 28) 604.

⁹¹⁷ TSCG art 3(1b).

⁹¹⁸ Hinarejos (n 35) 601.

⁹¹⁹ *ibid.*

⁹²⁰ Regulation 2021/240 (n 203) art 4(b) and 5.

⁹²¹ *cf. ibid* art 8.

⁹²² *ibid* 6(1).

— Council of the European Union

Institution of the European Union based in Brussels (BE) and in Luxembourg (LU). It consists of ministers representing each Member State.⁹²³ The Council takes decisions by qualified majority voting, except where the treaties provide otherwise.⁹²⁴ Jointly with the European Parliament, the Council exercises legislative and budgetary functions. The Council meets in several different ministerial configurations depending on the policy field, its meetings are chaired by the rotating presidency.⁹²⁵ Despite the similar name, its functioning and purpose are very different to the European Council (see EU CO).

— Board of Governors

Executive organ of the European Stability Mechanism, composed of the finance ministers of the Eurozone.⁹²⁶ Votes are weighted in accordance with the financial contribution of the ESM members.⁹²⁷ This organ should not be confused with the ECB's Governing Council or the ESM's Board of Directors.

— Board of Directors

Subsidiary organ of the ESM appointed by the Board of Governors. This administrative body is composed of "people of high competence in economic and financial matters"⁹²⁸ who shall ensure compliance with the foundational ESM Treaty and the by-laws adopted by its Board of Governors.⁹²⁹

— European Semester

Conditionality-based policy framework establishing a "cycle of economic, fiscal, labour and social policy coordination" helping EU Member States to "align their budgetary and economic policies with the rules agreed at EU level".⁹³⁰ The European Semester has been created by the six-pack legislation after the global financial crisis to increase the surveillance and coordination of economic policies on an EU level. By implementing a common annual timeline, it should be easier to identify and address common challenges early on.⁹³¹ The European Semester has been adapted to accommodate the NGEU fund and especially its RRF.

⁹²³ TEU (n 70) art 16(1) and 16(2).

⁹²⁴ *ibid* art 16(3).

⁹²⁵ TFEU (n 36) art 236.

⁹²⁶ TESM art 5.

⁹²⁷ *ibid* art 4(7).

⁹²⁸ *ibid* art 6(1).

⁹²⁹ *ibid* art 6(6).

⁹³⁰ NN, 'European Semester' (*consilium.europa.eu*, 17 August 2022) <<https://bit.ly/2W5tQWj>> accessed 3 December 2022.

⁹³¹ cf. NN, 'The European Semester' (*ec.europa.eu*) <<https://bit.ly/3FxL5Z7>> accessed 3 December 2022.

— Eurosystem

Monetary authority of the Eurozone, composed of the ECB and the central banks of the Member States who have adopted the euro. The Eurosystem and the European System of Central Banks (composed of the ECB and all EU central banks) are bound to co-exist as long as there are EU Member States outside the euro area.⁹³²

— Eurogroup

An informal composition of the Council of the European Union composed of the finance ministers from the Eurozone countries, as well as representatives of the Commission and the ECB.⁹³³ The ministers elect among themselves a president for a renewable 2.5-year term.⁹³⁴ The Eurogroup serves as a forum to discuss matters relating to the common currency.⁹³⁵

— Governing Council

Main decision-making body of the ECB. It is composed of six rotating Executive Board members as well as all central bank governors of the Eurozone. It takes the necessary decisions to deliver the mandate of the ECB and its Eurosystem.⁹³⁶

— Six-Pack

Legislative bundle of four regulations⁹³⁷, one Council regulation⁹³⁸ and one directive⁹³⁹. It was enacted in 2011 to establish the European Semester and to strengthen the Stability and Growth Pact by introducing the EDP and the MIP.

— Troika

Informal decision group composed of the EC, the ECB, and the IMF. It was formed at the height of the Eurozone crisis to manage the "bailouts".

— Two-Pack

Legislative bundle of two regulations.⁹⁴⁰ It was enacted in 2013 to strengthen the European Semester and the Stability and Growth Pact for Eurozone countries by increasing economic and budgetary surveillance through draft budgetary plans.

⁹³² NN, 'ECB, ESCB and the Eurosystem' (n 859).

⁹³³ NN, 'Eurogroup' (*consilium.europa.eu*) <<https://bit.ly/3VMeaVF>> accessed 3 December 2022.

⁹³⁴ cf. Protocol No. 14 to the Lisbon Treaty.

⁹³⁵ NN, 'How the Eurogroup Works' (*consilium.europa.eu*, 15 November 2022) <<https://bit.ly/3FnjCJi>> accessed 3 December 2022.

⁹³⁶ cf. NN, 'Governing Council' (*ecb.europa.eu*, 19 November 2021) <<https://bit.ly/3FjP4qT>> accessed 3 December 2022.

⁹³⁷ Regulation 1173/2011 - Regulation 1176/2011. Ann.: Established through the OLP.

⁹³⁸ Council Regulation 1177/2011. Ann.: Established by means of a special legislative procedure.

⁹³⁹ Directive 2011/85/EU (n 874).

⁹⁴⁰ Regulation 472/2013 (n 463); Regulation 473/2013 (n 221).

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Summary

The Economic and Monetary Union (EMU) is perhaps one of most tangible and impactful achievements of the European Union. The euro as the EU's single currency not only influences every transaction made in the Eurozone, its legal framework also has an increasing impact on the fiscal and economic policies of the Member States.

In the last two decades, the concept of conditionality has become increasingly widespread within the legal framework of the EU. Put simply, this means that different leverage mechanisms are applied by the supranational institutions to incentivize political reforms. Conditionality can best be thought of as a system based either reward or punishment, and sometimes both. To follow the metaphor spelled out in the title, the EU's Member States are nudged into complying with common objectives in two ways: By promising the reward of financial incentives (carrot) or by sanctioning non-compliance (stick).

While there is plenty of literature regarding either the legality or the legitimacy of conditionality-based instruments, this thesis has focused on the implementation and enforcement of conditionality rules. This aspect has been less considered by legal scholars, and most of the existing research on conditionality-based instruments does not include the measures that have been adopted recently in the aftermath of the Covid-19 pandemic.

This work has focused on the conceptual evolution of conditionality, rather than on the legality of the instruments in a stricter sense. The research conducted has been descriptive in nature and did not rely on critical analysis (legality) or on a normative discussion (legitimacy). This thesis has tried to explain how EU institutions influence national budgets through EMU instruments relying on conditionality. This research question has been answered by classifying such instruments according to four main aspects: typology, implementation, enforcement and application.

Firstly, there is a distinction to be made between positive (incentive-based) and negative (sanction-based) conditionality measures. The instruments' typology is further distinguished according to the temporal scope: Does the compliance with the prescribed conduct have to come before (*ex ante*) or after (*ex post*) the disbursement of the financial benefit? In practice however, the lines between *ex ante* and *ex post* positive conditionality are often blurred: Most EU financial instruments involve thresholds at the beginning as well as further monitoring after the incentive has been granted. This double safeguard mechanism is referred to as "sticks-and-carrots" conditionality.

Negative conditionality measures are always *ex post* in EMU law, as their aim is to prevent a certain (undesired) behavior, rather than fostering a certain (desired) behavior. They do not involve any sort of incentive but rather sanctions as a disincentive or punishment for non-compliance with the prescribed conduct.

The second aspect, implementation, goes into further detail concerning the practicalities of enforcement. This category describes how the enforcement mechanism is intended to work in practice, e.g. which EU institutions are responsible for the oversight and which legal tools are at their disposal.

The third aspect, enforcement, has distinguished between instruments with a rule-based and a cooperation-based mechanism or both (hybrid). In case of the monetary instruments (see chapter 5), the enforcement category has been subdivided into implicit and explicit references to conditionality.

Finally, there has been a classification concerning the application of the imposed conditions, i.e. how high or low the thresholds are for the implementation of the incentive or sanction (soft/medium/strict). Unlike previous publications, this thesis has made a direct comparison between fiscal and monetary instruments. The research results have been summarized in form of a self-drafted taxonomy table (see chapter 7).

The research has focused on internal conditionality rules and not discussed the usage of conditionality in the EU's external relations. The second important limitation of the scope will be that only instruments impacting national budgets directly have been considered: Even though spending conditionality has long been used in the scope of the EU's Multiannual Financial Framework (MFF), the mechanisms at work here are fundamentally different to those prescribed by "independent" legislative instruments. Therefore, the notoriously controversial "rule of law conditionality" has not been discussed in much detail by this thesis, because it is implemented through the EU budget. Moreover, this thesis has only tackled spending conditionality measures that are targeted towards national actors and excluded those directed towards private stakeholders.

The Economic and Monetary Union (EMU) is much more than a body of technical rules or a regular common currency area: It includes a single monetary policy, a single currency and also the coordination of national economic policies. Not all Member States have the same degree of integration within the EMU. This means that as of 2023, only 20 Member States have already given up their national currency and adopted the euro. The seven remaining states (except for Denmark which has an opt-out) are committed to adopting the euro, but their economies have not yet met the convergence criteria. Therefore, not all countries are equally affected by conditionality-based instruments, as they are in different phases of EMU integration.

The main difference to other monetary unions is the lack of a centralized fiscal power. This means that while monetary policy is centralized, the economic leg of EMU remains firmly in the hands of the different national governments. On the one hand, monetary policy is an exclusive EU competence for the Member States that have given up their national currencies. This means that this aspect of EMU always has enjoyed the highest level of supranational integration.

This asymmetric construction, which combined a federalized and depoliticized monetary policy with a plurality of national fiscal policies, seemed to work quite well in its first decade. This does not mean however that EMU was completely without constraints in its early period. It was based on two different yet complementary sets of rules: The Stability and Growth Pact covered all rules regarding fiscal discipline, while soft law measures were to promote a sustainable economic policy.

It was the global recession and the subsequent sovereign debt crisis that made EMU's weaknesses evident. While the lack of economic coordination was finally acknowledged as a potential source of instability, many states were still reluctant to cede core state power to technocratic management in the field of economic policy. As the redistribution of resources was off the table, the Member States had to agree upon rigid constraints on their fiscal autonomy.

The legal structure of EMU has been influenced by the constant tension caused by the imbalance between the supranational monetary policy and intergovernmental fiscal/economic policy. As it turned out during the Eurozone crisis, the trust the Maastricht treaty had placed on market mechanism was "largely misplaced". In order to fix this problem without resorting to the cumbersome treaty revision procedure, the EU has increasingly resorted to conditionality-based instruments as a workaround. Those measures will now be successively presented and classified according to the predefined criteria.

The Stability and Growth Pact is the oldest conditionality-based instrument affecting national budgets in the context of EMU law. Its rules are meant to ensure that the Member States coordinate their fiscal policies and pursue sound public finances by keeping their annual deficit and debt below a certain GDP percentage. The SGP consists of a preventive and a corrective arm: The preventive arm is meant to ensure sound budgetary policies over the medium term, while the corrective arm can be activated in case that an excessive deficit has already emerged. Unlike the other conditionality-based instruments that will be discussed in this section, the SGP has its roots mainly in primary EU law.

Due to several legislative reforms of its secondary law framework, the enforcement of SGP rules has become medium over time. The SGP's Excessive Deficit Procedure is a prime example of ex post negative conditionality: Theoretically, sanctions are adopted after non-compliance has occurred. The EU lacks effective legal remedies of enforcement, as compliance with EU law by the Member States is ultimately voluntary. Sanctions under the SGP are only a nominal step of last resort, while in practice the Pact relies heavily on peer pressure and recommendations.

Secondly, soft law measures have been used extensively in the field of EMU since the early days despite their apparent lack of normative force. Before the global financial crisis, non-binding recommendations were essentially the only instrument of EMU law apart from the

previously described SGP. In the context of EMU, soft law measures strive to describe the conditions for inclusive economic growth, influencing behavior without creating law. They are thus cooperation-based rather than rule-based. Soft law measures are implemented primarily on the political level, setting informal standards through encouragement by the Commission as well as peer pressure in the Council. Soft law measures are not devoid of legal effect, however they only work through the back door in an area of jurisprudential uncertainty. They can best be described as relying on ex ante positive conditionality, as most of the previously described instruments are based on political incentives and a retroactive encouragement.

Thirdly, the European Semester (ES) is a cycle for the coordination of national economic and fiscal policies under a common budgetary timeline. The ES process involves a systematic review of budgetary plans before the formal adoption in the fall. Many scholars believe that this instrument represents a fundamental shift in EU socioeconomic governance, as it has led to a regular and institutionalized interaction between Member States and EU bodies. The application of its admittedly rather complex procedure has produced mixed results in practice, as the Member States of the Eurozone have shown very different rates of implementation.

The European Semester combines the two previously described instruments into a hybrid framework, relying on both rules and coordination. The application of conditionality in the ES can best be described as medium, as it combines the rule-based elements of the SGP with softer forms of coordination. Due to the connection with the RRF, the ES has become a prime example of sticks- and carrots-conditionality, as it involves both a negative incentive (sanctions for EZ-countries) and a positive incentive (funds of the NGEU). Despite the ramped-up enforcement, the role of the EP has remained weak in the process.

The Treaty on Stability, Coordination and Governance (TSCG), which is also known as the Fiscal Compact, is an intergovernmental agreement that has entered into force in 2013, at the peak of the Eurozone crisis. The most important addition that the Fiscal Compact has made to the EU fiscal governance framework is the obligation to implement rules on budgetary discipline into national law. Beyond this, it has been argued that the Treaty did not add much that is new in terms of economic or fiscal integration. Therefore, the TSCG has been described as a primarily political commitment. The Fiscal Compact is not part of EU law, even though EU institutions have played an important role in negotiating, drafting and applying the SCG Treaty. The TSCG relies on rule-based, ex post negative conditionality that is enforced judicially rather than politically. In practice however, the judicial application is very soft and unlikely to ever be used, as the imposition of financial penalties is regarded as a measure of very last resort.

The European Stability Mechanism is a permanent instrument for financial assistance that has been established to safeguard the stability of the Eurozone. The ESM is based on an intergovernmental treaty outside the scope of EU law, signed and ratified by all EZ-Members. There are six financial instruments within the ESM toolbox that can be used to mitigate different

kinds of financial imbalances. In the context of the global Covid-19 pandemic, the ESM also established a new temporary credit line containing €240 billion. The main difference to a regular market transaction are the concessional interest rates that are substantially lower than those offered by private creditors. Those lower interest rates are automatically passed on to the beneficiary country according to the financing costs of the ESM. Decisions within the ESM are taken by its executive organ: the Board of Governors, which is composed of the finance ministers of the Eurozone. It takes the most important decisions regarding the ESM's capital structure, economic policy conditionality and also the ultimate decision whether or not to provide support.

The complete lack of democratic constraints in the decision-making process has led to severe legitimacy concerns: negotiations involving the ESM are made in an intergovernmental setting behind closed doors, and involving only national executives. The creation of the ESM had come with high political and economic costs and has led to severe distributive conflicts. While a transfer of the ESM into EU law is legally possible, it seems very unlikely in the medium term due to political constraints. However, the treaty establishing the ESM is currently undergoing a revision.

As the threat to withdraw the positive incentive (cheap loans) in case of non-compliance acts as the main motivation, the ESM can be categorized as relying on ex post positive conditionality. The ESM is rule-based and based on strict conditionality that is contained within a Memorandum of Understanding. As the current reform proposal shows, the ESM remains a highly controversial instrument that is in need of further adjustments.

All of the previously described instruments were mostly used to enforce fiscal rigor and austerity during the Eurozone crisis. The mutualization of sovereign debt had remained a major taboo. While the proposal to introduce a European fiscal capacity was supported by the European Commission and the EP, no real progress had been made up until the outbreak of the Covid-19 pandemic.

The uncontrolled spread of the virus has acted as an institutional and political earthquake in the EU, which suffered under the biggest economic shock after the Second World War. Due to the limited EU budget, the adopted measures to ensure the functioning of the internal market were initially rather shy and disappointing. But, as so often in the EU context, the institutions managed to overcome the initial paralysis after some rounds of negotiation. The pandemic seemed to have opened a window of opportunity for Southern Europe, as Covid-19 called for a response that would safeguard the EU's social and economic cohesion.

It soon had become evident that the exogenous challenge posed by Covid-19 was huge and that a more ambitious reaction than the previously described measures would be necessary. For the first time in the EU's history, aspirations about a transfer union started to materialize in order to alleviate the economic and social consequences of COVID-19.

After five days of intense negotiations, the European Council ultimately found a compromise on the Next Generation EU fund to mitigate the impact of the pandemic. This instrument is more than a regular spending program, as its principal objective is the promotion of economic convergence. The ultimate size of the NGEU fund was settled at €750 billion in 2018 prices. According to the new Own-Resources decision (ORD), this amount is to be financed through the long-term issuance of debt in the markets by the Commission on behalf of the EU.

The NGEU fund made up of both grants (52% comprehensively) and loans (48%). Within the NGEU, the Recovery and Resilience Facility (RRF) has the biggest share as it takes up almost 90% of the entire recovery fund. The NGEU package also contains six smaller cohesion programs, but their funding had to be decreased in the negotiation process.

The legal engineering of the NGEU fund has been described as a building of three floors. The Own Resources decision acts as the top floor and covers the volume of the EU's liabilities as well as the financial conditions for repayment. The intermediate floor is covered by the EU Recovery Instrument Regulation, which works as the control room, allocating the borrowings to the different measures and programs of NGEU. Finally, the ground floor is made up of the different programs to which the resources are allocated, such as the Recovery and Resilience Facility (RRF).

As already mentioned, the general objective of the RRF is to promote the EU's economic, social and territorial cohesion in order to restore sustainable economic growth after the pandemic. It is important to note that under the RRF regulation, funds are mostly allocated on the basis of various broad policy goals that are not strictly related to the pandemic, such as the transition to a digitalized and carbon-neutral economy. Like the NGEU fund in general, the RRF consists of both loans and grants. While the subsidies have been very prized by the Member States, most of the national administrations have not requested any loans. It thus seems that the grant-based part of the RRF has had the most economic impact.

Despite being based entirely on existing EU Treaty provisions, the RRF has established an innovative solidarity-based system of economic governance. In the architecture of the RRF, the strategic objectives are defined by the EU in line with long-term political priorities. The overarching aim of the RRF is to make available new financial resources to the Member States that will help to build back better the national economies for the EU's Next Generation.

There is a decisive difference between the ESM and the RRF: In the first case, the instrument foresees an intergovernmental budgetary transfer from one group of Member States to another, giving each national government a right to veto its disbursement decision. The RRF on the other hand is based on supranational common resources that are raised on the financial markets and disbursed through the EU framework.

The RRF relies on hybrid enforcement, based on a discursive policy space. The RRF's governance mechanism relies on a complex procedure based on the submission of National

Recovery and Resilience Plans (NRRP) by the national governments. The right of initiative thus lies firmly in the hands of national administrations, as the European Union can only approve but not launch any projects. In order to be granted financial assistance, the national administrations must submit duly reasoned and substantiated roadmaps outlining the broad policy objectives, as well as envisaged milestones, targets and an indicative timetable concerning the implementation of reforms. The national capitals are also required to provide an estimated total cost of the reforms and investments, as well as an allocation to the various policy objectives.

The RRF then foresees a three-step process that leads to the disbursement of the funds: 1) approval of the NRRPs; 2) approval of compliance with the objectives set out in the plans; and 3) approval of payments. In each of the phases of this governance mechanism, the EU implements a double filter by both the supranational and the intergovernmental layer. The main innovation of the RRF is the widespread use of EU funds as a reward/carrot, in order to promote national reforms that are in line with EU strategic objectives. The RRF thus has a strong ex ante positive conditionality aspect, in that the policy guidance, negotiations and oversight occur before the disbursement of the funds.

However, there is also an ex post positive conditionality aspect to the RRF that should not be overlooked. To be precise, the Commission continues its monitoring of the relevant milestones and targets even after the first disbursements of the funds: Further implementing decisions releasing additional funds can be taken by the Council only if the Commission's assessment of the reform progress is positive. Moreover, the financial assistance can also theoretically be suspended by the Council upon a Commission proposal if the Council has determined a violation of the SGP's excessive deficit rule by a Member State.

There are two further aspects that enforce conditionality rules ex post in the RRF. The first of those legal features is the so-called emergency brake. This control mechanism relies on a provision contained in the regulation's recital and not on substantive legal provisions. The emergency brake can also be pulled by the Economic and Financial Committee in case that either the milestones or targets of the NRRP have not been met. As a result of this procedure, the disbursement of funds can be slowed down by up to three months. Ultimately however, this provision cannot prevent the Commission from ultimately going ahead with the payments. To sum up, the RRF can be best categorized as "sticks and carrots" conditionality. Even though the ex ante aspect is predominant, the Rule of Law regulation, the emergency brake mechanism, the link to the SGP, the disbursement in tranches and more general rules of transparency and good governance act as ex post safeguards.

An analysis of the implementation and enforcement of conditionality in EMU law would not be complete without also considering the monetary instruments launched by the European Central Bank since the beginning of the Eurozone crisis. By linking the eligibility for its

purchasing programs to compliance with the macroeconomic adjustment programs, the ECB has almost acted as an enforcer of the Troika's conditionality. During the Eurozone crisis and the Covid-19 pandemic, the European Central Bank was confronted with new challenges, which were not anticipated in its mandate. Rather than having to keep down inflation, the ECB had to mitigate the effects of a deflationary recession. The ECB's legal mandate did not provide any clear guidance on how the governors had to respond to this unexpected scenario.

Ultimately, those legal gaps and lack of political reform will have forced the European Central Bank to stretch its mandate to the outer limits. The ECB was thus facing a choice between a strict interpretation of its mandate or safeguarding the euro. Due to the incomplete and asymmetrical nature of EMU, the ECB decided to develop new tools to plug gaps in the system, leading to a de facto compensation for the lack of fiscal integration.

To analyze its enforcement and implementation of monetary conditionality-based instruments, the categories of the classification conducted by this research needed to be slightly adjusted. Instead of differentiating between ex ante/ex post as well as between positive/negative conditionality, the category "typology" has described whether the monetary instrument was "quantitative" or "selective". Moreover, the category "enforcement" has subdivided the monetary instruments into mechanisms with an implicit or explicit reference to conditionality.

The ECB's primary objective is maintaining price stability within the single currency area. All measures taken by the ECB must therefore be necessary to preserve the singleness and effectiveness of monetary policy. As an EU institution, the ECB is also constrained by the general pillars of EU law such as the principles of conferral, institutional balance, proportionality, non-discrimination and an open market economy. Moreover, it is expressly forbidden to the ECB to purchase sovereign debt directly from the Member States, the so-called monetary financing prohibition. Due to its conditionality-based bond purchasing programs, the ECB has controversially become the largest creditor in the Eurozone. As part of the Troika, the Central Bank has participated in the negotiations of the MoUs and also played a major role in monitoring the compliance with policy conditionality.

The Securities Markets Program (SMP) marks the first time that the ECB has gone beyond its traditional strategy of influencing interests through the policy rate. The SMP can thus be considered as the ECB's first large-scale implementation of unconventional monetary policy. To be make it compatible with the monetary financing prohibition, the Governing Council has decided to conduct the purchases of bonds issued by public entities on the secondary market. Despite being based upon a legally binding act, the Securities Markets Program has relied upon implicit conditionality. This is because the scope of conditionality was not formalized in any official document, much unlike later ECB bond-purchasing programs. The SMP purchases were instead tied to self-styled conditions that took the form of reform requests addressed informally.

Despite not being formalized, the conditions imposed in the SMP context were nonetheless stringent and pervasive, as the ECB was setting the policy agenda and instruments to be adopted in exchange for its support. Considering the urgency at the time of its adoption, the SMP was clearly focused on extinguishing the fire on the financial markets: Due to the implicit and informal nature of conditionality, the application proved to be soft in practice compared to the following monetary instruments. In a nutshell, the SMP was hurriedly implemented as an extraordinary measure.

At the peak of the European sovereign debt crisis in September 2012, the ECB established its Outright Monetary Transactions (OMT) program. The Bank announced that if a Member State was having liquidity problems and private investors would not buy its bonds, the ECB would step in and buy these state securities on the secondary market as a lender of last resort. The basic premise of the OMT program is thus very similar to the Securities Markets Program that it replaced: Both programs are selective in their typology as they both target individual Member States and do not cover the entire Eurozone. This is because the monetary policy transmission mechanism was disrupted in some countries, but not in others.

There are however also several differences between the OMT and the SMP: Unlike its predecessor, the OMT program is not covered by a formal and binding decision by the ECB's Governing Council but by a short press release. The enforcement as well as the content of its requirements are the most fundamental innovations by the OMT program. For the first time, bonds issued by countries in financial difficulty required "strict and effective conditionality" attached to an appropriate financial assistance program such as the ESM to be eligible for purchase. This first explicit reference to policy conditionality has led the German Federal Constitutional Court to argue that the OMT program is an instrument of economic policy.

In contrast to the SMP, the OMT program was never actually activated by the ECB, as its mere existence had a strong effect on the markets, in particular on the yields of sovereign bonds. Despite its non-implementation and the lack of a challengeable binding decision, the OMT program became subject to a legal challenge by a group of fiscally conservative German activists. The Luxembourg Court has found the OMT's conditionality to be a sufficient safeguard to ensure that the instrument would not have an effect equivalent to a direct purchase.

While the SMP and especially OMT succeeded in absorbing the biggest shocks of the sovereign debt crisis, the economy of the Eurozone had remained fragile due to strong deflationary tendencies. In this context, the ECB launched the Public Sector Purchasing Program (PSPP) in 2015 to support economic growth by expanding its balance sheet (quantitative easing). Until December 2022, the ECB has purchased bonds in the total rounded value of €2.742.802.000.000 under the PSPP, which amounts to over 20% of the Eurozone's GDP.

The ECB's Governing Council had launched the PSPP because the bank had reached the so-called zero lower bound and could no longer set lower interests to kickstart the economy. While the pursuit of the pre-crisis inflation target by all means caused notable controversy within the ECB's decision-making organ, the ECB was indeed able to bring down interest rates in financial markets without needing to lower its deposit rate further.

Just as the OMT program, the PSPP relies on explicit conditionality. The major difference compared to its predecessors is that the PSPP is not targeted but quantitative, as the low inflation was not a localized issue but one affecting the entire Eurozone. The undifferentiated application combined with a decentralized implementation mean that the PSPP was less effective as an enforcer of conditionality than the OMT. Considering that the purchases are still directly linked to the Troika conditionality, the application of the PSPP can be best described as medium.

Just as the Eurozone economy started to cool down and recover from the sovereign debt crisis, the ECB had to counter the biggest recession it had ever faced in its short existence: The Covid-19 pandemic. Learning from its mistakes in the Eurozone crisis, the Governing Council has acted quickly to avoid an increasing spread on the yields of government bonds, stabilize the financial markets and support the economic recovery. For these aims, the ECB has introduced the Pandemic Emergency Purchasing Program (PEPP).

The Central Bank set out to reassure the financial markets by directly purchasing assets from countries on the periphery of the Eurozone, which were subject to high pressure by the financial markets. The PEPP was a temporary QE program covering both public and private debt. It can therefore be classified as a quantitative program, as the PEPP's principal aim is to mitigate the economic crisis by facilitating additional borrowings across the Eurozone. As its name already suggests, the PEPP is very similar to its predecessor the PSPP. The main difference is that unlike PSPP, the PEPP has not been established to fight deflation.

As the PEPP was conceived as a crisis response measure designed to stimulate the economy suffering from an unprecedented recession, the application of conditionality is very soft compared to its predecessors. Crucially, the program also comes without any explicit reference to policy conditionality in its legal act. This structure based on implicit conditionality thus seems to be a step backwards in terms of transparency and predictability.

Since the summer of 2021, inflation has been sharply increasing in the Eurozone. To respond to the continuously rising prices, the European Central Bank began to signal a normalization of its monetary policy at the end of 2021. Especially since the start of the Russian invasion of Ukraine in early 2022 and the consequent use of energy blackmail as a political weapon, the cost of living saw a significant increase in the entire EU. To curb inflation, the European Central Bank decided to ramp up the key interest rates and to gradually discontinue the asset purchases that were conducted as part of the PSPP and the PEPP.

These policies combined with the economic downturn have led to an increase in the yields of sovereign bonds across the Eurozone. For this reason, the European Central Bank launched the Transmission Protection Instrument. The declared goal of the TPI is to ensure an even monetary transmission across the common currency area. The European Central Bank sets out to reach this objective by means of selective public and private bond purchases from countries whose interest rate increases are not considered to be justified by macroeconomic fundamentals. The objective of the ECB's most recent instrument is therefore very similar to the OMT program. But unlike the OMT, which is tied to compliance with the ESM, the TPI is linked to the EU law mechanisms of fiscal and economic governance.

There are four non-binding criteria concerning TPI bond eligibility: Compliance with the EU fiscal framework, absence of severe macroeconomic imbalances, fiscal sustainability as well as sound and sustainable macroeconomic policies. Those criteria encompass practically all aspects of EU economic governance and have therefore been criticized for being too vague and flexible. Just as the ES, the application of conditionality in the TPI can therefore best be classified as medium. This selective bond-purchasing program contains an explicit reference to conditionality which creates for the first time ever a direct link between the fiscal and monetary instruments.

Even though the TPI has not yet been activated, Markus Kerber, a Eurosceptic German attorney, has announced in July 2022 his plans to file a constitutional complaint against the ECB's newest monetary instrument. There are also several scholars who doubt the legality of the TPI. Out of all previously described ECB programs, the TPI will likely have the most profound impact on the EMU framework due to its link with the EU fiscal instruments.

All in all, conditionality certainly has led to a shift in the institutional power balance of the EU. Scholars have warned that the increasing reliance on conditionality in both fiscal and monetary instruments could ultimately entail that the initial ideal of solidarity between the EU and Member States is now effectively being replaced by a de facto conditional solidarity. The European Parliament as the EU's only directly elected institution is still far too often relegated to an advisory role or even entirely bypassed in the legislative adoption.

Open questions also remain concerning the Next Generation EU fund, notably the issue whether this temporary crisis response measure represents a genuine fiscal capacity or even a "Hamiltonian moment", in the sense that it could lead to a further federalization in the field of taxation. Calls have already emerged in the context of the war in Ukraine to convert NGEU into a permanent fiscal capacity capable of absorbing economic shocks. It remains to be seen whether the political circumstances allow for this consequential step, and whether the Treaties are amended accordingly.

Giving the EU more powers in the field of taxation, combined with a stronger voice of the EP could ultimately herald a new era of conditionality: The final Consolidation Phase, as has been observed in the USA. At this point, it is impossible to predict if and at which pace the EU would ever reach this phase, however the preceding research seems to suggest that further integration in the field of EMU remains very likely.

Conditionality can be a useful tool to promote reforms and economic growth in Member States with a weak institutional capacity. However, conditionality has its adversaries as it can ultimately lead to an erosion of national sovereignty without an adequate compensation in accountability on the European level. Whether good or bad, it is undeniable that conditionality has been extended to cover the entire EMU legal framework since the introduction of the common currency.

Nowadays, conditionality is not only a much more common phenomenon in fiscal and monetary EU policy than in the early days, but it has also been used in great plurality. Almost all parameter values of the four predefined characteristics (typology, implementation, enforcement and application) have been observed throughout the research. The high influence of conditionality on EMU law can thus be observed both quantitatively and qualitatively relating to its functional use.

Despite this expansion of conditionality, fiscal and economic policy has remained firmly in the hands of national administrations. However, their power is being incrementally restricted by increasing regulatory constraints imposed at the supranational level. As compliance with European law is ultimately voluntary, the EU cannot efficiently use coercion against its own Member States. The flagrant failure of conditionality in the Development Phase (1997-2009) has shown that negative conditionality based on sanctions is not an effective enforcement mechanism in the EU context.

The European Union thus has the most impact on national budgets when it uses "carrots" rather than "sticks". Ultimately, the EU framework is geared towards preventing breaches from occurring in the first place through communication and cooperation. However, the research also shows that purely cooperative forums risk being dismissed as a talking shop. Therefore, the EU seems to obtain the best results when it combines rule-based and cooperation-based enforcement into a hybrid accountability framework.

The research has shown that selective bond purchasing programs such as SMP, OMT and TPI have a far greater impact on national fiscal policy than the quantitative easing tools. Those selective programs have the potential to act as the ultimate enforcer of policy conditionality that has been previously agreed on in political negotiations. While initially, the programs were not linked to the EMU governance mechanisms but rather to intergovernmental agreements adopted in the context of the Troika, the Transmission Protection Instrument seems to have brought a paradigm shift: The fiscal and monetary instruments now seem closer than ever.

Yet, many questions regarding the legality and legitimacy of this development persist. The structure and identity of EMU law seems to be once again at stake. Once again, this development has can have both positive and negative implications. In the end, the debate regarding the use of conditionality in EMU law illustrates the constant tension between solidarity and responsibility that has characterized the European Union since its very foundation. If well implemented, conditionality has the potential to act as a mediator between those two poles: Ideally, it could ease the transition into a more integrated and resilient economic union.