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The Recovery Fund: Legal Issues

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1. Open points

In the video conference of April 23 the European Council (EC) agreed, with the consent of all Member States (MS), to establish a Recovery Fund (RF, also the Fund) dedicated to overcoming the unprecedented coronavirus crisis. As we learn from the Conclusions of the conference drawn by the EC President, it was also agreed that (i) the RF is needed and urgent, that (ii) it shall be of a sufficient magnitude and targeted to the sectors and geographical areas most affected; and that (iii) the Commission is delegated to analyse the exact needs and to urgently come up with an appropriate proposal.

The guidelines provided by the EC are certainly relevant. Yet, the basic points of the new instrument are still to be defined, which makes the European Commission's task a rather difficult one. The following remarks present some legal issues which the Commission will have to consider. They bear, in particular, on the general framework, the financing and the disbursements of the RF.

2. The general framework

It appears that the RF is to be instituted within European Union law and by means of the devices provided by this law. Thus, the Fund will not be based on an extra-EU agreement, as in the case of the European Stability Mechanism (ESM). It also appears that its creation will not entail a revision of the EU Treaties, which would not be compatible with the urgency placed in the project.

Once the recourse to a revision procedure is ruled out, articles 122.2 and 352 of the TFEU can offer a suitable basis for the establishment of the Fund. As is well known, the first norm (art. 122.2) entitles the European Union to provide financial assistance to MS facing severe difficulties due to natural disasters or exceptional circumstances beyond their control. In its turn, the second norm (art. 352) allows the European Union to adopt acts needed to attain objectives laid down in the Treaties when the necessary powers are lacking.

Recourse to art. 122.2 was made for establishing the European Financial Stabilisation Mechanism (EFSM) in 2010 as a response to the economic and financial crisis of that time (regulation 39775/EEC). While art. 352 itself has never been used until now for similar purposes, its normative predecessors (i.e. articles 235 EEC and 308 EC) were invoked to provide financial help to the MS hit by the oil crisis in 1975 or those facing balance of payments problems in 1988 and 2002 (regulations 1969/88/EEC and 332/2002 EC).

It is noteworthy, however, that in 1975, 1988 and 2002, when those measures were adopted, no legal basis was available other than the residual power provided by said articles 235 and 308. In fact, the Treaty norms then corresponding to the current art. 122.2 TFUE, namely articles 108 EEC and 119 EC, contemplated only financial assistance granted to the State in difficulty by the other MS. The presence now of art. 122.2 should make recourse to art. 352 no longer necessary, as confirmed by the EFSM Regulation. Nonetheless, art. 122.2 could be interpreted in the sense that the European Union may provide assistance only in the form of loans and not grants, which would again require the application of art. 352.

In principle, the RF may also be set up by means of an enhanced cooperation, thereby concerning only the MS (for instance the euro-zone States) participating in this initiative. In such a case, articles 122.2 or 352 TFEU would be applied in conjunction with articles 20 TUE and 326-334 TFUE. However, as we read in the Conclusions of the EC meeting, a link has been explicitly established between the new Fund and the coming Multiannual Financial Framework (MFF). This clearly indicates that the Fund, being inserted in the European Union's budget, is meant to involve all MS, thus avoiding the governance problems arising from enhanced cooperation.

3. The financing of the RF

The question that immediately follows is: how is the RF going to be financed, since the current EU budget appears inadequate to cope with the foreseen magnitude of the new instrument? The increase of the needed resources could be effected through (i) contributions of the MS, (ii) European taxes, (iii) borrowings on the market.

National contributions constitute at present the main revenue of the EU. According to suggestions that apparently are gaining the support of certain MS, they could be raised from the current level of 1% to that of 2% of the aggregate GDP of the European Union. This increase could be implemented (without changing the Treaties) through the heavy procedure of art. 311 TFEU, which requires a unanimous decision from the Council and the subsequent approval by each MS. Admittedly, it is a procedure greatly resembling the simplified revision of the Treaties under art. 48 TEU.

The same burdensome procedure should apply if real European taxes were to be established. At present, direct European Union levies are limited to the custom duties on imports from outside the EU, which count for a marginal percentage of the EU revenues. The introduction of European taxes (such as a web tax, a border carbon tax, a financial transaction tax) would substantially contribute to enhancing the EU budget.

Borrowings on the market by the European Union, including the issuance of debt instruments in the form of bonds, represent the other source for financing the RF. Contrary to a widespread narrative, this source is not new and does not call for a particularly onerous procedure under EU law. As mentioned in a recent study (S. Horn, J. Meyer, C. Trebesh, European Community Bonds since the Oil Crisis: Lessons for Today? Kiel Policy Brief N. 136/April 2020), recourse to European bonds goes back to 1975, when the Community Loan Mechanism (CLM) was set up at the time of the oil crisis. The same instrument has been reused over the years and adjusted to assist States facing balance of payments difficulties. More recently, the European Union was authorised to borrow money on the market in 2010 to finance the operations of the EFSM.

The debt instrument in question is not subject to heavier procedural requirements than those applied to the other sources previously examined. The initial CLM, as well as the more recent EFSM, have been established by means of regulations adopted by a qualified majority vote of the Council. This can be clearly inferred from art. 122.2 TFEU, which has provided the legal basis for the establishment of the EFSM. The unanimity of the Council is instead required should art. 352 TFEU be used for the issuance of EU bonds. But also in this case, the decision of the Council does not need the separate approval of the MS as imposed by art. 311 TFEU.

The borrowings of the European Union may be confronted with a different problem. The success on the market of any debt instrument is conditioned by the confidence of creditors in the ability of the debtor to service the debt. In our case, the debtor being the European Union, the creditors will look firstly at the EU budget and secondly at the presence of a guarantee by the MS, possibly in the form of a joint or several commitment. At the time of the CLM the liabilities were supported by a guarantee assumed by the MS pro quota, determined in proportion to their respective wealth. No guarantee was instead contemplated in regard to the EFSM. Clearly, the confidence of the creditors would be greatly enhanced if they could rely upon the purchases of the European bonds by the ECB and the ESM.

It appears that currently the MS are not prepared to undertake any commitment with regard to the repayment of any debt instrument issued by the European Union. One can only note that the more the own resources of the European Union are increased, the less there is the need for guarantees from the MS.

The implementation of the financing of the RF, whatever the means pursued, will take time. The procedures of articles 311 and 352 are complex and lengthy; similarly, the placement of European debt instruments on the market cannot be completed swiftly. By contrast, the start of the RF's operations is claimed by many MS as a matter of urgency. A proposal to rapidly put in place a bridge loan is being considered. The loan could be looked for on the financial market or come from the ESM, although this is not expressly contemplated in the latter's statute. A direct intervention of the ECB is barred for the time being, due to the prohibition of monetary financing under art. 123 TFEU. The ECB could only purchase European bonds in the secondary market after their placement in the primary market.

4. Disbursements of the RF

The debate on this point is concentrated on how the Fund's resources will be dispensed to the MS. However, it should not be neglected that they can be used directly by the European Union to carry out its own investment projects in public goods of European relevance.

The disbursements towards MS may take the form of loans, guarantees or grants. Loans and guarantees are the usual way in which the European Union or other European entities provide financial assistance to MS. For instance, the proposed facility of the ESM designed to finance health care expenditures will be implemented through loans; the SURE program launched by the Commission to support unemployment costs is equally based on loans; the so-called Junker plan aiming to incentivise national investments involves guarantees to back States' borrowings; loans and guarantees characterise the European Investment Bank (EIB) activities.

The provision of grants, instead of (or together with) loans and guarantees, should not pose legality problems. If it is deemed that art. 122.2 TFUE does not offer a sufficient legal basis because the financial assistance contemplated therein authorises only the supply of loans, the obstacle can be overcome by having recourse to the broader provision of art. 352 TFEU. However, should this norm be applied, the unanimity of the Council is required instead of the qualified majority vote envisaged in art. 122.2.

Grants should also pass the test of the no bail-out clause of art. 125 TFUE. Actually, even loans, and more so grants, would be prohibited, if a very strict interpretation of this provision was followed. But the Court of Justice has clarified (see the Pringle and QE decisions) that art. 125 is not infringed provided that the beneficiary State bears sole responsibility for its own debt and is not induced by the assistance extended to it to disregard a sound budgetary policy. Grants dispensed by the RF would not prevent the satisfaction of these conditions.

Grants appear compatible also with art. 310 TFEU, which requires that the EU budget be in balance. But we must make a distinction here. If the Fund is financed exclusively through borrowings, the ensuing proceeds can be only used for back-to-back loans to the MS. Grants would create a liability not matched by a corresponding revenue of the Fund. By contrast, if grants are charged to resources of the Fund other than borrowings, such as own taxes of the European Union or targeted contributions of the MS or an *ad-hoc* allocation of revenues within the MFF, then the prescription of art. 310 would be met. In this case grants would not cause a deficit in the overall budget of the European Union.

Clearly, a substantial difference marks loans and guarantees when compared to grants. Unlike the latter, the former entails an increase of the national debt. It is thus understandable that highly indebted countries push for the supply of grants rather than loans and guarantees. However, long-term loans at minimal interest rates do not appear very different from grants. An appropriate mix of loans, guarantees and grants would also reduce the impact of the RF actions on the national debt.

The operations of the Fund, in whichever form, will inevitably lead to an enlargement of the EU's competences. This development will entail various degrees of control and power of the European Union over the use by the MS of the facilities received from the Fund. The control may be light, or enhanced as contemplated in Regulation No 472/2013. It may also confer to the European Union the power to enforce obligations undertaken by MS pursuant to memoranda of understanding of the ESM type or contractual arrangements as envisaged in the so-called Four Presidents Report of 2012. In any case the new competences of the EU will require a more solid democratic base for the governance of the Economic and Monetary Union (EMU).

5. Conclusions

The foregoing remarks on how the RF is going to be set up and function evidence the difficulty of the task assigned to the Commission. Crucial points are still unresolved. They involve delicate questions bearing on the legitimacy, efficiency and democracy of the new instrument.

Certainly the Commission will not start from scratch. It can rely on remarkable contributions on the subject of EMU completion which have been provided by the Commission itself, other EU institutions, the MS and various scholars. Nonetheless, the work to be done is sizeable, to say the least, and it must be carried out in a short period of time.

We are eagerly waiting for the Commission's proposal.