

European Monetary Fund

The Commission's Proposal to Establish a European Monetary Fund: A Critical Analysis

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Abstract: On December 6, 2017, the European Commission published a set of proposals to reform the euro area. These proposals include, inter alia, the creation of a post of European Finance minister, a euro area budget-line and the establishment of a European Monetary Fund (EMF). The latter will be at the centre of this article. The Commission does not intend to set up the EMF anew from scratch. Rather, the new EMF is to be built on the well-established structure of the European Stability Mechanism (ESM). The new EMF will thus succeed to and replace the ESM, with the latter's current financial and institutional structure essentially preserved. However, the new institution will also take on a number of additional functions, such as providing a financial backstop for the Single Resolution Fund (SRF), enhanced monitoring tasks and the responsibility to report regularly to the European Parliament. But will these changes make EMU more efficient, coherent and democratic? And has the EU the competence to establish such a mechanism at all? The objective of this article is to answer these complex questions.

Keywords: EU Law, Economic and Monetary Union, Eurozone crisis, Reform proposals.

I. Introduction

The banners at the entrance to the Bank of Greece museum in Athens promise a 'fascinating journey through Greece's economic and monetary history. Inside the museum ranks of glass cases enclose an array of coins and old bank notes, as well as the paraphernalia used to make them. The bills range from 5 drachma up to 100 million drachma, a reminder that Greece has had problems with inflation in the past. The end of history, at least for this exhibition, is 2001 when Greece adopted the euro. But the country's present troubles suggest an important chapter to the story of Greek money is still to be written. Some reckon the drachma may roll off the presses again'.¹

In order to prevent that from happening a number of measures have been taken both by the EU and the euro area Member States. For instance, major bail-out mechanisms were established – the

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1 *Greece and the euro - An economy crumbles*, THE ECONOMIST, Jan. 28, 2012, available at <http://www.economist.com/node/21543522> (last visited Jan. 3, 2019).

EFSF² and the EFSM³ – worth several hundred billion euros. Later in 2011, the so-called six-pack measures were enacted, introducing a macroeconomic surveillance mechanism and better budgetary surveillance. 2012 then saw the signing of the ‘Treaty on Stability, Coordination and Governance in the Economic and Monetary Union’ – commonly referred to as the Fiscal Compact. The latter aims to complement the six-pack measures by obliging states to introduce so called ‘debt-brakes’.

However, all these measures have not yet brought about the desired effect. The biggest flaw in the EU’s strategy thus far has been that it sought ‘to muddle through the sovereign-debt crisis rather than get on top of it’.⁴ The establishment of a permanent European Stability Mechanism (ESM) in 2012 was supposed to put an end to this ‘muddling through’ strategy and provide a solid, clearly structured mechanism to prevent future crises. But the ‘big bazooka’⁵ – as it is sometimes referred to – also suffers from a fundamental flaw: It constitutes an anomaly in the EU system insofar as it is an intergovernmental institution based on an international treaty between the nineteen euro area Member States and not an EU institution. At the same time it is – at least to a certain extent – integrated into the institutional framework of the EU: For instance, the ECJ is tasked with solving disputes between the ESM and ESM Member States. This ‘partial involvement’ of EU institutions in an intergovernmental mechanism has generated a ‘complex landscape where judicial protection, respect of fundamental rights and democratic accountability are fragmented and unevenly implemented’.⁶

All in all, this created a bizarre and opaque situation. On December 6, 2017, the Commission therefore proposed to integrate – as part of a comprehensive EMU reform package – the ESM into the EU legal framework. In the course of this process the ESM should also be given additional tasks and be renamed *European Monetary Fund* (EMF). But will these changes finally put an end to the ‘muddling through’ strategy? Will they achieve the objectives set, i.e. making EMU more efficient, coherent and democratic? And – on a more practical note – has the EU the competence to establish such a mechanism at all?

In order to answer these complex questions, this article will be structured as follows:

- (1) It will first analyse the main features of the new EMF.
- (2) It will then set out the rationale for integrating the new mechanism into the EU legal framework.
- (3) Having done so, it will then examine whether such integration is legally possible. In other words, it will analyse whether the EU has the competence to establish such a mechanism.
- (4) It will then critically examine whether the new EMF will actually make EMU more efficient and democratic.

2 EFSF is the abbreviation used for the ‘European Financial Stability Facility’.

3 EFSM is the abbreviation used for the ‘European Financial Stabilisation Mechanism’.

4 *Hopes raised, punches pulled*, THE ECONOMIST, Feb. 10 2012), available at <https://www.economist.com/node/18114793> (last visited Jan. 3, 2019).

5 *Mario Draghi: the man behind Europe’s ‘big bazooka’*, THE TELEGRAPH, Feb. 29, 2012, available at <https://www.telegraph.co.uk/finance/economics/9113256/Mario-Draghi-the-man-behind-Europes-big-bazooka.html> (last visited Jan. 3, 2019).

6 Cf. *Proposal for a Council regulation on the establishment of a European Monetary Fund*, COM (2017) 827 final (Dec. 6, 2017) at 3.

II. The Main Features of the New EMF

As already mentioned above, the Commission does not intend to set up the EMF anew from scratch. Rather, the new EMF is to be built on the well-established structure of the ESM.⁷ Hence, a brief overview of the main elements of the ESM is in order before we turn to the changes introduced by the Commission proposal.

A. The European Stability Mechanism (ESM)

The contours of the ESM, the facility, which took over from the EFSF in 2012, were first revealed at the European Council meeting on March 24-25, 2011, and later specified in the ESM Treaty (ESMT).

1. Function

The purpose of the ESM is similar to that of the EFSF, namely to reduce instability in the euro area by providing financial assistance to its Member States under strict conditionality.⁸ Yet despite this similar function, the ESM differs significantly from the EFSF in a number of respects as outlined below.

2. Legal Nature, Institutional Structure and Governance

In contrast to the EFSF, which had been established as a private company (a *société anonyme* under Luxembourg law)⁹, the ESM was established as an intergovernmental organisation on the basis of a treaty (the ESM-Treaty) between the euro area Member States. This international treaty was signed by the Heads of State and Government of the euro area on February 2, 2012 and subsequently ratified by national parliaments.¹⁰ It eventually entered into force on September 27, 2012.

The institutional structure of the ESM is based on two pillars: The Board of Governors and the Board of Directors:

Board of Governors. The key decision-making body of the ESM is the Board of Governors (BoG). It consists of the euro area Finance Ministers as voting members, while the European Commissioner for Economic and Monetary Affairs and the President of the ECB may also participate in the meetings of the BoG but only on an observer basis.¹¹ Other persons, including

⁷ In legal terms, it will succeed to and replace the ESM, including in its legal position, with all its rights and obligations.

⁸ See Article 3 of the ESM Treaty (ESMT), available at <http://www.european-council.europa.eu/media/582311/05-tesm2-en12.pdf> (last visited Jan. 3, 2019), which provides: "The purpose of the ESM shall be to mobilise funding and provide stability support under strict conditionality, appropriate to the financial assistance instrument chosen, to the benefit of ESM Members which are experiencing, or are threatened by, severe financing problems, if indispensable to safeguard the financial stability of the euro area as a whole and of its Member States. For this purpose, the ESM shall be entitled to raise funds by issuing financial instruments or by entering into financial or other agreements or arrangements with ESM Members, financial institutions or other third parties."

⁹ See European Financial Stability Facility, Articles of Association, Article 1(1), available at http://www.efsf.europa.eu/attachments/efsf_articles_of_incorporation_en.pdf (last visited Jan. 3, 2019).

¹⁰ Membership in the ESM shall be open to the other Member States of the EU once they meet the criteria for joining the euro area and their 'derogation' status is abrogated, Article 2(1) ESMT.

¹¹ Conclusions of the European Council of 24/25 March 2011, EUCO 10/1/11 REV 123, 22. See also Article 5 (3) ESMT.

representatives of organisations, such as the IMF, may be invited [...] to attend meetings as observers on an *ad hoc* basis'.¹²

The BoG is the highest decision making body of the ESM.¹³ Initially it was envisaged that the BoG would decide on (a) the granting of financial assistance, (b) the terms and conditions of financial assistance, (c) the lending capacity of the ESM and (d) changes to the menu of instruments et seq. only by *mutual agreement*¹⁴ given the far-reaching implications of these decisions. Yet, the voting rules were later modified to make sure that the 'ESM is in a position to take the necessary decisions in all circumstances'.¹⁵ Against the backdrop of the escalating crisis, an emergency procedure was included.¹⁶ In case of such an emergency, the mutual agreement rule will be replaced by a qualified majority of 85%, whereby voting weights will be proportional to the Member States' respective capital subscriptions to the ESM.¹⁷ *Board of Directors.* In addition to the Board of Governors, there will be a second decision-making body - the so-called Board of Directors. It will be 'responsible for specific tasks delegated by the Board of Governors. Each euro area country will appoint one Director and one alternate Director, with the European Commission and the ECB as observers. A Managing Director responsible for the day-to-day management of the ESM will chair the Board of Directors'.¹⁸ Decisions by the Board of Directors will be taken by *qualified majority*, unless stated otherwise.¹⁹

3. Capital Structure

The ESM has a total subscribed capital of € 704,8 bn., of which € 80,5 bn. is in the form of paid-in capital provided by the euro area Member States'.²⁰ The remaining € 624,3 bn. will be provided by euro area Member States in the form of callable capital. Although the ESM's capital base will thus (nominally) amount to € 704,8 bn., its effective lending capacity will only be around € 500 bn., giving the facility a security buffer of 40%. This significant level of over-collateralisation is supposed to help the ESM achieve the best credit rating (AAA).

Each State's share in the ESM will be based on its respective participation in the ECB's paid-in capital. Hence, Germany, with a share of 27% of ECB capital, will contribute € 21,7 billion.²¹ In addition, Germany's share of callable capital will amount to € 168,3 bn.²² Smaller states, such as Finland, with a share of 1,8% of ECB capital, will contribute € 1,4 bn. in paid-in capital and € 11,1

12 Article 5(5) ESMT.

13 Conclusions of the European Council of 24/25 March 2011, EUCO 10/1/11 REV 123, 23.

14 See Article 5(6) ESMT. The term 'mutual agreement' is defined in Article 4(3) ESMT: 'The adoption of a decision by mutual agreement requires the unanimity of the members participating in the vote. Abstentions do not prevent the adoption of a decision by mutual agreement'.

15 Statement by the euro area Heads of State or Government, Dec. 9, 2011, 6.

16 An emergency exists, 'if the Commission and the ECB both conclude that a failure to urgently adopt a decision to grant or implement financial assistance [...] would threaten the economic and financial sustainability of the euro area', Article 4(4) ESMT.

17 See Article 4(4) ESMT. It should be noted that the emergency procedure only applies in the cases of Articles 13 – 18 ESMT, see Article 5(6) ESMT.

18 ECB, *The European Stability Mechanism*, EBC Monthly Bulletin July 2011, available at http://www.ecb.int/pub/pdf/other/art2_mb201107en_pp71-84en.pdf (last visited Jan. 3, 2019).

19 Article 6(5) ESMT.

20 European Council Summit Conclusions 24/25 March 2011, 24.

21 See Annex 1 and 2 of the ESMT.

22 See Annex 1 and 2 of the ESMT.

bn. in the form of callable capital and guarantees.²³ Last but not least, states in which GDP per capita is less than 75% of the EU average are given a discount in the first twelve years of their membership in the euro area.²⁴

In light of the ESM's strong capital backing (i.e. the combination of paid-in capital and callable capital) credit enhancements, such as the ones put in place under the EFSF due to its structure of guarantees only, will no longer be required.

4. Instruments

As outlined above, the purpose of the ESM is to reduce instability in the euro area by providing financial assistance to its Member States. The financial assistance envisaged under the ESM Treaty can take the form of:

- Loan disbursements²⁵
- Precautionary facilities²⁶
- Facilities to finance the recapitalisation of banks²⁷
- Facilities for the purchase of bonds in the secondary markets²⁸
- Facilities for the purchase of bonds in the primary markets²⁹

Financial assistance will normally be granted in the form of a loan to an ESM Member State. Such loans are subject to strict conditionality: 'The conditionality attached to the ESM loans shall be contained in a macro-economic adjustment programme detailed in the Memorandum of Understanding (MoU), in accordance with Article 13(3)'.³⁰ The financial terms of each ESM loan on the other hand will be specified in a separate financial assistance facility agreement. Other instruments include precautionary facilities,³¹ facilities to finance the recapitalisation of banks,³² facilities for the purchase of bonds in the secondary markets and facilities for the purchase of bonds in the primary markets. It should be noted that the Board of Governors may from time to time review the list of financial assistance instruments and decide to amend it.³³ However, such amendments require mutual agreement.³⁴

23 See Annex 1 and 2 of the ESMT.

24 See European Council Summit Conclusions 24/25 March 2011, 34.

25 See Article 16 ESMT.

26 See Article 14 ESMT.

27 See Article 15 ESMT.

28 See Article 18 ESMT.

29 See Article 17 ESMT.

30 Article 16(2) ESMT.

31 See Article 14 ESMT.

32 See Article 15 ESMT.

33 See Article 19 ESMT.

34 Article 5(6)(i) ESMT.

5. Procedure

The financial support outlined above will follow a complex procedure, starting with the request by a Member State for financial assistance. This request is to be addressed to the chairperson of the ESM's Board of Governors.³⁵

Assessment. Following this request, the Commission, in liaison with the ECB/IMF, will assess three aspects: (1) whether there is a risk to the financial stability of the euro area as a whole and (2) whether public debt in the respective Member State is sustainable.³⁶ 'If, on the basis of the sustainability analysis, it is concluded that a macroeconomic adjustment programme can realistically restore public debt to a sustainable level, the Commission will then assess (3) the actual financing needs of the respective state'.³⁷

Negotiation. Based on this assessment, the BoG shall then entrust the Commission³⁸ to negotiate a macroeconomic adjustment programme, the details of which will be set out in a Memorandum of Understanding (MoU).³⁹ This MoU shall specify the conditionality attached to the financial assistance and be fully consistent with the overall EU framework for economic policy coordination.⁴⁰ At the same time, the Managing Director of the ESM will prepare a draft financial assistance agreement, specifying the complex financial terms and conditions.⁴¹

Signature and approval. The MoU will be signed by the Commission on behalf of the ESM, subject to prior approval by the Board of Governors.⁴² 'The Board of Directors shall then approve the financial assistance facility agreement detailing the financial aspects of the stability support to be granted'.⁴³

Surveillance. Once the first tranche of financial assistance has been disbursed, the Commission – together with the ECB and the IMF – will monitor compliance with the macroeconomic adjustment programme.⁴⁴

6. Dispute Settlement

In case of a dispute between an ESM Member State and the ESM regarding the interpretation or application of the ESM Treaty, the dispute shall first be submitted to the Board of Governors for decision.⁴⁵ Only if the ESM Member State contests the BoG's decision, will the dispute be submitted to the ECJ.⁴⁶ The ECJ's judgment shall be binding on the parties in the procedure, which shall take the necessary measures to comply with the judgment within a period to be decided by the ECJ.⁴⁷ Such a delegation of jurisdiction is possible under Article 273 TFEU, but is not without problems:

35 Article 13(1) ESMT.

36 Article 13(1)(a)-(b) ESMT.

37 ECB, *The European Stability Mechanism*, EBC Monthly Bulletin July 2011, 77. See also Article 13(1)(c) ESMT.

38 Together with the IMF and the ECB.

39 ECB, *The European Stability Mechanism*, EBC Monthly Bulletin July 2011, 77. See also Article 13(3) ESMT.

40 Article 13(3) ESMT.

41 Article 13(3) ESMT.

42 Article 13(4) ESMT.

43 Article 13(5) ESMT.

44 Article 13(7) ESMT.

45 Article 37(2) ESMT.

46 Article 37(2) ESMT.

47 Article 37 ESMT.

This 'partial involvement' of EU institutions, such as the ECJ, in an intergovernmental mechanism has generated a 'complex landscape where judicial protection, respect of fundamental rights and democratic accountability are fragmented and unevenly implemented'.⁴⁸ This has led to frequent calls for reforms, which were eventually heeded in late 2017.

B. Transforming the ESM into an EMF – the Key Changes

On 6 December 2017, the Commission published a set of proposals to reform the euro area. These proposals include, inter alia, the creation of a post of European Finance Minister, a euro area budget-line, the integration of the fiscal compact into the Union legal framework and the establishment of a European Monetary Fund. The latter will be at the centre of this section. The Commission does not intend to set up the EMF anew from scratch. Rather, the new EMF is to be built on the well-established structure of the ESM.⁴⁹ The new EMF will thus succeed to and replace the ESM,⁵⁰ with the latter's current financial and institutional structure essentially preserved.⁵¹ However, the new institution will also take on a number of additional responsibilities/functions. Moreover, some further modifications are necessitated by the integration of the mechanism into the EU legal framework. These are set out in the *Draft Statute of the EMF*⁵² annexed to the *Draft Regulation on the establishment of the EMF* and will be analysed in the next section.

1. The Key Changes

a. Negotiating and Monitoring Reform Programmes

So far negotiating reform programmes and monitoring compliance was the task of 'the institutions', i.e. the Commission, the ECB and the IMF. Under the new proposal, the IMF – despite its long-standing experience – will no longer be involved. All references to the IMF are deleted in the new draft. Interestingly, the role exercised so far by the IMF is not passed on to the EMF. Rather 'conditionality is for the Commission to keep. According to Article 13 of the draft EMF statute, conditionality is negotiated by the Commission, in liaison with the ECB, and 'in cooperation with the EMF'. 'Cooperation' is admittedly a very weak form of involvement, especially if it is compared with the phrase 'together with' that previously described IMF involvement under the ESM Treaty. Moreover, MoUs shall be signed by both the Commission and the EMF. In contrast, under the ESM Treaty, MoUs were signed by the Commission 'on behalf' of the ESM. The phrase 'on behalf', establishing an agent-principal relation between the Commission and the ESM, is now deleted, meaning that the Commission becomes legally a co-owner of EMF conditionality. Finally, under the

48 COM (2017) 827 final, supra note 6, 3.

49 In legal terms, it will succeed to and replace the ESM, including in its legal position, with all its rights and obligations.

50 See Article 2(1) COM (2017) 827 final, supra note 6, at 26; Article 2(1) provides: 'The EMF shall succeed to and replace the European Stability Mechanism (ESM), including its legal position and assuming all rights and obligations. [...].'

51 COM (2017) 827 final, supra note 6, at 5.

52 The *Statute of the EMF* forms an integral part of the Regulation, see Article 1(2) of said Regulation.

proposed EMF statute, compliance with conditionality is monitored solely by the Commission, in liaison with the ECB. No role is explicitly provided for the EMF in this critical phase'.⁵³

In conclusion, the proposed changes significantly strengthen the role of the European Commission. Given the latter's self-perception as an increasingly political actor, it is likely that we will see a softening of reform conditions in the future due to political compromises.⁵⁴

b. Common Backstop to the SRF/Lender of Last Resort

The EMF would also take over certain functions in the banking union. It would provide the common backstop to the Single Resolution Fund (SRF) and act as a lender of last resort in order to facilitate the orderly resolution of distressed banks. For this purpose, the EMF will be able to provide credit lines or guarantees to secure measures by the Single Resolution Board (SRB).⁵⁵ In this way, the EMF will supplement the system of financing the orderly resolution of banks in the banking union: The 'liability cascade' put in place envisages a primary liability of shareholders and creditors ('bail-in'). If that proves insufficient, then the SRF, worth € 55 bn. and financed by bank levies, will be activated. Only if the SRF proves insufficient, too, then recourse to the EMF as ultima ratio would be possible. The proposed EMF instrument thus implements the options of the SRB already set out in Article 74 of Regulation 806/2014. Pursuant to Article 74, the SRB shall 'where the amounts raised or available in accordance with Articles 70 and 71 are not sufficient to meet the Funds' obligations ... contract for the fund financial arrangements, including, where possible, public financial arrangements, regarding the immediate availability of additional financial means to be used in accordance with Article 76 ...'.⁵⁶

In sum, the EMF would provide the common last-resort backstop to the SRF. The underlying rationale is to provide 'enhanced confidence to all parties concerned with regard to the credibility of the actions to be taken by the SRB and to increase the capacity of the SRF'.⁵⁷

c. Changes to the Decision-Making Mechanism

In terms of governance, the Commission proposal includes the possibility for faster decision making in certain situations. For instance, a so-called reinforced qualified majority, which requires 85% of the votes, suffices for specific decisions on stability support, disbursements and the deployment of the financial backstop. However, unanimity voting will be kept for all major decisions with financial impact, such as capital calls.

These new voting rules deserve a closer examination. They are set out in Article 4 of the draft statute of the EMF:

(...)

53 Michael Ioannidis, *Towards a European Monetary Fund: Comments on the Commission's Proposal*, EU Law Analysis Blog, Jan. 31, 2018, available at <http://eulawanalysis.blogspot.de/2018/01/towards-european-monetary-fund-comments.html> (last visited Jan. 3, 2019).

54 The non-participation of the IMF in the future only serves to underline this impression.

55 See Article 22(1) of the Draft Statute of the EMF, European Commission, ANNEX to the Proposal for a Council Regulation on the establishment of the European Monetary Fund, COM (2017) 827 final (Dec. 6, 2017), at 13.

56 Article 74, Regulation 806/2014.

57 COM (2017) 827 final, *supra* note 6, at 4.

2. The decisions of the Board of Governors and the Board of Directors shall be taken by unanimity, reinforced qualified majority, qualified majority or simple majority as specified in this Regulation. In respect of all decisions, a quorum of two thirds of the EMF Members with voting rights representing at least two thirds of the voting rights must be present.
3. Abstentions by members present in person or represented shall not prevent the adoption of a decision requiring unanimity.
4. The adoption of a decision by reinforced qualified majority requires 85% of the votes cast.
5. The adoption of a decision by qualified majority requires 80% of the votes cast.
6. The adoption of a decision by simple majority requires a majority of the votes cast.
7. The voting rights of each EMF Member, as exercised by its representative on the Board of Governors or Board of Directors, shall be equal to the number of shares allocated to it in the authorised capital stock of the EMF. (...).⁵⁸

Articles 4(2) and 4(4) thus introduce a *reinforced qualified majority*, which requires 85% of the votes cast. According to Article 5(7), the Board of Governors shall take the following decisions by such a reinforced qualified majority:

(...)

- (a) provide stability support to EMF Members, including the policy conditions as stated in the memorandum of understanding referred to in Article 13(3), and to establish the choice of instruments and the financial terms and conditions, in accordance with Articles 14 to 18;
- (b) request the Commission to negotiate, in liaison with the ECB, the economic policy conditions attached to each financial assistance, in accordance with Article 13(3);
- (c) change the pricing policy and pricing guideline for financial assistance, in accordance with Article 20.⁵⁹

In other words, fundamental decisions by the EMF, such as the *provision of stability support* no longer require a unanimous vote as was the case under the old Article 5(6)(f) ESMT; rather a reinforced qualified majority will suffice in the future. The same is true for the decision to request the Commission to negotiate the economic policy conditions attached to each financial assistance, as well as for the decision to change the pricing policy for financial assistance.⁶⁰

Conditions are lowered even further under the new emergency procedure set out in Article 3(2) of the draft Regulation. It provides:

- (2) Where circumstances require the urgent provision of stability support to an EMF Member in accordance with Article 16, decisions may be taken by an emergency procedure. In such an event, the decision taken by the Board of Governors or the Board of Directors shall be transmitted to the Council immediately after its adoption together with the reasons on which it is based. Upon request of the Chairperson, the Council shall discuss the decision, within 24 hours of its

⁵⁸ Article 4(2)-(8) of the Draft Statute of the EMF, *supra* note 55, at 2.

⁵⁹ Article 5(7)(a)-(c) of the Draft Statute of the EMF, *supra* note 55, at 3.

⁶⁰ See Article 5(7)(b)-(c) of the Draft Statute of the EMF, *supra* note 55, at 3.

transmission. The Council may object to the decision. In the event of an objection, *the Council may itself adopt another decision on the matter*, or refer the matter back to the Board of Governors for another decision.

[...]

(4) Where the Council acts in accordance with paragraphs 1 or 2, [...] the votes of members of the Council representing Member States whose currency is not the euro shall be suspended. A qualified majority shall be defined in accordance with Article 238(3) TFEU.⁶¹

In other words, if the Council objects to a decision made by the Board of Governors, it can adopt another (diverging) decision on the matter. This decision is made on the basis of the qualified majority rules of Article 238(3) TFEU (55%/65%).⁶²

In summary, under the old system unanimity used to be the rule, whereas the 85% threshold was the exception ('emergency procedure'). In contrast, under the new system, the 85% threshold becomes the rule and the new exception for emergency cases lowers requirements even further (55%/65%).

d. Modified Conditions for Activating Stability Support

Moreover, the Commission proposal modifies the conditions under which stability support can be activated. Article 12(1) of the draft statute stipulates that the EMF may provide stability support if this is 'indispensable to safeguard the financial stability of the euro area *or* of its Member States'. In contrast, under the old ESM Treaty such support could only be provided if necessary 'to safeguard the financial stability of the euro area *as a whole and* of its Member States'.⁶³ Although only four words have been changed, the implications of this modification should not be underestimated. In the future, financial support could thus be provided even if it is only the financial stability of a single Member State that is in danger, while so far the stability of the euro area as a whole had to be at stake. Such a softening of the conditions for stability support might increase the incentives for moral hazard by individual Member States.

2. Conclusion: 'Honni soit qui mal y pense'

In conclusion, the draft proposal contains a plethora of changes. Apart from the provisions on the common backstop to the Single Resolution Fund (SRF), these changes are often difficult to detect – sometimes only a few words are changed and sometimes they result from complex cross-reference. Hence, one is left guessing: Is this a case of suboptimal legal drafting or a deliberate strategy?

III. Integrating the ESM into the EU legal framework – a critical analysis

⁶¹ Article 3(2) and 3(4) COM (2017) 827 final, *supra* note 6, at 27.

⁶² Note that the votes of the members of the Council representing Member States whose currency is not the euro shall be suspended, see Article 3(4) COM (2017) 827 final, *supra* note 6, at 5.

⁶³ Articles 3 and 12 ESMT.

This section will critically analyse the proposed integration of the ESM into the EU legal framework. In particular, it will examine the *rationale* for integrating the ESM into the framework of the European Treaties. It will then analyse whether such integration is legally possible - in other words, whether the EU has a *competence* to do so. Finally, it will turn to the *wider implications* of such integration.

A. The Rationale for Integrating the ESM into the EU Legal Framework

So far the ESM constitutes an anomaly in the EU system. It is an intergovernmental institution based on an international treaty between the nineteen euro area Member States rather than an EU institution. At the same time it is – at least to a certain extent - integrated into the institutional framework of the EU: For instance, the ECJ is tasked with solving disputes between the ESM and an ESM Member or between ESM Members.⁶⁴ Such a conferral of jurisdiction is possible under Article 273 TFEU. Moreover, the Council must approve macroeconomic adjustment programmes negotiated within the framework of an ESM-programme, before the respective ESM bodies can adopt it formally.

The ESM was also authorised by its Member States to delegate certain tasks to other European institutions, such as the Commission and the ECB.⁶⁵ For instance, the Commission is responsible for (a) negotiating the conditions and (b) monitoring compliance with the macroeconomic adjustment programmes. This ‘partial involvement’ of EU institutions in an intergovernmental mechanism has generated a ‘complex landscape where judicial protection, respect of fundamental rights and democratic accountability are fragmented and unevenly implemented’.⁶⁶ This created a bizarre and opaque situation. Hence, the underlying idea of ‘integrating the ESM into the Union legal framework’ is to end this anomaly and make the institutional structure of EMU more coherent. European issues, in particular those with a direct reference to the euro area, should be dealt with in the EU Treaties. Otherwise we will see a further fragmentation of legal sources, which will eventually reduce transparency and legitimacy. In the long run, such fragmentation could also weaken European institutions and the EU in general.

From a practical perspective, integrating the ESM into the EU legal framework also has a number of advantages: For instance, EU institutions could be directly involved in the daily operations of the ESM; recourse to the complex concept of ‘Organleihe’ would therefore no longer be necessary. Moreover, ESM personnel would be subject to the [Staff Regulations of Officials and the Conditions of Employment of Other Servants](#) of the European Union. This would clarify their status and simplify their mobility between the European institutions. Perhaps even more important, the integrated ESM would be fully subjected to the jurisdiction of the ECJ, while so far the latter could only exercise limited jurisdiction over the ESM.⁶⁷

64 See Article 37(3) ESMT.

65 See Council Document 12114/11 of 24 June 2011 which provides: ‘The representatives of the Governments of the Member States of the European Union agree that the ESM Treaty include provisions for the European Commission and the European Central Bank to carry out the tasks as set out in that Treaty’.

66 COM (2017) 827 final, *supra* note 6, at 3.

67 See Article 37(3) ESMT.

In summary, the integration of the ESM into the EU legal framework would make the institutional structure of EMU more coherent and transparent. It would end an anomalous situation that resulted from 'a patchwork of decisions taken to face an unprecedented crisis'.⁶⁸

B. The Competence for Integrating the ESM into the EU Legal Framework

One of the fundamental principles of EU law is the principle of conferral established in Article 5(2) TEU. Under this principle, the EU shall only act within the limits of the powers conferred upon it by the Member States in the Treaties. It highlights that the EU – as a supranational institution – lacks a so-called 'competence-competence', i.e. a power to create its own competences (this jurisprudential doctrine is often referred to by using the German term 'Kompetenz-Kompetenz'). Practically speaking this means that the EU – whenever enacting a new legislative act – has to rely on a specific legal base in the Treaties, implied powers⁶⁹ or the subsidiary competence enshrined in Article 352 TFEU.

This section will therefore analyse the potential legal bases that might justify the establishment of the EMF.⁷⁰ It will first analyse *specific* legal bases, such as Article 122(2) TFEU et al. In case none of them applies to the case under consideration, we will turn to the *subsidiary* competence enshrined in Article 352 TFEU.

1. Specific Legal Bases

The issue of whether or not the EU has the power to establish a financial stability mechanism was addressed – albeit indirectly – by the ECJ in *Pringle* (2012). In this case, the ECJ held that the establishment of the ESM constitutes an economic policy measure. Articles 2(3) and 5(1) TFEU, however, restrict the role of the Union in the area of economic policy to the adoption of mere coordinating measures. Hence, the provisions of the TEU and the TFEU *do not confer any specific power* on the Union to establish a stability mechanism:

'... as regards whether Decision 2011/199 affects the Union's competence in the area of the coordination of the Member States' economic policies, it must be observed that, since Articles 2(3) and 5(1) TFEU restrict the role of the Union in the area of economic policy to the adoption of coordinating measures, the provisions of the TEU and TFEU do not confer any specific power on the Union to establish a stability mechanism of the kind envisaged by Decision 2011/199'.⁷¹

Nonetheless, the Court goes on to examine – at least cursorily – Article 122(2) TFEU and Article 143(2) TFEU. It quickly concludes, though, that none of them is applicable in the case at hand:

'Admittedly, Article 122(2) TFEU confers on the Union the power to grant ad hoc financial assistance to a Member State which is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control. However, as emphasised by the European Council in recital 4 of the preamble to Decision 2011/199, Article 122(2) TFEU does

⁶⁸ COM (2017) 827 final, supra note 6, at 3.

⁶⁹ Dogmatically speaking, 'implied powers' are also considered to be 'conferred' within the meaning of Article 5(2) TEU, see judgment of 31 March 1971, AETR, C 22/70, EU:C:1971:32, para. 15, 19.

⁷⁰ And hence the enactment of the underlying legislative act, i.e. the 'Regulation on the establishment of the European Monetary Fund'.

⁷¹ Case C-370/12, *Pringle v. Government of Ireland and Others*, ECLI:EU:C:2012:756, para. 64.

not constitute an appropriate legal basis for the establishment of a stability mechanism of the kind envisaged by that decision. The fact that the mechanism envisaged is to be permanent and that its objectives are to safeguard the financial stability of the euro area as a whole means that such action cannot be taken by the Union on the basis of that provision of the TFEU'.⁷²

The second provision examined - Article 143 TFEU - is not applicable either. It only allows for financial assistance for Member States whose currency is not the euro.⁷³

In summary, none of the specific legal bases analysed can be invoked to justify the establishment of the EMF. Hence, recourse to the subsidiary competence under Article 352 TFEU is possible.⁷⁴

2. Article 352 TFEU

It therefore comes as no surprise that the European Commission bases its proposal for a Council Regulation on Article 352 TFEU. This article - often referred to as the 'flexibility clause' - stipulates:

If action by the Union should prove necessary, within the framework of the policies defined in the Treaties, to attain one of the objectives set out in the Treaties, and the Treaties have not provided the necessary powers, the Council, acting unanimously on a proposal from the Commission and after obtaining the consent of the European Parliament, shall adopt the appropriate measures. Where the measures in question are adopted by the Council in accordance with a special legislative procedure, it shall also act unanimously on a proposal from the Commission and after obtaining the consent of the European Parliament.

In other words, for Article 352 TFEU to apply, the following conditions must be met: (a) the measure must be within the framework of EU policies; (b) the envisaged measure must be necessary (c) to attain one of the EU's objectives; (d) no specific legal basis exists in the treaties ('subsidiarity'). We will now examine whether these conditions are met in the case under consideration.

a. Within the Framework of Union Policies

First of all, the establishment of the EMF must constitute an action by the Union within the framework of the policies defined in the treaties. This is undoubtedly the case. The ECJ has already decided in *Pringle* (see above) that the establishment of a stability mechanism is an economic policy measure, which falls within the scope of application of the EU Treaties (see Article 120 TFEU et seq.):

'In the light of the objectives to be attained by the stability mechanism the establishment of which is envisaged by Article 1 of Decision 2011/199, the instruments provided in order to achieve those objectives and the close link between that mechanism, the provisions of the TFEU relating to economic policy and the regulatory framework for strengthened economic governance of the

⁷² Id. para. 65.

⁷³ The ECJ held: 'Further, even if Article 143(2) TFEU also enables the Union, subject to certain conditions, to grant mutual assistance to a Member State, that provision covers only Member States whose currency is not the euro', Case C-370/12, *supra* note 71, para. 66.

⁷⁴ Implied powers are evidently not applicable in the case under consideration.

Union, it must be concluded that the establishment of that mechanism falls within the area of economic policy'.⁷⁵

b. Attainment of an EU Objective

Moreover, the measure must be necessary to attain one of the objectives of the EU. In the case under consideration, the objective to be attained is the establishment of an economic and monetary union whose currency is the euro, Article 3(4) TEU. But is the establishment of a EMF really necessary to attain said objective? This question will be analysed in the next section.

c. Necessity

The interpretation of the term 'necessary' is a more complicated endeavour. Since the establishment of the ESM six years ago, the euro area has been equipped with a stability mechanism to help Member States in crisis and to safeguard stability in the euro area as a whole. Hence, one could argue that the establishment of the EMF by means of an EU Regulation is not 'necessary' anymore.

Or to put it more generally: Can an EU measure still be considered 'necessary', when the Member States have already taken collective measures outside the EU legal framework (e.g. the conclusion of an international treaty) to attain the objective?

Some argue that in such cases EU action is no longer 'necessary' within the meaning of Article 352 TFEU.⁷⁶ In support of their view, they point to the radiating effect of the general subsidiarity principle as enshrined in Article 5(3) TEU. This radiating effect needs to be taken into account when interpreting the term 'necessity'. Such an interpretation leads them to conclude that EU action can no longer be regarded as 'necessary' within the meaning of Article 352 TFEU, when the respective objective has already been attained by Member State measures.⁷⁷ In such a case, there is no longer a discrepancy between the objective and the realisation of the objective.⁷⁸

Others fundamentally disagree. They argue that collective action by Member States is a clear indication that a uniform regulation is necessary to attain an EU objective.⁷⁹ Moreover, there is a qualitative difference between the attainment of an objective by Member States on the one hand and by the EU on the other: While EU action ultimately leads to legislation that is characterised by the principle of supremacy and subject to uniform judicial control by the ECJ, collective action by the Member States results in international treaties. The latter, however, lack the above-mentioned characteristics and hence constitute a much weaker form of legal safeguard. Furthermore, states can withdraw from international treaties relatively easy and thereby escape their obligations.⁸⁰

⁷⁵ Case C-370/12, *supra* note 71, para. 60.

⁷⁶ See e.g., Fritz Behrens, *RECHTSGRUNDLAGEN DER UMWELTPOLITIK DER EUROPÄISCHEN GEMEINSCHAFT* 278 (1976).

⁷⁷ Ivo Schwartz, *EG-Rechtsetzungsbefugnisse – insbesondere nach Artikel 235 – ausschließlich oder konkurrierend?*, EuR 32 (1976).

⁷⁸ Behrens, *supra* note 76, at 278.

⁷⁹ Marcus Geiss, *Art. 352 TFEU*, in *EU KOMMENTAR*, 18 (Jürgen Schwarze ed., 2012).

⁸⁰ Richard H. Lauwaars, *Artikel 235 als Grundlage für die flankierenden Politiken im Rahmen der Wirtschafts- und Währungsunion*, EuR 104 (1976).

The latter approach is more convincing for the following reasons: First, there is – as outlined above – a qualitative difference between the attainment of an objective by Member States and by the EU. Moreover, the first approach suffers from dogmatic flaws: It mixes up ‘necessity’ within the meaning of Article 352 TFEU with the requirements of the general subsidiarity principle enshrined in Article 5(3) TEU. Both aspects, however, need to be clearly separated: Only once the competence *establishing* ‘necessity’ for EU action is given, can the *exercise* of this competence be measured against the general subsidiarity principle.

While the latter approach is generally more convincing, one must not forget that the case under consideration is special insofar as the Member States have acted outside the EU legal framework but nevertheless conferred jurisdiction upon the ECJ for certain disputes. Hence one of the key reasons for allowing parallel action by the EU is not given in the case under consideration. On that basis one might deny the existence of ‘necessity’. However, such an interpretation would ignore all the other essential features of EU law mentioned above. Moreover, there is the risk that Member States could escape their obligations by unilaterally withdrawing from the international treaty.

In conclusion, it can therefore be argued that action by the EU is necessary in the case under consideration, despite the fact that the Member States have already taken measures in the form of the ESMT.

d. No Specific Legal Base in the Treaties

Given the subsidiary nature of Article 352 TFEU, it only applies when no specific legal base in the EU Treaties exists. As already outlined above this criterion is met in the case at hand. In *Pringle*, the ECJ held that Articles 2(3) and 5(1) TFEU restrict the role of the Union in the area of economic policy to the adoption of mere coordinating measures. Hence, the provisions of the TEU and the TFEU *do not confer any specific power* on the Union to establish a stability mechanism:

‘[...] as regards whether Decision 2011/199 affects the Union’s competence in the area of the coordination of the Member States’ economic policies, it must be observed that, since Articles 2(3) and 5(1) TFEU restrict the role of the Union in the area of economic policy to the adoption of coordinating measures, the provisions of the TEU and TFEU do not confer any specific power on the Union to establish a stability mechanism of the kind envisaged by Decision 2011/199’.⁸¹

e. Further Aspects: Unwritten Conditions

According to the jurisprudence of the ECJ, Article 352 TFEU also contains an unwritten condition. In Opinion 2/94⁸² the Court held, that the flexibility clause ‘being an integral part of an institutional system based on the principle of conferred powers, *cannot serve as a basis for widening the scope of [Union] powers* beyond the general framework created by the provisions of the Treaty as a whole and, in particular, by those that define the tasks and the activities of the [Union]. On any view, [Article 352] cannot be used as a basis for the adoption of provisions whose effect would, in substance, be to amend the treaty without following the procedure which it provides for that purpose’ (*Emphasis added*).⁸³ This jurisprudence was later confirmed in Opinion 2/13. Here the

⁸¹ Case C-370/12, *supra* note 71, para. 64.

⁸² Opinion C-2/94, ECLI:EU:C:1996:140.

⁸³ *Id.* para. 30.

Court held that accession to the ECHR ‘... would have entailed a substantial change in the existing Community system for the protection of human rights [...] Such a modification of the system for the protection of human rights in the Community, with equally fundamental institutional implications for the Community and for the Member States, would have been of constitutional significance and would therefore have been such as to go beyond the scope of Article 235 of the EC Treaty (which became Article 308 EC), a provision now contained in Article 352(1) TFEU, which could have been brought about only by way of amendment of that Treaty’.⁸⁴

Against this background, the scope of application of Article 352 TFEU needs to be restricted to cases of intrinsic Treaty supplementation. Hence, a distinction has to be made between admissible Treaty *supplementation* (covered by Article 352 TFEU), and inadmissible Treaty *amendment* (covered only by Article 48 TEU).⁸⁵ From a dogmatic perspective, this element is regarded as a negative intrinsic requirement deduced by means of a teleological reduction.⁸⁶

The key question therefore is whether the envisaged integration of the ESM into the EU legal framework, i.e. the takeover of the ESM's tasks by the EU, leads to a treaty *amendment* or a mere treaty *supplement*. This is decided by the Court on the basis of an analysis of the effects that the adoption of the provision would have.⁸⁷ The establishment of the EMF would lead to a takeover by the EU of powers to safeguard financial stability in the euro area – a task so far exercised by the euro area Member States. This takeover would also include the transfer of the right to decide on the use of the financial resources provided by the euro area Member States.⁸⁸ In this way, the EU's coordinating competences in the field of economic policy would be substantially extended: The Union would henceforth be equipped with significant decision making and implementing powers regarding the provision of stability support. Whether such an extension of Union powers is compatible with the ECJ's jurisprudence seems questionable. Indeed, it seems that a future EMF which employs strict (and binding) conditionality and which has the right to decide⁸⁹ on the provision of stability support ‘goes beyond the distribution of powers to the Union, which in the field of economic policy has coordinating competences only’.⁹⁰

This appears to be confirmed by earlier statements of the ECJ in *Pringle*, where the Court held that ‘[...] the ESM is not concerned with the coordination of the economic policies of the Member States, but rather constitutes a financing mechanism. Under Articles 3 and 12(1) of the ESM Treaty, the purpose of the ESM is to mobilise funding and to provide financial stability support to ESM Members who are experiencing, or are threatened by, severe financing problems. While it is true that, under Article 3, Article 12(1) and the first subparagraph of Article 13(3) of the ESM Treaty, the financial assistance provided to a Member State that is an ESM Member is subject to strict conditionality, appropriate to the financial assistance instrument chosen, which can take the form of a macro-economic adjustment programme, the conditionality prescribed nonetheless *does not*

84 Opinion C-2/13, ECLI:EU:C:2014:2454, para. 38.

85 Matthias Rossi, *Art. 352*, in: EUV/AEUV KOMMENTAR, 74 (Christian Calliess/Matthias Ruffert eds., 2016).

86 *Id.* at 74.

87 *Id.* at 74.

88 For details see below, point 3.b.

89 For details see below, point 3.b.

90 Ioannidis, *supra* note 53.

constitute an instrument for the coordination of the economic policies of the Member States [...] (Emphasis added).⁹¹

In summary, the establishment of the EMF seems to be a case of Treaty amendment and not Treaty supplementation, for which Article 48 TEU would be the appropriate legal base and not Article 352 TFEU.

f. Conclusion

In conclusion, it appears highly questionable whether Article 352 TFEU can be invoked as a legal basis for integrating the ESM into the EU legal framework. Yet not only issues of competence pervade the proposal. Even if the Commission nonetheless decides to go ahead with its proposal, it will encounter further problems as outlined in the next section.

C. The Wider Implications of Integrating the ESM into the EU Legal Framework

1. More Democratic? Accountability Towards the European Parliament

One of the guiding principles of the Commission's reform proposals was to strengthen democratic accountability:

'Completing EMU also means greater political responsibility and transparency about who decides what and when at the different levels. This requires bringing the European dimension of decision-making closer to citizens and more to the forefront of national debates and making sure that both national parliaments and the European Parliament have sufficient powers of oversight'.⁹²

Hence, it comes as no surprise that the draft Regulation on the establishment of the EMF seeks to make the EMF accountable to the European Parliament. For instance, Article 5 of the draft Regulation provides that the EMF shall submit annual reports on the execution of its tasks and respond to oral and written questions put to it by the European Parliament. There are, however, 'two difficulties with such an accountability scheme. First, these are only reporting obligations and do not allow Parliament any influence in the actual decision-making of the EMF. Second, the European Parliament may not be an adequate forum for EMF accountability purposes in the first place. Members of the EMF are only euro area Members, but in the European Parliament all EU Member States are represented, not only those that have adopted the euro. The EMF is thus made accountable to an institution with a different composition than the Members that provide for its capital'.⁹³ Whether the proposal really contributes to making EMU more democratic is thus questionable.

2. More Efficient? The New Decision-Making Procedure

Another important objective of the Commission's proposal was to make the EMF more efficient by speeding-up the decision making process. For this purpose, the draft introduces the concept of a *reinforced qualified majority*. It requires 85% of the votes cast,⁹⁴ whereby the voting rights of each

⁹¹ Case C-370/12, *supra* note 71, para. 110-111.

⁹² COM (2017) 827 final, *supra* note 6, at 3.

⁹³ See Ioannidis, *supra* note 53.

⁹⁴ See Articles 4(2) and (4) of the Draft Statute of the EMF, *supra* note 55, at 3.

Member State are equal to the number of shares allocated to it in the authorised capital stock of the EMF.⁹⁵ Hence, large States, such as Germany hold 27% of all votes while smaller states, such as Austria, are only allocated 3% of the votes.

Pursuant to Article 5(7) of the draft Statute, the Board of Governors shall take the following decisions by *reinforced qualified majority*:

(...)

(a) provide stability support to EMF Members, including the policy conditions as stated in the memorandum of understanding referred to in Article 13(3), and to establish the choice of instruments and the financial terms and conditions, in accordance with Articles 14 to 18;

(b) request the Commission to negotiate, in liaison with the ECB, the economic policy conditions attached to each financial assistance, in accordance with Article 13(3);

(c) change the pricing policy and pricing guideline for financial assistance, in accordance with Article 20;

In other words, fundamental decisions by the EMF, such as the provision of stability support, no longer require a unanimous vote (as was the case under the old Article 5(6)(f) ESMT); rather a reinforced qualified majority will suffice in the future. The same is true for the decision to request the Commission to negotiate the economic policy conditions attached to each financial assistance, as well as for the decision to change the pricing policy for financial assistance.⁹⁶

So does this amount to a major innovation enhancing the efficiency of the mechanism? We must not forget that even under the old system these decisions could be taken by a qualified majority of 85%. However, this was only possible under exceptional circumstances ('emergency situations'): When both the Commission and the ECB had concluded that a failure to urgently adopt a decision to grant financial assistance would threaten the economic and financial sustainability of the euro area, then the emergency voting procedure could be used. What used to be the exception (85% threshold) now becomes the rule. This will affect small states more negatively, as they can now be outvoted. Big states, such as Germany with a 27% share of all votes, retain their veto right, at least *prima facie*. On closer examination, it turns out that they, too, will lose their veto right in case the new emergency procedure applies.⁹⁷ This new procedure is codified in Articles 3(2) and (4), which provide:

(2) Where circumstances require the urgent provision of stability support to an EMF Member in accordance with Article 16, decisions may be taken by an emergency procedure. In such an event, the decision taken by the Board of Governors or the Board of Directors shall be transmitted to the Council immediately after its adoption together with the reasons on which it is based. Upon request of the Chairperson, the Council shall discuss the decision, within 24 hours of its transmission. The Council may object to the decision. In the event of an objection, *the Council may itself adopt another decision on the matter*, or refer the matter back to the Board of Governors for another decision.

⁹⁵ Article 4 of the Draft Statute of the EMF, *supra* note 55, at 3.

⁹⁶ See Article 5(7)(b)-(c) of the Draft Statute of the EMF *supra* note 55, at 3.

⁹⁷ An interesting question that arises in this context is who will decide that an emergency situation does exist. In contrast to the ESMT, the draft does not specify this.

[...]

(4) Where the Council acts in accordance with paragraphs 1 or 2, [...] the votes of members of the Council representing Member States whose currency is not the euro shall be suspended. A qualified majority shall be defined in accordance with Article 238(3) TFEU.⁹⁸

Under these provisions even big states such as Germany or France would lose their veto, as the Council decides on the basis of the qualified majority rules of Article 238(3) TFEU (55%/65%)⁹⁹ and *not* the voting rules laid down in Article 4(4) of the draft Regulation (85%).¹⁰⁰ This loss of veto power will raise complex constitutional issues in a number of Member States, such as Germany, where the Constitutional Court had recently decided that the loss of a veto right would not be compatible with the budgetary sovereignty of the German Parliament.¹⁰¹ The principle of democracy - as enshrined in Article 20 of the German Basic law - requires that the German Parliament remains the place in which autonomous decisions on revenue and expenditure are made, including those with regard to international liabilities.¹⁰² However, this will no longer be the case once the veto right is lost. This would interrupt the democratic legitimization nexus between the budgetary overall responsibility of the national parliament and the ESM/EMF. It would shift the democratic decision making process to the supranational level, where the European Parliament still plays a marginal role only (see above).¹⁰³

In sum, under the old system unanimity used to be the rule, whereas the 85% threshold was the exception ('emergency procedure'). In contrast, under the new system the 85% threshold becomes the rule and the new exception lowers requirements even further (55%/65%). While that may accelerate the procedure and thereby enhance efficiency, it raises other serious problems: Most importantly, the new decision making procedure will lead to the loss of a veto right. This, in turn, has serious democratic implications and hence raises complex constitutional issues in states such as Germany. In light of these implications, it is highly questionable whether individual Member States and in particularly Germany will - and indeed can - support the proposal.

3. More Democratic? Withdrawal from an International Treaty v. Repealing an EU Regulation

The integration of the ESM into the EU legal framework will bring about another important legal change. As the ESMT constitutes an international treaty, a Member State can *unilaterally* withdraw from it according to Article 56 et seq. VCLT. Such unilateral withdrawal is no longer possible, once

⁹⁸ Article 3(2) and 3(4) COM (2017) 827 final, supra note 6, at 27.

⁹⁹ Note that the votes of the members of the council representing Member States whose currency is not the euro shall be suspended, see Article 3(4) COM (2017) 827 final, supra note 6, at 5.

¹⁰⁰ See Article 3(4) COM (2017) 827 final, supra note 6, at 27.

¹⁰¹ See 2 BvR 1390/12, Leitsatz: No. 4: 'Die haushaltspolitische Gesamtverantwortung des Deutschen Bundestages setzt voraus, dass der Legitimationszusammenhang zwischen dem Europäischen Stabilitätsmechanismus und dem Parlament unter keinen Umständen unterbrochen wird. [...] sicherzustellen, dass die gegenwärtig gegebene und verfassungsrechtlich geforderte Vetoposition der Bundesrepublik Deutschland auch unter veränderten Umständen erhalten bleibt' ['In accordance with the general competence of the Parliament of German Federal Parliament to determine budgetary policy, the democratic legitimization of the European Stability Mechanism through the Parliament may not be impeded [...] in order to guarantee that the currently existing and constitutionally required veto right of the Federal Republic of Germany remains intact also under changed circumstances.'].
¹⁰² See 2 BvR 1390/12.

¹⁰³ The role of national parliaments in the EMF is marginal, too, see Article 6 of the Draft COM (2017) 827 final.

the ESM is integrated into the EU legal framework. According to the *actus contrarius* doctrine, *unanimity* would be required to repeal the Regulation on the establishment of the EMF.¹⁰⁴ Thus, Member States should be aware that once the EMF is established and integrated into the EU legal framework it will be very difficult to 'escape' its obligations.

IV. Conclusion

The Commission's proposal faces a plethora of problems: First of all, it seems highly questionable whether the EU has indeed the competence to integrate the ESM into the EU legal framework. In particular, the invocation of Article 352 TFEU as legal base is not convincing for the reasons outlined above.

Second, the integration of the ESM into the EU legal framework will not render EMU any more democratic. The European Parliament continues to play a marginal role only – all it can do is to request annual reports by the EMF and to demand a hearing of the Managing Director.

Third, efficiency may indeed be increased by changing the decision-making procedure. However, it comes at a cost of democratic legitimacy: The principle of democracy – as enshrined, *inter alia*, in Article 20 of the German Basic Law – requires that the German Parliament remains the place in which autonomous decisions on revenue and expenditure are made, including those with regard to international liabilities. However, this will no longer be the case once the veto right is lost (e.g. during the emergency procedure). This would interrupt the democratic legitimization nexus between the budgetary overall responsibility of the national parliament and the ESM/EMF. It would shift the decision making process to the supranational level, where the European Parliament still plays a marginal role only. In light of these implications it is highly questionable whether the individual Member States and in particularly Germany will – and indeed can – support the proposal, which requires unanimity.¹⁰⁵

104 Provided Article 352 TFEU is indeed used – as proposed by the Commission – as the legal base for enacting said Regulation.

105 At least if one accepts the Commission's view that Article 352 TFEU is the appropriate legal base.