

STUDY

Requested by the AFCO committee



Fiscal policy in times of crises

An analysis of EMU constitutional
framework



Policy Department for Citizens' Rights and Constitutional Affairs
Directorate-General for Internal Policies
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Fiscal policy in times of crises

An analysis of EMU Constitutional Framework

Abstract

This study, commissioned by the European Parliament's Policy Department for Citizens' Rights and Constitutional Affairs at the request of the AFCO Committee, examines the fiscal responses of the EU to the Covid-19 pandemic and the war in Ukraine. It claims that the law & policy tools developed to address these crises have led to the establishment, and consolidation, of an EU fiscal capacity – contributing to overcoming the original imbalance of the EU's Economic & Monetary Union. Nevertheless, the study claims that these developments now require appropriate institutional adjustments, and considers options to achieve them.

This document was requested by the European Parliament's Committee on Constitutional Affairs.

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LIST OF ABBREVIATIONS

AFCO	Committee on Constitutional Affairs
CFSP	Common Foreign & Security Policy
ECB	European Central Bank
EPF	European Peace Facility
EFSD	European Financial Stability Facility
EFSD	European Financial Stability Facility
EFSM	European Financial Stability Mechanism
EMU	Economic and Monetary Union
ESM	European Stability Mechanism
EU	European Union
EURI	EU Recovery Instrument
IMF	International Monetary Fund
MFA+	Macro-Financial Assistance Instrument for Ukraine
NGEU	Next Generation EU
NRRP	National Recovery and Resilience Plans
ORD	Own Resources Decision
PEPP	Pandemic Emergency Purchase Programme
RRF	Recovery and Resilience Facility
SGP	Stability and Growth Pact
SURE	European Instrument for Temporary Support to Mitigate Unemployment Risks in an Emergency
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union

EXECUTIVE SUMMARY

This study examines from an EU law and policy perspective the fiscal responses of the European Union (EU) to the recent and ongoing crises, in particular the Covid-19 pandemic and the war in Ukraine, with the aim to assess their impact on the European constitutional architecture of economic governance – what is technically known as Economic & Monetary Union (EMU). The study argues that the EU's responses to the pandemic and now the war have had profound consequences on EMU, leading first to the establishment and then to the consolidation of an EU fiscal capacity – meaning a centralised budget, funded by common borrowing, to undertake EU domestic and foreign spending programs, and to be prospectively repaid by common taxes. As such, the legal developments that have occurred since 2020 have contributed to rebalancing the original asymmetry of EMU and to advancing European fiscal integration in remarkable ways.

Nevertheless, as the study shows, these developments in fiscal integration have not been so far accompanied by corresponding institutional adjustments to enhance the EU's effectiveness and legitimacy. Several constitutional and governance shortcomings still limit the EU's ability to mobilise resources and leverage power on the international stage. In particular, from a constitutional viewpoint, it is concerning that the EU constitutional architecture of economic governance continues to exclude the European Parliament – the only EU institution directly elected by EU citizens – from decisions on borrowing, taxing and spending. Moreover, the EU decision-making system on fiscal matters remains subjected to unanimity rule, which constantly threatens EU action due to national vetoes. As such, this study discusses the need, and options, for further treaty reforms in the area of EMU.

1. INTRODUCTION

This study, commissioned by the Policy Department for Citizens' Rights and Constitutional Affairs of the European Parliament (EP) at the request of the Committee on Constitutional Affairs (AFCO), examines from an EU law and policy perspective the fiscal responses of the European Union (EU) to the recent and ongoing crises, in particular the Covid-19 pandemic and the war in Ukraine, with the aim to assess their impact on the European constitutional architecture of economic governance – what is technically known as Economic & Monetary Union (EMU). The study argues that the EU's responses to the pandemic and now the war have had profound consequences on EMU, leading first to the establishment and then to the consolidation of an EU fiscal capacity – meaning a centralised budget, funded by common borrowing, to undertake EU domestic and foreign spending programs, and to be prospectively repaid by common taxes. As such, the legal developments that have occurred since 2020 have contributed to rebalancing the original asymmetry of EMU and to advancing European fiscal integration in remarkable ways.¹

Nevertheless, as the study shows, these developments in fiscal integration have not been so far accompanied by corresponding institutional adjustments to enhance the EU's effectiveness and legitimacy. Several constitutional and governance shortcomings still limit the EU's ability to mobilise resources and leverage power on the international stage. In particular, from a constitutional viewpoint, it is concerning that the EU constitutional architecture of economic governance continues to exclude the EP – the only EU institution directly elected by EU citizens – from decisions on borrowing, taxing and spending. Moreover, the EU decision-making system on fiscal matters remains subjected to unanimity rule, which constantly threatens EU action due to national vetoes. As also the Conference on the Future of Europe has conclusively noticed, reforming those structural features is thus imperative if the EU retains a fiscal capacity forward.² As such, this study discusses the need, and options, for further treaty reforms in the area of EMU.

The study is structured as follows: Chapter 2 provides the background by outlining the state of EMU before the pandemic, and the war in Ukraine – from its original set up with the Treaty of Maastricht to the changes occurred in response to the euro-crisis. Chapter 3 analyses the EU's fiscal response to the pandemic and examines the new European instrument for temporary support to mitigate unemployment risks in an emergency (SURE) and the Next Generation EU (NGEU) Recovery Fund. This chapter discusses how these tools contribute to establishing a fiscal capacity, while outlining some of their challenges. Chapter 4 analyses the EU's fiscal responses to the war in Ukraine and examines new mechanisms like the European Peace Facility and the Macro-Financial Assistance Instrument for Ukraine. This chapter discusses how these tools contribute to consolidating a fiscal capacity, while highlighting several ongoing constraints. In light of this, Chapter 5 maps what constitutional reforms would be needed to back the fiscal transformations occurred since 2020, and considers several options ahead, also in view of the outcome of the Conference on the Future of Europe, and the debate on treaty reforms triggered by the new momentum towards enlargement. Chapter 6, finally, concludes.

¹ See Federico Fabbrini, *EU Fiscal Capacity: Legal Integration after Covid-19 and the War in Ukraine* (Oxford University Press 2022) and Federico Fabbrini, "Funding the War in Ukraine: The European Peace Facility, the Macro-Financial Assistance Instrument and the Slow Rise of an EU Fiscal Capacity" (2023) 11 *Politics & Governance*, from which this study draws.

² Conference on the Future of Europe, Report on the Final Outcome, 9 May 2022.

2. BACKGROUND: EMU BEFORE THE PANDEMIC AND THE WAR

2.1. Introduction

The establishment of EMU represented a milestone for the EU and a major step forward for the project of European integration. Since the 1992 Treaty of Maastricht, the EU has been endowed with a framework to coordinate the Member States economic policies, and since 2002, when the euro started circulating as a legal tender, the majority of EU Member States has had a single currency. Nevertheless, EMU was established through a compromise, and as such its original set-up revealed an asymmetry between the economic and the monetary legs of integration. The euro-crisis and the responses to it challenged that original settlement, and led to changes in EMU, but they did not fundamentally complete the EU architecture of economic governance with a fiscal capacity. This chapter maps the basic features of EMU and its evolution until the pandemic, highlighting the outstanding elements in the debate on completing EMU.

2.2. The original settlement of EMU

The decision to establish EMU was as much an economic choice – driven by the idea to complete the internal market by removing the transaction costs of currency exchange³ – as a political one – driven by the desire to deepen European integration so as to make it irreversible. In fact, the establishment of EMU can only be interpreted in the historical context of the end of the Cold War and the re-unification of Germany. As a long body of historical research has pointed out, therefore, EMU was inevitably the result of a political compromise.⁴ While in the run-up to the intergovernmental conference leading toward the Maastricht Treaty multiple voices⁵ had emphasized the importance of integrating in parallel both monetary and fiscal policies, the Treaty fully federalized monetary policy while leaving instead economic policy mostly decentralized, subject to a number of fiscal rules.⁶ As such, flouting the requirement of an optimal currency area,⁷ EMU was born as an asymmetric union, with a strong M leg, and a weak E leg.⁸

On the monetary side, the Maastricht Treaty paved the way for the adoption of the euro as the currency of the EU. The majority of EU Member States – with the exception of the United Kingdom (UK) and Denmark, which secured an opt-out to maintain their national currencies⁹ – transferred their monetary sovereignty to the EU. Moreover, the Treaty established a fully-fledged federal institution – the

³ See Jacques Delors, Report on Economic and Monetary Union in the European Communities (Publication Office of the EC 1989) 89.

⁴ See Harold James, *Making the European Monetary Union* (Harvard University Press 2014) and Martin Heipertz & Amy Verdun, *Ruling Europe: The Politics of the Stability and Growth Pact* (Cambridge University Press 2011).

⁵ See Barry Eichengreen, *European Monetary Unification* (MIT Press 1993).

⁶ See Tommaso Padoa Schioppa, *The Road To Monetary Union in Europe* (Oxford University Press 2000).

⁷ On the concept of optimal currency areas see Robert Mundell, 'A Theory of Optimum Currency Area' (1961) 51 *American Economic Review* 657.

⁸ See Paul De Grauwe, *Economics of the Monetary Union* (Oxford University Press 12th ed 2018).

⁹ See today Protocol No. 15 and Protocol No. 16.

European Central Bank (ECB) – to govern the single currency for all Eurozone states.¹⁰ The ECB is an EU institution,¹¹ and according to Article 127 TFEU its primary objective is to maintain price stability.¹² Moreover, the ECB was protected by the interference of national governments or private actors by a strong guarantee of independence.¹³ This institutional architecture operated as the background for the introduction of the euro, which started circulating as the currency of 12 EU Member States in 2002, and progressively expanded to encompass (as of 1 January 2023) 20 EU Member States.

On the economic side, however, the Maastricht Treaty did not formalise a major transfer of powers from the Member States to the EU institutions. In fact, the Member States did not delegate fiscal powers to the supranational institutions, and EMU was born without a fully-fledged federal fiscal capacity. Rather, the Member States maintained control over their budgetary policies – albeit accepting to subject them to mechanisms of coordination. On the understanding that in a currency union the economic policy of each Member States was a matter of common concern,¹⁴ the EU Member States decided to set up an institutional framework in which they could coordinate their national budget policies: Specifically, in 1997, they created the Eurogroup, the informal gathering of Finance Ministers of those EU Member States that use the euro as their currency.¹⁵ At the same time, in order to avoid cases of moral hazard and minimise the risks of negative externalities, the Maastricht Treaty backed up the decentralised economic framework with two legal tools.

First, the Maastricht Treaty entrenched the so-called Stability and Growth Pact (SGP), a set of legally-binding mathematical rules¹⁶ designed to ensure that Member States would run sound national budgetary policies. Specifically, the SGP compelled the EU Member States adopting the euro as their currency to maintain an annual budget deficit of below 3% of gross domestic product (gdp), as well as a public debt below 60% of gdp, with a medium term objective to reduce debt towards this target. Moreover, the SGP introduced *ex ante* surveillance procedures as well as a possible *ex post* correction mechanism to sanction Member States running excessive deficits.¹⁷ In particular, the Commission was vested with the responsibility to monitor Member States' budgetary policy, with the possibility to propose measures (including, in the extreme case, fines) in cases of serious deviation from the rules – which, however, had to be adopted by the Council by qualified majority. Second, to enhance the credibility of the SGP, the Treaty also codified a no-bailout rule, geared toward excluding any form of debt mutualisation vis-à-vis Member States which, due to their unsound budgetary policy, were unable to service their debt. In fact, the no-bailout rule prohibited both the EU institutions and the Member States from providing financial stability support to countries in distress,¹⁸ and banned the ECB from coming to the rescue via its monetary policy of Eurozone Member States which faced a budget crisis.¹⁹

¹⁰ See Martin Selmayr & Chiara Zilioli, *The Law of the European Central Bank* (Hart 2001).

¹¹ Art 13 TEU.

¹² See ECB Monetary Policy Strategy, 8 May 2003.

¹³ Art. 282 TFEU.

¹⁴ See Art. 121(1) TFEU.

¹⁵ See today Protocol No. 14.

¹⁶ See today Protocol No. 12.

¹⁷ See Art.s 121 and 126 TFEU.

¹⁸ See Art. 125 TFEU.

¹⁹ See Art. 123 TFEU.

2.3. EMU after the euro-crisis

The original architecture of EMU endured more or less unchanged for the first decade of the euro's life. However, the explosion of the euro-crisis in 2008/2009 quickly exposed the weaknesses of the original EMU constitutional settlement. In fact, precisely the deficiencies of EMU transformed a financial crisis into an existential challenge for the EU, to the point that the survival of the euro as a currency union was itself in question at the time. Yet, through their concerted action, the EU institutions and the Member States managed to address at least the most immediate effects of the euro-crisis by reforming the constitutional architecture of EMU. In particular, as I explained in detail in a prior book,²⁰ three main legal and institutional responses to the euro-crisis took place.

First, the EU institutions and Member States strengthened budgetary constraints, acting on the assumption that the lax enforcement of the SGP was the main cause of the euro-crisis. To this end, in 2011 and 2013 the EU institutions amended EU fiscal rules with the adoption of several new EU regulations and directives – the so-called 'Six Pack'²¹ and 'Two Pack'²² – which strengthened both the preventive and corrective arms of the SGP, among others by enhancing the Commission surveillance power over Member States' budget laws and introducing a reversed qualified majority rule in the Council as a condition to block Commission proposals to sanction a disobedient Member State. Moreover, 25 out of the then 27 EU Member States adopted in 2012 a treaty outside the EU legal order – the Treaty on Stability, Coordination and Governance in the EMU, generally referred as the Fiscal Compact²³ – which compelled signatory parties to introduce a balanced budget amendment within their national constitutional system, and further tightened the deficit rule which states had to respect in drafting their budget laws.

Second, the EU institutions and Member States created new mechanisms of financial stabilisation for countries in fiscal stress, moving beyond a strict construction of the no-bailout rule. In particular, in 2011 the Council set up a temporary European Financial Stability Mechanism (EFSM),²⁴ which was soon replaced by a European Financial Stability Facility (EFSF)²⁵ – a private law entity incorporated under

²⁰ See Federico Fabbrini, *Economic Governance in Europe: Comparative Paradoxes and Constitutional Challenges* (Oxford University Press 2016).

²¹ See Regulation 1173/2011, of the European Parliament and of the Council of 16 November 2011 on the Effective Enforcement of Budgetary Surveillance in the Euro Area, [2011] OJ L 306/1; Regulation 1174/2011, of the European Parliament and of the Council of 16 November 2011 on Enforcement Measures to Correct Excessive Macroeconomic Imbalances in the Euro Area, [2011] OJ L 306/8; Regulation 1175/2011, of the European Parliament 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 L 306/12; Regulation 1176/2011, of the European Parliament and of the Council of 16 November 2011 on the Prevention and Correction of Macroeconomic Imbalances, [2011] OJ L 306/25; Council Regulation 1177/2011, of 8 November 2011 amending Regulation (EC) No 1467/97 on Speeding Up and Clarifying the Implementation of the Excessive Deficit Procedure, [2011] OJ L 306/33; Council Directive 2011/85/EU of 8 November 2011 on Requirements for Budgetary Frameworks of the Member States, [2011] OJ L 306/41.

²² See Regulation 473/2013 of 21 May 2013 of the European Parliament and the Council on monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficits in euro-area Member States [2013] OJ L 140/11; Regulation 472/2013 of 21 May 2013 of the European Parliament and the Council on enhanced surveillance of euro-area Member States experiencing or threatened with serious difficulties with respect to their financial stability [2013] OJ L 140/1.

²³ See Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, 2 March 2012, [hereinafter Fiscal Compact].

²⁴ Council Regulation No. 407/2010/EU of 11 May 2010 establishing a European financial stabilisation mechanism [2010] OJ L 118/1.

²⁵ Decisions of the Representatives of the Government of the Euro Area Member States Meeting within the Council of the EU, ECOFIN, 9 May 2010. Doc. No. 9614/10.

Luxembourg law – and then by a permanent European Stability Mechanism (ESM) – established in 2012 by an intergovernmental treaty between the Eurozone states.²⁶ The EFSM, EFSF and ESM supported five Eurozone Member States which had lost access to the international financial markets – Greece, Portugal, Ireland, Cyprus and (partially) Spain – giving loans subject to conditionality. Stabilisation of public finances, otherwise, was complemented by new steps designed to integrate financial markets – notably the creation of a Banking Union, with a Single Supervisory Mechanism²⁷ for the largest transnational banks and a Single Resolution Mechanism²⁸ to wind-down failing credit institutions. All this was then backed-up by ground-breaking unconventional policies of the ECB which, after launching in 2010 a Securities Market Programme to purchase government bonds on the secondary market,²⁹ announced in 2012 an Outright Monetary Transaction plan to buy state securities of countries which accepted to enter into an ESM-financed support program,³⁰ and deployed since 2015 a quantitative easing policy designed to sustain the EU economy against deflationary trends.³¹

Third, complementing the developments above, the EU institutions and Member States also created new governance mechanisms. In order to ensure a better surveillance of budget rules, a new European Semester was created, whereby Member States are now requested to submit their respective draft budget bills to the Commission for review before these are tabled for approval in national parliaments. And in order to manage financial support programmes and secure respect for the conditionality attached to it in Member States receiving ESM aid, the format of the so-called troika – a grouping of the Commission, ECB and the International Monetary Fund (IMF) – took hold.³² On top of this, the Fiscal Compact also created a brand new institution to provide a forum for top-level discussion on the functioning of the Eurozone and its challenges: the Euro Summit.³³

However, as I explained elsewhere,³⁴ the legal and institutional responses to the euro-crisis did not fundamentally alter the original asymmetry of EMU. In particular, they did not lead to the establishment of a real EU fiscal capacity. Therefore, despite numerous high-level reports by the EU Institutions calling for further steps forward to deepen EMU, at the beginning of 2020, EMU still remained incomplete. In fact, proposals to establish a fiscal capacity were made between 2012 and 2020 by ad hoc groups established to reflect on the future of EMU, as well as by the Commission, the EP and groups of Member States. Nevertheless, the euro-crisis and the responses to it tainted inter-state relations, creating a profound distrust between Member States and essentially foreclosing any possibility to further deepen

²⁶ Treaty Establishing the European Stability Mechanism, 25 March 2011.

²⁷ Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions [2013] OJ L 287/63.

²⁸ Regulation (EU) No. 806/2014 of the European Parliament and of the Council establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Bank Resolution Fund and amending Regulation (EU) No 1093/2010 of the European Parliament and of the Council [2014] OJ L 225/1.

²⁹ Decision of the ECB of 14 May 2010 establishing a *securities market programme* (ECB/2010/5), [2010] OJ L124/8.

³⁰ ECB, Press release, 'Technical Features of Outright Monetary Transactions', 6 September 2012.

³¹ See Decision (EU) 2015/774 of the European Central Bank of 4 March 2015 on a secondary markets public sector asset purchase programme (ECB/2015/10), OJ 2015 L 121/20, amended several times.

³² See also European Parliament resolution of 13 March 2014 on the enquiry on the role and operations of the Troika (ECB, Commission and IMF) with regard to the euro area programme countries, (2013/2277(INI)).

³³ Art. 12 Fiscal Compact.

³⁴ See Federico Fabbrini, 'A Fiscal Capacity for the Eurozone: Constitutional Perspectives', Policy Department for Citizens' Rights and Constitutional Affairs, Directorate General for Internal Policies, European Parliament, February 2019, 16.

EMU.³⁵ This created profound recriminations between Member States,³⁶ making it impossible to progress on reforms, completing EMU, and preparing it for the next crisis.³⁷

³⁵ See Markus Brunnermaier, Harold James and Jean-Pierre Landau, *The Euro and the Battle of Ideas* (Princeton University Press 2016).

³⁶ See also French President Emmanuel Macron, speech, Athens, 7 September 2017 (defining the euro-crisis as “une forme de guerre civile interne” due to North vs. South divisions in the Eurozone).

³⁷ See Henrik Enderlein et al, “Repair and Prepare: Growth and the Euro after Brexit”, Bertelsmann Stiftung & Jacques Delors Institut 2016.

3. THE EU FISCAL RESPONSE TO THE COVID-19 PANDEMIC

3.1. Introduction

The outburst of Covid-19 pandemic in February 2020 profoundly challenged and changed the world we live in. In the EU, the pandemic caused first and foremost a dramatic health crisis, which quickly unleashed also devastating socio-economic effects. However, the EU Institutions and Member States took unprecedented steps to tackle Covid-19. Beside cooperation on the purchase of vaccines, the EU played a leading role in tackling the socio-economic consequences of the pandemic. In particular, in Spring 2020, the Commission decided for the first time ever to suspend the application of the SGP,³⁸ the ECB rolled out a new Pandemic Emergency Purchase Programme (PEPP),³⁹ and the Eurogroup approved a package of measures, also including an innovative European instrument for temporary support to mitigate unemployment risks in an emergency (SURE).⁴⁰ Moreover, the EU Institutions approved the 'Next Generation EU' (NGEU) Recovery Fund – an innovative budget designed to support the EU post-pandemic economic recovery worth EUR 750bn at 2018 prices, which correspond to circa EUR 806,9bn at current prices.

This chapter argues that the measures adopted by the EU Institutions and Member States to address the devastating economic damages of Covid-19 constitute a watershed in the process of European integration with profound implications for the EU constitutional architecture of economic governance. In particular, NGEU constitutes a paradigm change for EMU, which goes well beyond what was achieved in response to the euro-crisis. In fact, NGEU, which is additional to the Multi-Annual Financial Framework (MFF), is resourced by raising common debt on the financial markets; it is disbursed to the Member States (between 2021 and 2026) both in the forms of loans and grants, i.e. non repayable support, and it will be repaid (after 2058) by raising new EU own resources, i.e. new EU taxes. As such, by endowing the EU for the first time, with significant borrowing, spending and taxing powers, NGEU establishes a fiscal capacity in the EU constitutional architecture of economic governance and leads to the emergence of new arrangements in EMU, which go a long way in tackling the original asymmetry of EMU.

Yet, while the EU's response to the pandemic profoundly differed from its response to the euro-crisis, and drew policy lessons from it,⁴¹ the legal innovations engineered in the aftermath of Covid-19 also face several challenges. To begin with, as a multi-annual spending programme stretching beyond the pandemic, NGEU will need to be properly managed by the EU institutions and successfully implemented by the Member States. Moreover, both SURE and NGEU have been technically designed as temporary instruments, specifically designed to address an exceptional occurrence like Covid-19. Therefore, it remains to be seen if these tools can sediment into the EU legal order and be turned into more permanent features thereof. Finally, while the approval of the fiscal responses to the pandemic did not require any change to the EU Treaties, and could safely be accomplished on the basis of the existing legal framework, there is little doubt that the advances in fiscal integration occurred since the

³⁸ European Commission press release 'Coronavirus: Commission proposes to activate fiscal framework's general escape clause to respond to pandemic', 20 March 2020, IP/20/499.

³⁹ Decision (EU) 2020/440 of the European Central Bank of 24 March 2020 on a temporary pandemic emergency purchase programme (ECB/2020/17), OJ 2020 L 91/1.

⁴⁰ Council of the EU Report on the comprehensive economic policy responses to the Covid-19 pandemic, 9 April 2020.

⁴¹ See Marco Buti, *The Man Inside* (Bocconi University Press 2022)

explosion of Covid-19 have also exposed several structural shortcomings in the EU system of governance. In particular, the limited involvement of the EP on decisions about borrowing, spending and taxes poses a conundrum.

As such, the chapter is structured as follows: Section 3.2 describes the SURE mechanism, Section 3.3 describes the legal architecture of NGEU, focusing in particular on the Recovery and Resilience Facility (RRF).⁴² Section 3.4 highlights the consequences of these legal instruments for the EU architecture of economic governance and explain how they lead to the establishment of a fiscal capacity, while Section 3.5 points out what are some of the challenges connected to these new instruments, and that flow from the EU constitutional settlement.

3.2. European Instrument for Temporary Support to Mitigate Unemployment Risks in an Emergency (SURE)

On 2 April 2020, the Commission proposed the establishment of SURE, a new European instrument for temporary support to mitigate unemployment risks in an emergency.⁴³ SURE is a secondary insurance system designed to support the heavily under-pressure national unemployment insurance regimes through loans backed-up by Member States' guarantees.⁴⁴ As such SURE sought to ease the most dramatic labour market effect of the Covid-19 crisis, and aligned with the idea of social Europe.⁴⁵ A week later, on 9 April 2020, the Eurogroup, meeting in an inclusive format open to non-Eurozone Member States approved a package of measures to respond to the economic consequences of Covid-19, worth potentially EUR 540bn.⁴⁶ In this context, the Eurogroup also endorsed the Commission proposal for the establishment of SURE, which was then formally approved as a regulation of the Council and entered into force on 19 May 2020.⁴⁷

SURE is based on Article 122 TFEU, which allows the granting of EU financial assistance to Member States facing difficulties caused by exceptional occurrences beyond their control. SURE is a tool providing financial assistance in the form of loans to the Member States, whose public expenditures had suddenly and severely increased as of February 2020 due to the adoption of national measures directly related to short-time work schemes and similar measures to address the unemployment caused by the pandemic. In fact, Article 3(2) of the regulation explicitly stated that Member States 'shall use the Union financial assistance under this Instrument in support of national schemes supporting short-term work or similar measures'. In governance terms, SURE works according to the following procedures: pursuant to Article 6 of the regulation, Member States make a request to the Commission for loans, which are then approved by the Council on the basis of a Commission's proposal. Pursuant

⁴² Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility, OJ 2021 L 57/17 [hereinafter RRF].

⁴³ European Commission Proposal for a Council Regulation on the establishment of a European instrument for temporary support to mitigate unemployment risks in an emergency (SURE) following the COVID-19 outbreak, 2 April 2020, COM(2020)139 final.

⁴⁴ See also Cristina Dias & Alice Zoppè, 'The SURE: Main Features', European Parliament Research Service, European Parliament, 28 May 2020.

⁴⁵ See also Interinstitutional Proclamation, European Pillar of Social Rights, Gothenburg, 17 November 2017.

⁴⁶ Council of the EU Report on the comprehensive economic policy responses to the Covid-19 pandemic, 9 April 2020.

⁴⁷ Council Regulation (EU) 2020/672 of 19 May 2020 on the establishment of a European instrument for temporary support to mitigate unemployment risks in an emergency (SURE) following the Covid-19 outbreak, OJ 2020 L 159/1, Art. 4 [hereinafter SURE regulation].

to Article 8, then, the relevant Member State and the Commission conclude a loan agreement, setting the term of the financing and the corresponding interest rate.

In funding terms, instead, SURE has a budget of EUR 100bn, which the Commission was empowered to raise on the financial markets on behalf of the EU as a whole, but subject to the Member States' capital guarantees. According to Article 4 of the regulation 'the Commission shall be empowered to borrow [EUR 100bn] on the capital markets or with financial institutions on behalf of the Union'. Nevertheless, pursuant to Article 11, Member States 'contribute to the Instrument by counter guaranteeing the risk born by the Union'. In fact, according to Article 12, SURE 'shall only become available after all the Member States have contributed to the Instrument with contributions referred in Article 11(1) for an amount representing at least' EUR 25bn. As such, SURE was established on the basis of irrevocable, unconditional and on demand guarantees by the Member States, worth EUR 25bn, which allowed the EU to contract borrowing on the financial markets.⁴⁸ Article 12(3) of the SURE regulation introduced however a sunset, stating that SURE funding 'shall end on 31 December 2022', unless the Council on a proposal of the Commission, agrees to extend it further, each time for an extra period of six months.

3.3. Next Generation EU (NGEU) Recovery Fund

The idea for pandemic recovery plan was initially sponsored by the EP,⁴⁹ and by France and Germany jointly.⁵⁰ NGEU was formally proposed by the European Commission in May 2020,⁵¹ and endorsed by the European Council in July 2020.⁵² The European Council meeting on NGEU lasted 5 days, from 17 to 21 July, making it the longest European summit since the Treaty of Nice. Thanks to these prolonged negotiations, Member States managed to overcome the reluctance of frugal countries to authorise the EU to issue common debt. In the fall of 2020, however, further opposition against NGEU was raised by Hungary and Poland, which tried to use their veto on the MFF and NGEU to prevent the entry into force of a rule of law conditionality regulation affecting them. Eventually, in December 2020, the European Council managed to overcome the opposition by Hungary and Poland.⁵³ The deal reached by the European Council effectively delayed the application of the rule of law conditionality regulation, and as such was rightly criticized by the EP.⁵⁴ However, it was instrumental to permit the entry into force of NGEU in 2021.

NGEU is established through a complex legal constellation, summarized in Table 1. On the one hand, there is the **EU Recovery Instrument (EURI)**,⁵⁵ adopted through a Council regulation based on Article

⁴⁸ See Alessandro Nato, 'Il meccanismo europeo di sostegno temporaneo per attenuare i rischi di disoccupazione nello stato di emergenza (SURE): solidarietà in prestito nella crisi covid-19?' (2020) *La Comunità internazionale* 265.

⁴⁹ European Parliament Resolution of 15 May 2020 on the new multiannual financial framework, own resources and the recovery plan, (2020/2631 (RSP)).

⁵⁰ French-German Initiative for a European Recovery from the Coronavirus Crisis, 18 May 2020.

⁵¹ European Commission Communication on 'Europe's Moment: Repair and Prepare for the Next Generation', 27 May 2020, COM(2020)456 final.

⁵² European Council Conclusions, 17-18-19-20-21 July 2020, EUCO 10/20.

⁵³ European Council Conclusions, 10-11 December 2020, EUCO 22/20.

⁵⁴ See European Parliament resolution of 17 December 2020 on the Multiannual Financial Framework 2021-2027, the Inter-Institutional Agreement, the EU Recovery Instrument and the Rule of Law Regulation, (2020/2923 (RSP)).

⁵⁵ Council Regulation (EU) 2020/2094, of 14 December 2020, establishing a European Union Recovery Instrument to support the recovery in the aftermath of the COVID-19 crisis, OJ 2020, L 433 I/23 [hereinafter EURI].

122 TFEU, which sets the overall financial envelope of NGEU and the general allocation of resources between its various programs. The EURI is then completed by the **Recovery & Resilience Facility (RRF)**, which regulates the disbursement of grants and loans to the Member States, and the objectives to be reached with this funding. The RRF is adopted in the form of an EP and Council regulation, based on Article 175 TFEU, on economic, social and territorial cohesion. On the other hand, NGEU depends on the **Own Resources Decision (ORD)**⁵⁶ – the legal act of the Council, adopted on the basis of Article 311 TFEU, which established the revenues of the EU budget, increasing the spending ceilings and authorizing the Commission to issue debt. At the same time, NGEU is connected to the **MFF 2021-2027**⁵⁷ – the general EU budget, which is approved by the Council with the consent of the EP according to Article 312 TFEU. Both the MFF and the RRF, then, are subject to the regulation on the general regime of conditionality for the protection of the Union budget,⁵⁸ which is jointly adopted by the EP and the Council on the basis of Article 322 TFEU on financial matters – designed to fight rule of law backsliding and misappropriation of EU funds. The last piece of the NGEU puzzle then is an **interinstitutional agreement (IIA)**⁵⁹ between the Council, Commission and EP, concluded on the basis of Article 295 TFEU, which sets out among others a roadmap for the introduction of new European taxes to repay the capital and interests of NGEU.

⁵⁶ 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, OJ 2020 L 424/1 [hereinafter ORD].

⁵⁷ Council Regulation (EU, Euratom) 2020/2093 of 17 December 2020 laying down the multiannual financial framework for the years 2021 to 2027, OJ 2020, L 433 I/11.

⁵⁸ Regulation (EU, Euratom) 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, OJ 2020 L I 433/1.

⁵⁹ 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, OJ 2020 L 433 I/28.

Table 1: Legal Structure of NGEU

LEGAL ACT	LEGAL BASIS	PURPOSE
Council Regulation (EU) 2020/2094, of 14 December 2020, establishing a European Union Recovery Instrument to support the recovery in the aftermath of the COVID-19 crisis	Art. 122 TFEU	Establishes NGEU and defines its size
Council Regulation (EU, Euratom) 2020/2093 of 17 December 2020 laying down the multiannual financial framework for the years 2021 to 2027	Art. 312 TFEU	Establishes the MFF 2021-2027 and defines its size
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	Art. 311 TFEU	Authorizes the funding of the MFF and NGEU, in this case through the issuance of common debt
Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility	Art. 175 TFEU	Defines in detail the governance of NGEU and the specific criteria for the use of funds by the member states
Regulation (EU, Euratom) 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	Art. 322 TFEU	Sets the requirements of respect for the rule of law as a pre-condition to access EU funds under NGEU and the MFF
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	Art. 295 TFEU	Sets among others a road map towards the introduction of new EU taxes to repay capital and interests of NGEU

3.3.1. EU Recovery Instrument (EURI)

The EURI, which is a fairly short legal text, establishes an EU fund to support the recovery in the aftermath of the Covid-19 crisis. In its Article 1, the regulation clarifies that the subject matter and the scope of this fund is to finance measures ‘to restore employment and job creation’, to support ‘reforms and investments to reinvigorate the potential for sustainable growth’, to back-up ‘businesses affected by the economic impact of the COVID-19 crisis’, to promote ‘research and innovation in response to the COVID-19 crisis’, to increase ‘the level of the Union’s crisis preparedness’ as well as to ensure ‘a just transition to a climate-neutral economy’. To this end, Article 2 of the regulation sets the total amount of the EURI at EUR 750bn at 2018 prices, states that the instrument is funded ‘on the basis of the empowerment provided for in Article 5 of the Own Resources Decision’, and allocates the corresponding resources among the various programs that make up NGEU. Among these, the Recovery and Resilience Facility (RRF) has by far the lion’s share, as it is assigned EUR 312,5bn of grants and EUR 360bn of loans – for a total of EUR 672,5bn, hence almost 90% of the total NGEU envelop. These resources will need to be employed in a short time-frame, because, as foreseen by Article 3 of the regulation ‘the related legal commitments shall be entered into by the Commission by 31 December 2023.’

3.3.2. Own Resources Decision (ORD)

As mentioned, the European Commission power to issue common debt to finance NGEU is then specifically attributed in the Own Resources Decision (ORD) – which simultaneously enables the funding of the entire MFF 2021-2027. The ORD foresees in its Article 6 an extraordinary and temporary increase in the own resources ceilings for the allocation of the resources necessary for addressing the consequences of the Covid-19 crisis. Moreover, its Article 5(1)(a) states that ‘the Commission shall be empowered to borrow funds on capital markets on behalf of the Union up to EUR 750 000 million in 2018 prices.’ The same provision, also states that ‘[t]he repayment of the principal of the funds borrowed [...] and the related interest due shall be borne by the Union budget’⁶⁰ and clarifies that ‘[a]ll liabilities incurred by the exceptional and temporary empowerment of the Commission to borrow funds referred to in paragraph 1 of this Article shall be fully repaid at the latest by 31 December 2058.’ This confirms that the EU will need to equip itself with new own resources to repay capital and interests on the debts incurred to finance NGEU. The EU Institutions have committed in an IIA, concluded at the same time of the ORD, to work on a precise roadmap towards the introduction of new own resources, thus reforming the EU revenues’ system. In particular, in Annex II, this IIA envisions the introduction, as a first step, of ‘a new own resource [...] to apply as of 1 January 2021 composed of a share of revenues from national contributions calculated on the weight of non-recycled plastic packaging waste’⁶¹, and the roll out of a carbon border adjustment tax, ‘with a view to their introduction at the latest by 1 January 2023.’⁶² Moreover, longer term, beyond 2023, the IIA indicates also the introduction of ‘additional new own resources.’⁶³

⁶⁰ ORD, Art. 6(2).

⁶¹ Ibid., Annex II, para. 4.

⁶² Ibid., Annex II, para. 5.

⁶³ Ibid., Annex II, para. 10.

3.3.3. Recovery and Resilience Facility (RRF)

The precise legal terms that govern the expenditures of NGEU funds are spelled out in another EU regulation, which is much longer and more complex: the Recovery & Resilience Facility (RRF) regulation. This legal act, which includes 36 articles and several annexes, defines in great detail the ways and means in which the Member States receiving financial support from NGEU must use the available resources. Generally speaking, the RRF pursues three main functions. First, it sets out the goals and objectives which must be pursued by the Member States with NGEU money. Second, it spells out the rules and procedures to assign resources to the Member States, and to ensure that they respect the commitments that they have undertaken as a condition to receive NGEU funding. Third and finally, the RRF includes coordination rules between NGEU and others pre-existing mechanisms of economic policy governance, notably the European Semester, and final provisions to assess the program and its accounting. Overall, what emerges is a new system of economic governance in which the EU defines the strategic objectives, designed to strengthen the ecological and digital transition, inclusive growth, and economic resilience, and the Member States commit to reach these priorities as a condition to receive significant amounts of EU funds overtime.

More in detail, Chapter I of the regulation indicates in Article 3 that the RRF operates in six main areas – green transition, digital transformation, smart, sustainable and inclusive growth, social and territorial cohesion, health, and policies for the next generation. As clarified in Article 4, the general objective of the RRF is to promote the EU's economic, social and territorial cohesion by improving the resilience, crisis preparedness, adjustment capacity and growth potential of the Member States. Moreover the RRF aim to mitigate the social and economic impact of that crisis in particular on women, to contribute to the implementation of the European Pillar of Social Rights, and to support the green transition, by contributing to the achievement of the EU's 2030 climate targets and of the digital transition. By doing so, the RRF aspires to contribute to the upward economic and social convergence, restoring and promoting sustainable growth and the integration of the economies of the EU, fostering high quality employment creation, and contributing to the strategic autonomy of the EU alongside an open economy and generating European added value. To achieve these general objectives, 'the specific objective of the Facility shall be to provide Member States with financial support with a view to achieving the milestones and targets of reforms and investments as set out in their recovery and resilience plans'.⁶⁴

Chapter II of the regulation establishes the calculation methods to set the maximum value of EU financial contribution that each Member State can receive, both in grants and in loans. Specifically, with regard to grants, Article 11 states that the 'maximum financial contribution shall be calculated for each Member State [...] for 70 % [...] on the basis of the population, the inverse of the GDP per capita and the relative unemployment rate of each Member State [and] for 30 % [...] on the basis of the population, the inverse of the GDP per capita and, in equal proportion, the change in real GDP in 2020 and the aggregated change in real GDP for the period 2020-2021'. This complicated calculation method endeavours to keep into consideration the size of the Member State, its macro-economic condition before the pandemic, and the impact that Covid-19 had on its economy. The same provision states that '[t]he calculation of the maximum financial contribution [...] shall be updated by 30 June 2022'.⁶⁵ As foreseen in Article 12, then, the Commission shall make available for allocation 70% of the abovementioned amount '[u]ntil 31 December 2022' – hence frontloading the largest share of financial support, with a view to immediately support the economic recovery. Moreover, Article 13 of the

⁶⁴ Ibid., Art. 4(2).

⁶⁵ Ibid., Art. 11(2).

regulation empowers the Commission to ‘make a pre-financing payment of an amount of up to 13 % of the financial contribution’ already in 2021.

With regards to loans, instead, Article 14(5) states that ‘the maximum volume of the loan support for each Member State shall not exceed 6,8 % of its 2019 GNI in current prices’. As a consequence, the RRF introduces different mechanisms to calculate the precise amount that each EU Member States will receive in grants and loans. For grants, this support depends predominantly on the impact of the Covid-19 pandemic on the national economy. Annex IV to the regulation lists precisely the specific sums that each Member State is due to receive as non-repayable support. For loans, the calculation is based on a Member State’s GDP, through a simple mathematical calculation, irrespective of the impact of Covid-19. Nevertheless, the assumption of the EU Institutions is that Member States with lower financing costs than the EU itself will not request loans to the EU.

In order to access to the grants and loans of NGEU, Member States must prepare **National Recovery and Resilience Plans (NRRP)**, whose terms are stated in Chapter III of the regulation. Article 18 states that Member States wishing to receive a financial contribution shall submit to the Commission a recovery and resilience plan, ‘as a rule, by 30 April [2021].’⁶⁶ Each NRRP must be ‘duly reasoned and substantiated’⁶⁷. It must reflect a number of features, including:

- ‘an explanation of how the recovery and resilience plan, taking into account the measures included therein, represents a comprehensive and adequately balanced response to the economic and social situation of the Member State;’⁶⁸
- ‘envisaged milestones, targets and an indicative timetable for the implementation of the reforms, and investments to be completed by 31 August 2026;’⁶⁹
- and ‘the estimated total costs of the reforms and investments covered by the recovery and resilience plan submitted.’⁷⁰

Furthermore, the same provision foresees – coherently with the EU ambitious objective to reach climate neutrality, which is a political priority for the Commission’s Green Deal⁷¹ – which ‘at least 37 % of the recovery and resilience plan’s total allocation’⁷² must be devoted to support the environmental transition. At the same time, ‘at least 20 % of the recovery and resilience plan’s total allocation’⁷³ should contribute to the digital transition. Finally, the same clause also requires the Member States to explain ‘how the recovery and resilience plan contributes to effectively address all or a significant subset of challenges identified in the relevant country-specific recommendations’ which the EU Institutions address annually to the Member States in the framework of the European Semester.⁷⁴ In fact, as underlined in Article 17, ‘the recovery and resilience plans shall be consistent with the relevant country-specific challenges and priorities identified in the context of the European Semester’,⁷⁵ and this is a condition for eligibility of the NRRP. This significantly strengthens the ability of the Commission to influence national economic policies, favouring specific reforms and investments.

⁶⁶ Ibid., Art. 18(3).

⁶⁷ Ibid., Art. 18(4).

⁶⁸ Ibid., Art. 18(4)(a).

⁶⁹ Ibid., Art. 18(4)(i).

⁷⁰ Ibid., Art. 18(4)(k).

⁷¹ See European Commission Communication, ‘The European Green Deal’, 11 December 2019, COM(2019) 640 final.

⁷² RRF, Art. 18(4)(e).

⁷³ Ibid., Art. 18(4)(f).

⁷⁴ Ibid., Art. 18(4)(b).

⁷⁵ Ibid., Art. 17(3).

From a governance viewpoint, according to Article 19 of the regulation, it is for the Commission to assess the NRRP, evaluating their 'relevance, effectiveness, efficiency and coherence.'⁷⁶ In particular, for each criteria, the Commission must assess each NRRP within two months from its submission. It can also reject the NRRP, and ask the Member State to rewrite it. If the Commission gives a positive assessment of the NRRP in question, it proposes to the Council an implementing decision, which 'shall set out the reforms and investment projects to be implemented by the Member State, including the milestones and targets, and the financial contributions'.⁷⁷ According to Article 20 of the regulation, the Council adopts these implementing decisions, 'as a rule, within four weeks of the adoption of the Commission proposal'.⁷⁸ Once the Council has adopted the implementing decision, on the basis of Article 23, 'the Commission shall conclude an agreement with the Member State concerned constituting an individual legal commitment'. This agreement – which in case of loans is for all practical purposes a contract – sets 'the financial contribution to be paid in instalments,'⁷⁹ 'the description of the reforms and of the investment projects and the amount of the estimated total costs of the recovery and resilience plan'⁸⁰ and 'the time limit, which should be no later than 31 August 2026, by which the final milestones and targets for both investment projects and reforms must be completed'.⁸¹ Pursuant to Article 21, a Member State may make a reasoned request to amend a NRRP. Yet, the punctual respect of targets and milestone set in the NRRP is a condition for Member States to continue receiving NGEU support: as stated in Article 24(6), if 'the Commission establishes that the milestones and targets set out in the Council implementing decision [...] have not been satisfactorily fulfilled, the payment of all or part of the financial contribution and, where applicable, of the loan shall be suspended.'

Otherwise, precisely to guarantee that the resources made available by NGEU will not be wasted, the RRF recognizes also a sort of emergency brake procedure. As indicated in recital 52 of the regulation, '[i]f, exceptionally, 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. [...] In such exceptional circumstances, no decision authorising the disbursement of the financial contribution and, where applicable, of the loan should be taken until the next European Council has exhaustively discussed the matter. That process should, as a rule, not take longer than three months after the Commission has asked the Economic and Financial Committee for its opinion'. Although this extraordinary control mechanism is not regulated in the substantive text of the regulation, but only in the opening recital – whose legal efficacy is dubious – this reflects the political agreement reached within the European Council in July 2020.⁸² At the time when the European Council approved the Commission's NGEU proposal, the abovementioned proviso was agreed to reassure the frugal Member States of Northern Europe that NGEU funds would be used wisely and prudently. In fact, Article 10 of the regulation, which introduces measures linking the RRF to pre-existing EMU rules on sound economic governance, states that the Commission shall suspend payments to a Member State 'where the Council decides in accordance with Article 126(8) or (11) TFEU that a Member State has not taken effective action to correct its excessive deficit': hence a violation of the SGP excessive deficit rule will lead to suspension of funding under the RRF.

⁷⁶ Ibid., Art. 19(3).

⁷⁷ Ibid., Art. 20(2).

⁷⁸ Ibid., Art. 20(7).

⁷⁹ Ibid., Art. 20(5)(a).

⁸⁰ Ibid., Art. 20(5)(c).

⁸¹ Ibid., Art. 20(5)(d).

⁸² European Council Conclusions, 17-18-19-20-21 July 2020, EUCO 10/20.

In addition, the RRF introduces also a set of rules to secure the transparency and monitoring of the use of NGEU funds. There are at least half a dozen provisions – Articles 16, 25, 27, 29, 30, 31 – which impose, on the one hand, on the Member States to ‘report twice a year in the context of the European Semester on the progress made in the achievement of its recovery and resilience plan’⁸³; and on the other hand, on the Commission, to ‘present to the [EP] and the Council a review report on the implementation of the Facility’ by 31 July 2022;⁸⁴ to ‘transmit the recovery and resilience plans officially submitted by the Member States, [...] simultaneously and on equal terms to the [EP] and the Council without undue delay,’⁸⁵ to ‘monitor the implementation of the Facility and measure the achievement of the objectives;’⁸⁶ to ‘establish a recovery and resilience scoreboard [...], which shall display the progress of the implementation of the recovery and resilience plans of the Member States;’⁸⁷ and to ‘provide an annual report to the [EP] and the Council on the implementation of the Facility.’⁸⁸ In Article 22 it is finally clarified that in ‘implementing the Facility, the Member States, as beneficiaries or borrowers of funds under the Facility, shall take all the appropriate measures to protect the financial interests of the Union and to ensure that the use of funds in relation to measures supported by the Facility complies with the applicable Union and national law, in particular regarding the prevention, detection and correction of fraud, corruption and conflicts of interests’. As mentioned, finally, RRF funding is subjected to the important rule of law conditionality regulation – although this is not examined in detail here given the focus of this study.

3.4. The establishment of a fiscal capacity

The prime consequence of the fiscal and economic policy response to the Covid-19 pandemic is the establishment of an EU fiscal capacity – a centralised budget, funded by genuine own resources, to support common spending programs. This happened initially with SURE but most importantly with NGEU. With SURE, in fact, the European Commission acquired the power to issue bonds on the capital markets on behalf of the EU, up to a value of EUR 100bn. However, SURE was based on a mechanism of financial guarantees by Member States worth EUR 25bn, and only allowed transferring funds to individual countries as loans. From this point of view, therefore, the turning point really occurred with the establishment of NGEU. First, NGEU authorises the Commission to borrow ‘on behalf of the Union on the capital markets’⁸⁹ a very substantive amounts of resources, totalling EUR 750bn at 2018 prices, worth EUR 806,9bn at current prices. Second, NGEU allows the EU to transfer these resources to the Member States both as loans and grants (non-repayable support). Third, to repay NGEU’s capital and interest, the EU also agreed on a roadmap to repay this common debt through new, genuine EU taxes. As such, with NGEU the EU has effectively acquired borrowing, spending and taxing powers.

As explained in the prior chapter, the EU lacked a fiscal capacity even after the euro-crisis. In fact, despite multiple proposals advanced between 2012 and early 2020 – including by High Level Groups, the European Commission, the EP and several Member States jointly – the political cleavage between

⁸³ RRF, Art. 27.

⁸⁴ *Ibid.*, Art. 16(1).

⁸⁵ *Ibid.*, Art. 25(1).

⁸⁶ *Ibid.*, Art. 29(1).

⁸⁷ *Ibid.*, Art. 30(1).

⁸⁸ *Ibid.*, Art. 31(1).

⁸⁹ European Council Conclusions, 17-18-19-20-21 July 2020, EUCO 10/20, para A3.

Northern and Southern EU Member States, which emerged during the euro-crisis, had made progress on this issue impossible. This left the EU constitutional architecture of economic governance incomplete. While the EU does have the MFF, this budget does not allow for much discretionary spending to tackle unexpected economic shocks, as the funding is almost fully pre-committed for key policy programs, including agriculture and structural funds.⁹⁰ Moreover, notwithstanding the spirit and the letter of the EU Treaties, which require the EU budget to be funded by the EU's own resources, the MFF is for the most part today financed by contributions from the Member States.⁹¹ As a result, EU countries consider the contributions they make to the EU budget as *their* money, and aggressively measure the difference between their contributions to, and their receipts from, the EU budget. This has created an embarrassing spectacle, visible at all new MFF negotiations, revealing the unsustainability of a system where Member States quarrel about how much they pay into, and get from, the EU budget.⁹²

From this standpoint, therefore, NGEU constitutes a paradigm change for the EU: by allowing the EU to run a large budget, funded by resources raised on the capital markets and to be paid long-term by raising new EU taxes, NGEU effectively endows the EU with a fiscal capacity.⁹³ In fact, even though NGEU is not formally called a 'fiscal capacity' for all practical purposes it constitutes one – and arguably one which is significantly better than those proposed before the Covid-19 pandemic. NGEU presents several features that resemble prior initiatives put forward after the euro-crisis: for example, the conditional award of funding to the Member States upon respect of precise milestones and targets evokes the contractual agreements proposed by the Commission in 2012, and the focus on strategic priorities is akin to that of the European Investments Stabilization Function the Commission proposed in 2018. Nevertheless, NGEU goes beyond prior proposals for a fiscal capacity that had been debated before the explosion of Covid-19, by reflecting a much greater level of ambition. The initiatives advanced between 2012 and early 2020 envisioned raising resources for a fiscal capacity mostly through interstate transfers, and not via the issuance of common debt. Moreover, these proposals at best empowered the Commission to transfer funds to the Member States as loans, but rarely as grants. Lastly, the size of the fiscal capacity discussed before the pandemic was generally very small, which made it unsuitable to promote adequately EU public goods. From this point, therefore, NGEU engineers a major policy shift in the EU constitutional architecture of economic governance.⁹⁴ At the same time, NGEU differs from earlier proposals for a fiscal capacity because it is designed as an EU-wide instrument, rather than as a Eurozone-specific one, as was essentially the case in all initiatives advanced between 2012 and early 2020.

NGEU establishes an innovative system of economic governance in the EU, premised on the idea that it is the EU's task to lead the economic recovery through new budgetary means, which financially support the Member States. In the architecture of NGEU, the EU defines the strategic objectives, in line with political priorities it had championed for many years, including environmental and digital transition, and asks the Member States to achieve these by designing and implementing NRRPs. Moreover, the EU makes available to the Member States new financial resources, both as loans and as grants, to help them rebuild short-term their economies after Covid-19 and secure long-term social

⁹⁰ See generally Brigid Laffan, *The Finances of the European Union* (Palgrave MacMillan 1997).

⁹¹ Ubaldo Villani-Lubelli and L Zamparini (eds), *Features and Challenges of the EU Budget* (Elgar 2019).

⁹² Miguel Maduro, 'A New Governance for the European Union and the Euro', Policy Department for Citizens' Rights and Constitutional Affairs, Directorate-General for Internal Policies, European Parliament, September 2012.

⁹³ See Richard Crowe, 'An EU Budget for States and Citizens' (2021) *European Law Journal* 1.

⁹⁴ See also Bruno de Witte, 'The European Union's Covid-19 Recovery Plan: The Legal Engineering of an Economic Policy Shift' (2021) 58 *Common Market Law Review* 635.

resilience. Crucially, with NGEU the EU finances itself on the financial market through the issuance of common debt, and therefore acquires autonomous resources: this overcomes the key problem of the EU budget and breaks this politically and economically unsustainable logic of the MFF, based on inter-state transfers. The EUR 750bn of NGEU are not money of one Member State which are transferred to another Member State: rather, they are common debt which the EU incurs to support the recovery and the resilience of *all* its Member States.

This has important institutional consequences for the EU architecture of economic governance. Needless to say, the EU system of governance is increasingly subject to an intergovernmental drift⁹⁵ – as visible in the ever-more-important position of the European Council, which in fact played a key role in approving NGEU. Despite this, however, NGEU strengthens the role of the Commission in steering the European economic policy.⁹⁶ NGEU, in fact, shifts to the EU a significant degree of new, *real* fiscal powers. In particular, NGEU vests the Commission with a power it previously lacked, namely issuing common debt on behalf, and in the name of the EU. At the same time, NGEU also empowers the Commission to support the Member States with grants and loans, subject to the respect of precise milestones and targets which condition the continuing disbursement of EU funds. Although this power is subject to the approval and control of the Council, this constitutes a step forward compared to the simple coordination of national economic policies undertaken by the Eurogroup. In fact, the connection between NGEU and the MFF contributed to solidify the role of the Commission as a bulk EU Treasury:⁹⁷ and the Commission has now even created within its internal organization an administrative unit in charge of debt issuance and management.

This has implications both in terms of horizontal and vertical balance of power. On the one hand, this influences horizontally the balance between fiscal and monetary institutions. By strengthening the Commission, NGEU creates a fiscal interlocutor for the ECB.⁹⁸ Admittedly, the ECB had previously acted in concert with the EU intergovernmental institutions: for instance, the launch of OMT in 2012, followed approval of the Banking Union by the European Council.⁹⁹ Nevertheless, the ECB had repeatedly lamented the lack of a single fiscal body at EU level with which to interplay, and NGEU improves this situation. On the other hand, vertically, NGEU increases the leverage of the EU Institutions, and notably the Commission, *vis-à-vis* the Member States' governments, because through a system of significant financial incentives they can influence national economic policies, favoring virtuous behaviours such as reforms and investments. The problematic institutional aspect of the post-pandemic architecture of economic governance is however the negligible role of the EP, which is cut off from the mobilisation of EU resources and their control. From a constitutional viewpoint, this state of affairs is unsustainable and will have to be addressed, as will be pointed out also in the next section.

From the economic viewpoint, finally, through NGEU, the EU acquires the ability to stabilise the macro-economic cycle, intervening with own resources there where it is more necessary to ensure stable growth, high level of unemployment and economic convergence between Member States. At the same time, NGEU allows the EU to pursue a number of European public goods – such as the protection of the environment, digitalisation or social inclusion – even though this is done practically through

⁹⁵ See Sergio Fabbrini, *Which European Union? Europe after the Euro Crisis* (Cambridge University Press 2015).

⁹⁶ See also European Commission Communication, 'One year since the outbreak of Covid-19: fiscal policy response', 3 March 2021, COM(2021)105 final.

⁹⁷ European Commission Communication on 'A European Minister of Economy and Finance', 6 December 2017, COM(2017)823 final.

⁹⁸ See Phoebus Athanassiou, 'The institutional architecture and task of the European Central Bank', in Federico Fabbrini & Marco Ventoruzzo (eds), *Research Handbook on EU Economic Law* (Elgar 2019), 137, 165.

⁹⁹ See European Council Conclusions 29 June 2012, EUCO 76/12.

Member States' actions, funded by EU money. In fact, the largest share of NGEU funds, the RRF, will be spent directly by Member States, not by the EU institutions. Nevertheless, by empowering the Commission to issue debt on behalf of the EU, NGEU de facto leads to the creation of eurobonds, i.e. supranational debt instruments, which can constitute a liquid safe asset, easily tradable on the international financial markets. This contributes to strengthen EMU, including the international role of the euro.¹⁰⁰

3.5. Challenges

In response to the pandemic, the European architecture of economic governance has acquired features analogous to those of mature federal regimes. Nevertheless, a number of challenges surround the new fiscal policy instruments deployed by the EU to tackle Covid-19. As such, it remains to be seen whether NGEU constitutes a 'Hamiltonian moment', permanently transforming the EU, or rather an exceptional initiative. First, NGEU is the core economic policy instrument deployed by the EU to address the devastating socio-economic effects of Covid-19. NGEU, however, stretches beyond the pandemic, playing its effects over a five-year time-span, from 2021 to 2026, and with even a longer time-frame envisioned as far as the repayment of common debt is concerned. The success of NGEU, therefore, will depend on both its management at EU level, and its implementation at national level. From this point of view, therefore, important challenges to be monitored include enforcement of rule of law conditionality by the EU institutions,¹⁰¹ and effective *mise en oeuvre* of the RRF by the Member States, especially those receiving the greatest share of funding.¹⁰²

Second, the extraordinary measures deployed to tackle the Covid-19 emergency are formally crafted as temporary responses. The suspension of the SGP is meant to be provisional.¹⁰³ The SURE unemployment insurance scheme has a sunset clause, and the instrument ended its operation on 31 December 2022.¹⁰⁴ Most crucially, then, NGEU is conceived as an exceptional, one-off initiative. As the July 2020 European Council conclusions state, 'the powers granted to the Commission to borrow are clearly limited in size, duration and scope'¹⁰⁵ – a point restated in the EURI, which speaks of 'an exceptional response to temporary but extreme circumstances.'¹⁰⁶ Moreover, the time-limited nature of NGEU was admittedly important in some Member States in securing the domestic approval of the recovery plan via the ratification of the ORD.¹⁰⁷ A crucial question therefore is whether NGEU can be retained as a permanent feature of the EU legal order, or whether beyond Covid-19 EMU will return to a pre-pandemic normal. In this respect, conflicting trends exist.

¹⁰⁰ See European Commission Communication, 'Towards a stronger international role of the euro', 5 December 2018, COM(2018) 796/4.

¹⁰¹ See further Niels Kirst, 'Rule of Law Conditionality' (2021) *European Papers*.

¹⁰² See in particular on the case of Italy, Federico Fabbrini, 'Italy's National Recovery & Resilience Plan: Context, Content and Challenges' (2022) 27 *Journal of Modern Italian Studies* 658.

¹⁰³ Erik Jones, 'When and How to Deactivate the SGP General Escape Clause', Directorate-General for Internal Policies, European Parliament Economic Governance Support Unit, November 2020.

¹⁰⁴ See European Commission Communication, 'SURE after its sunset: final biannual report', 2 June 2023, COM(2023) 291 final.

¹⁰⁵ European Council Conclusions, 17-18-19-20-21 July 2020, EUCO 10/20, para A4.

¹⁰⁶ EURI, recital 6

¹⁰⁷ BVerfG, 2 BvR 547/21, 2 BvR 798/21, Final Judgment of 6 December 2022.

In fact, the measures adopted to respond to Covid-19 will leave a legacy in EMU. On the one hand, political economists have emphasized that institutions generally follow a logic of path-dependency, and that once an economic process or a governance arrangement is in place over-time, it becomes locked-in and it will be difficult to change it, as institutional actors become accustomed to the status quo.¹⁰⁸ On the other hand, legal scholars have also pointed out that measures adopted in times of emergency tend to sediment, and become normalized as the emergency ends.¹⁰⁹ From this point of view, one cannot exclude that the policy measures put in place in response to Covid-19 will become a part of the new normal for the EU. Otherwise, when time-limited measures prove successful, there is an interest in continuing them. And it should be born in mind that several of the measures deployed to address Covid-19 reflected policy proposals that had long been sought for by several institutional actors. For example, SURE tracks earlier proposals for a permanent EU unemployment insurance system¹¹⁰ – and as such, its success in the Covid-19 context may pave the way for its institutionalisation on a broader scale.¹¹¹ Similarly, NGEU recalls pre-pandemic initiatives to establish a fiscal capacity in the EU, and its success may increase the chances that it may be retained – particularly given continuing new economic challenges for the EU, which I will discuss in the next chapter.

Thirdly, if the EU manages to entrench the advances in fiscal integration occurred in response to the pandemic, there are still relevant constitutional challenges that it would need to address. NGEU is established within the existing EU Treaty framework, and properly grounded on its current legal bases. However, NGEU ultimately calls for an adjustment of the EU constitutional framework to increase the effectiveness and legitimacy of the newly emerged architecture of economic governance. From a substantive viewpoint, the establishment of the RRF requires a rethink of the powers to tax and spend conferred on the EU. On the one hand, Article 310(1) TFEU foresees that '[t]he revenue and expenditure shown in the [EU] budget shall be in balance' – thus constraining the EU ability to issue debt, unless the expenditure ceiling is raised accordingly. But this situation is harder to sustain with an enlarged budget. On the other hand, Article 113 TFEU allows the EU to 'adopt provisions for the harmonisation of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition.' However, the EU does not currently have the power of direct taxation. Yet, this state of affairs severely reduces the EU's effectiveness – particularly as a significant amount of resources will need to be raised to repay NGEU's capital and interests – prompting the question whether time has not arrived for the EU to enjoy a competence to introduce new direct taxes.

Moreover, from an institutional viewpoint, there is no doubt that NGEU also requires adequate reforms to increase the legitimacy and accountability of the EU decision-making system in financial matter. On the one hand, the increase of EU powers in fiscal affairs sits unwell with the exclusion of the EP – which is only consulted by the Council in its decisions on the adoption of harmonized taxes,¹¹² and on the EU own resources.¹¹³ This state of affairs can no longer be justified, given the principle of 'no taxation

¹⁰⁸ See Kurt Dopfer, 'Toward a Theory of Economic Institutions: Synergies and Path Dependency' (1991) 25 *Journal of Economic Issues* 535.

¹⁰⁹ See Oren Gross & Fionnuala Ní Aoláin, *Law in Times of Crises: Emergency Powers in Theory and Practice* (Cambridge University Press 2006).

¹¹⁰ See European Commission, 'Roadmap for a European Unemployment Benefit Scheme', January 2017.

¹¹¹ See also European Commission report on the European Instrument for Temporary Support to Mitigate Unemployment Risks in an Emergency (SURE) following the COVID-19 outbreak pursuant to Article 14 of Council Regulation (EU) 2020/672: SURE: One Year On, 22 September 2021, COM(2021)596 final.

¹¹² Art. 113 TFEU.

¹¹³ Art. 311 TFEU.

without representation'.¹¹⁴ In fact, the EP has struggled to affirm a role even in the oversight of the implementation of NGEU.¹¹⁵ On the other hand, the unanimity requirements for Council votes under Articles 113 and 311 TFEU are no longer sustainable if the EU needs to raise an increasing amount of resources, as national vetoes always threaten EU action.¹¹⁶ As a consequence more expedite steps need to be taken towards a more democratic and effective system of decision-making in tax matters based on qualified majority voting.¹¹⁷

¹¹⁴ See Giacinto Della Cananea, 'No Representation without Taxation: the European Union', in Lina Papadopoulou, Ingolf Pernice & Joseph HH Weiler (eds), *Legitimacy Issues of the European Union in the Face of the Crisis* (Nomos 2017) 95.

¹¹⁵ See European Parliament resolution of 20 May 2021 on the right to information of the Parliament regarding the ongoing assessment of the national recovery and resilience plans, (2021/2703 (RSP)).

¹¹⁶ See Sylvain Plasschaert, 'Towards an Own Resource for the European Union? Why? How? And When?' [2004] *European Taxation* 470.

¹¹⁷ See also European Commission Communication 'Towards a more efficient and democratic decision making in tax policy', 15 January 2019, COM(2019)8 final.

4. THE EU FISCAL RESPONSE TO THE WAR IN UKRAINE

4.1. Introduction

As Europe and the world were slowly re-emerging from the pandemic in February 2022, a new unprecedented crisis has erupted: the war in Ukraine, caused by Russia's illegal invasion. The return of the war on the European continent after 75 years of enduring peace shocked the EU and forced it to confront the demands of hard power at its Eastern borders. However, the EU and its Member States reacted in unprecedented ways to the war, taking major decisions in the areas of foreign policy and defense but also energy and migration. In this context, a pressing need for the EU Institutions and Member States has been to support Ukraine financially in its efforts to defend itself against the Russian aggression. The Russian military invasion of Ukraine, in fact, has caused a dramatic death toll, with probable cases of war crimes, massive displacement of refugees and widespread damage to critical infrastructures. Reacting to these horrific facts, and to such a blatant breach of international law, the EU has mobilised resources to both assist the Ukrainian military in purchasing defense weapons and the Ukrainian civilian authorities in funding operational government expenses and rebuilding, to the extent possible, critical infrastructures.

As this chapter argues, the war in Ukraine quickly prompted the EU to replicate some of the novelties it used to respond to the Covid-19 pandemic. In particular, the chapter examines the two key instruments that the EU deployed in the first year of the conflict to finance Ukraine in the war against Russia, namely the European Peace Facility (EPF),¹¹⁸ and the Macro-Financial Assistance Instrument for Ukraine (MFA+).¹¹⁹ The chapter endeavours to detail the legal features of these tools, to evaluate their intergovernmental *versus* supranational nature, and to reflect on their significance for the consolidation of a fiscal capacity in the EU. As the chapter points out, at the beginning of the war in Ukraine, the EU resorted to the EPF, a novel funding instrument dedicated to foreign policy objectives, which is fully funded by Member States' transfers and subjected to unanimous intergovernmental decision-making in the Council. Subsequently however, as the war in Ukraine continued, the EU crafted the MFA+, a larger EUR 18bn financing tool approved jointly by the EP and Council, which enables the Commission to issue common debt, backed-up by states' guarantees, and to transfer these own resources to Ukraine.

The response to the war in Ukraine, therefore, contributes to consolidate an EU fiscal capacity, beyond what happened in response to Covid-19. As seen in the prior chapter, the financial tools rolled out to address the pandemic were designed to be temporary. Yet, NGEU, and SURE, provided a model that the EU promptly re-used when facing the war in Ukraine. In particular, the MFA+ entails once again common borrowing and spending, which suggests a trend towards consolidating a centralised fiscal capacity at the EU level of government. Nevertheless, the consolidation of a fiscal capacity in the EU continues to be hampered by structural weaknesses. In particular, the MFA+ is exclusively designed to fund Ukraine in 2023 – for a 12-month period. Moreover, tactical opposition by a single Member State, Hungary, almost derailed the effort to pass the MFA+. In fact, the need to modify the general EU budget act – the MFF – in order to enable the Commission to issue common debt proved so daunting that the

¹¹⁸ Council Decision (CFSP) 2021/509 of 22 March 2021 establishing a European Peace Facility and repealing Decision (CFSP) 2015/528, OJ 2021 L 102/14 [hereinafter EPF Decision].

¹¹⁹ Regulation (EU) 2022/2463 of the European Parliament and the Council of 14 December 2022 establishing an instrument for providing support to Ukraine for 2023 (macro-financial assistance +), OJ 2022 L 322/1 [hereinafter MFA+ regulation].

MFA+ was adopted by resorting to Member States' financial guarantees. These will only later be replaced by a single guarantee from the EU budget. This confirms that several constitutional and governance shortcomings still limit the EU's ability to mobilise resources and leverage power on the international stage.

As such, the chapter is structured as follows: Section 2 examines the EPF, and Section 3 analyses the MFA+. Section 4 highlights the consequences of these legal instruments for the EU architecture of economic governance and explains how the MFA+ draws from SURE and NGEU and contributes to consolidate an EU fiscal capacity, while Section 5 points out what are some of the challenges connected to these instruments, and that flow from the EU constitutional settlement.

4.2. European Peace Facility (EPF)

The EPF is a novel funding mechanism that the EU created in 2021 as part of the financial package for 2021-2027, which is centered on the MFF and, in response to Covid-19, also includes the NGEU Recovery Fund. Its name notwithstanding, the EPF was specifically established as a special fund, originally worth EUR 5.6bn, to finance the common costs of military operations by the EU Member States under the EU Common Security and Defence Policy (CSDP), as well as actions to improve the military and defence capabilities of third states and international partner organisations. Adopted in the form of a Council decision, the EPF is based on Articles 28(1), 41(2), 42(4) and 30(1) TEU, which respectively allow the EU to act when the international situation so requires, to pool resources to this end, and to adopt initiatives unanimously in the Council, also at the request of the High Representative for Foreign Affairs and Security Policy (HR).¹²⁰ The EPF is built as an off-budget fund, outside the MFF, because Article 41(2) TEU explicitly prohibits charging to the EU budget 'expenditure arising from operations having military or defense implications'.

The EPF, as a tool of the EU Common Foreign & Security Policy (CFSP) and CSDP, is exhibit A of intergovernmentalism in the EU. The Council Decision establishing the EPF is extremely long – 76 articles and five annexes – and over-complicated. The EPF, as clarified in Article 9, should be used to achieve 'the strategic priorities set by the European Council and the Council', and must be consistent with the CFSP goals of the EU.¹²¹ Importantly, according to Article 36 'assistance measures can be implemented through grants'. Yet, from a governance viewpoint, the EPF is managed by a Facility Committee (FC), composed of representatives from all 27 Member States, which must take decisions by unanimity.¹²² A large administrative bureaucracy operates under the direction of the FC.¹²³ Moreover, as a further guarantee to Member States, the Decision establishes a direct link between participation in decisions on, and contribution to the financing of, operation and assistance measures: in particular, pursuant to Article 5, 'a Member State which has abstained in a vote on a Council Decision [...] is not obliged to contribute to the funding of that operation.'

From a financing viewpoint, as mentioned, the EPF is entirely resourced through Member States' transfers. According to Article 18(7)(a) of the Council Decision, the EPF revenues consist primarily of 'contributions payable by the contributing Member States'. As clarified in Article 26, Member States'

¹²⁰ See Joris Larik, *Foreign Policy Objectives in EU Constitutional Law* (Oxford University Press 2016).

¹²¹ EPF Decision, Art. 8.

¹²² *Ibid.*, Art. 11(14).

¹²³ See *Ibid.*, Arts 12, 13, and 15.

contributions are determined on the basis of the Gross National Income (GNI), and are requisitioned by the FC annually.¹²⁴ Nevertheless, as a further guarantee to Member States' discretion – and yet another confirmation of the intergovernmental nature of the EPF – Article 27 states that '[a] Member State which has indicated its intention to abstain from the adoption of an assistance measure [...] may identify other assistance measures to which it will make an additional contribution'. This means that while the EPF is a common financial pot, each Member State still maintains full control on where its share of the funding is directed. Furthermore, numerous reporting and accounting obligations are connected to the EPF, including a duty by administrators to report to the FC on expenditures every three months,¹²⁵ and a right for the Council to review the Decision whenever a Member State so requires, and at least every three years.¹²⁶

In particular, as the conflict in Ukraine continued, the EPF proved an important tool in the EU defense strategy. In February 2022, the Council quickly approved a Decision on assistance measure for the supply to the Ukrainian armed forces of military equipment.¹²⁷ The Decision empowered the HR to implement the measure,¹²⁸ making arrangements with the beneficiary, including ensuring compliance with international human rights law and humanitarian law,¹²⁹ and foresaw a disbursement of EUR 450mn.¹³⁰ This amount was doubled in March 2022,¹³¹ and tripled in April 2022 to a total of EUR 1.5bn.¹³² Subsequently, EPF funding to support to the Ukrainian military were further tapped in May 2022,¹³³ and July 2022,¹³⁴ bringing the total size of support to EUR 3.1bn. This, combined with other EPF expenditures towards other third countries carried out in 2022, largely depleted in a single year a budget that had been designed for a seven-year time frame. As a result, the Council decided in December 2022 for a EUR 2bn increase in the EPF for 2023,¹³⁵ and in June 2023, the Council agreed to a further EUR 3.5bn top-up of the EPF, increasing its size to EUR 12bn.¹³⁶

¹²⁴ *Ibid.*, Art. 29.

¹²⁵ *Ibid.*, Art. 38.

¹²⁶ *Ibid.*, Art. 75.

¹²⁷ See Council Decision (CFSP) 2022/338 of 28 February 2022 on an assistance measure under the European Peace Facility for the supply to the Ukrainian Armed Forces of military equipment and platforms designed to deliver lethal force, OJ 2022 L 60/1.

¹²⁸ *Ibid.*, Art. 4.

¹²⁹ *Ibid.*, Art. 3.

¹³⁰ *Ibid.*, Art. 2.

¹³¹ See Council Decision (CFSP) 2022/471 of 23 March 2022 amending Decision (CFSP) 2022/338 of an assistance measure under the European Peace Facility for the supply to the Ukrainian Armed Forces of military equipment and platforms designed to deliver lethal force, OJ 2022 L 96/43.

¹³² See Council Decision (CFSP) 2022/636 of 13 April 2022 amending Decision (CFSP) 2022/338 on an assistance measure under the European Peace Facility for the supply to the Ukrainian Armed Forces of military equipment, and platforms, designed to deliver lethal force, OJ 2022 L 117/34.

¹³³ See Council Decision (CFSP) 2022/809 of 23 May 2022 amending Decision (CFSP) 2022/338 on an assistance measure under the European Peace Facility for the supply to the Ukrainian Armed Forces of military equipment, and platforms, designed to deliver lethal force, OJ 2022 L 145/40.

¹³⁴ See Council Decision (CFSP) 2022/1285 of 21 July 2022 amending Decision (CFSP) 2022/338 on an assistance measure under the European Peace Facility for the supply to the Ukrainian Armed Forces of military equipment, and platforms, designed to deliver lethal force, OJ 2022 L 195/93.

¹³⁵ Council Decision (CFSP) 2023/577 of 13 March 2023 amending Decision (CFSP) 2021/509 establishing a European Peace Facility, OJ 2023 L 75/23.

¹³⁶ Council of the EU press release, "European Peace Facility: Council agrees on second top-up of the overall financial ceiling by 3.5 billion", 26 June 2023.

4.3. Macro-Financial Assistance Instrument

Given the limited resources available under the EPF, and as the war in Ukraine worsened, in Fall 2022, the Commission proposed to establish the MFA+ in the form of a regulation of the EP and Council.¹³⁷ Going beyond the piecemeal support that the EU had given to the Ukrainian government in the initial months of the war,¹³⁸ the MFA+, worth EUR 18bn, was designed to provide predictable, continuous, orderly and timely financial relief to Ukraine in 2023, thus supporting its rehabilitation and reconstruction and prospectively its preparation for EU membership.¹³⁹ The Commission's proposal, which was based on Article 212 TFEU – the treaty provision dealing with economic, financial and technical cooperation with third countries – was endorsed by the EP and the Member States in the Council. Hungary, however, vetoed it, mostly as a bargaining chip to obtain concession from the Commission on an unrelated measure. To tackle the problem of rule of law backsliding at play in Hungary, in fact, the Commission had suspended the transfer of NGEU funds to Hungary,¹⁴⁰ which was thus eager to use every available card to overcome the application of the rule of law conditionality regulation, and obtain much needed additional EU funds.

In the end, in order to circumvent Hungary's veto, in December 2022 the Council decided to amend slightly the Commission proposal, and passed it with the EP approval.¹⁴¹ Specifically, the Council changed the original funding scheme proposed by the Commission, which envisaged guaranteeing the issuance of EUR 18bn of common debt through the EU budget. Since that required an amendment to the MFF – a change on which Hungary had a right to veto¹⁴² – the Council rather opted to back-up the EUR 18bn of new common debt of the MFA+ through Member States' guarantees, provided by 26 Member States pro-quota.¹⁴³ (In what is certainly not a coincidence, though, two days before the Council also approved the Hungarian NRRP,¹⁴⁴ thus ensuring that Hungary could access in the future NGEU money, if the Commission were to de-block them pursuant to the rule of law conditionality regulation.) Admittedly, the MFA+ still foresees that were an amendment to the MFF to be approved, then the EU budget would replace Member States' guarantees – but as the MFA+ only operates in 2023, it is unclear if that will actually occur.

The MFA+ presents more supranational features than the EPF. The EP and Council regulation establishing the MFA+ is only 21 articles long, and fairly linear. As clarified in Article 2, the objective of the instrument is to provide 'short-term financial relief to Ukraine [...] and initial support towards post-war reconstruction', and the MFA+' areas of support include financing of Ukraine's funding need,

¹³⁷ See European Commission proposal for a Regulation of the European Parliament and the Council establishing an Instrument for providing support to Ukraine for 2023 (macro-financial assistance+), 9 November 2022, COM(2022)597 final.

¹³⁸ See e.g. Decision (EU) 2022/1201 of the European Parliament and the Council of 12 July 2022 providing exceptional macro-financial assistance to Ukraine OJ 2022 L 186/1 (providing EUR 1bn of emergency funds).

¹³⁹ European Council conclusions 23-24 June 2022, EUCO 24/22, para. 11 (granting candidate status to Ukraine).

¹⁴⁰ European Commission press release, "EU budget: Commission proposes measures to the Council under the conditionality regulation", 18 September 2022, IP/22/5623.

¹⁴¹ European Parliament legislative resolution of 14 December 2022 on the Council position at first reading with a view to the adoption of a regulation of the European Parliament and of the Council establishing an instrument for providing support to Ukraine for 2023, P9_TA(2022)0439.

¹⁴² Art. 312 TFEU.

¹⁴³ European Parliament press release, "Parliament agrees to adapted €18 billion loan to Ukraine", 14 December 2022.

¹⁴⁴ Council of the EU press release, "NextGenerationEU: Member States Approve National Plan of Hungary", 12 December 2022.

restoring critical infrastructure as well as alignment with the EU regulatory framework.¹⁴⁵ Based on Article 4 of the regulation, the MFA+ provides support in the form of loans, although additional amounts can be contributed by Member States as grants. From a governance viewpoint, the MFA+ regulation vests the key decision-making power in the Commission. Pursuant to Article 11, ‘the support under the Instrument shall be made available by the Commission in instalments’. However, the regulation introduces a number of pre-conditions for the support under the MFA+, including ‘that Ukraine continue[s] to uphold and respect effective democratic mechanisms [...] and the rule of law’.¹⁴⁶ The Commission signs the memorandum of understanding (MoU) with Ukraine setting out priority actions;¹⁴⁷ reviews compliance with the *ex ante* conditionality;¹⁴⁸ and can reduce, suspend or cancel support under the MFA+.¹⁴⁹

From a financing viewpoint, the MFA+ instrument is based on the issuance of common EU debt, rather than Member States’ transfers. Specifically, Article 16 of the MFA+ regulation states that ‘in order to finance the support under the Instrument in the form of loans, the Commission shall be empowered, on behalf of the Union, to borrow the necessary funds on the capital markets or from financial institutions’. Loans to Ukraine, which are set at a very favourable term, ‘shall have a maximum duration of 35 years’¹⁵⁰, and the EU can offer an interest rates subsidy to Ukraine.¹⁵¹ The supranational dimension of EU common debt, though, is counter-balanced by the intergovernmental left-over of Member States’ guarantees. As already mentioned, in fact, given the impossibility to amend the MFF and raise the EU budget ceiling, Article 5(2) of the MFA+ regulation states that Member States contribute to guarantee the debt ‘in the form of irrevocable, unconditional and on-demand guarantees through a guarantee agreement to be concluded with the Commission.’ Such national guarantees are determined pro quota on the basis of each Member State’s GNI,¹⁵² but ‘shall cease to be callable as of the date of application of an amendment to [the MFF Regulation].’¹⁵³ The usual annual reporting obligation is imposed by the regulation on the Commission,¹⁵⁴ which must also constantly keep the EP and Council informed on disbursement operations.¹⁵⁵

4.4. The Consolidation of a Fiscal Capacity

The EU financial response to the war in Ukraine during 2022 and 2023 reveals a trend towards the consolidation of a fiscal capacity in the EU. The unprecedented geo-political threat posed by the Russian military aggression at Europe’s Eastern borders forced the EU Institutions and Member States to resort to funding mechanisms analogous to those rolled out in response to the Covid-19 pandemic. At the start of the war in Ukraine, the EU Member States deployed for the first time the EPF – a new tool designed to back up the EU voice in foreign affairs. Nevertheless, the limited size of the EPF – and

¹⁴⁵ MFA+ regulation, Art. 3.

¹⁴⁶ *Ibid.*, Art. 8.

¹⁴⁷ *Ibid.*, Art. 9.

¹⁴⁸ *Ibid.*, Art. 12.

¹⁴⁹ *Ibid.*, Art. 13.

¹⁵⁰ *Ibid.*, Art. 16(2).

¹⁵¹ *Ibid.*, Art. 17.

¹⁵² *Ibid.*, Art. 5(3).

¹⁵³ *Ibid.*, Art. 6(f).

¹⁵⁴ *Ibid.*, Art. 20.

¹⁵⁵ *Ibid.*, Art. 15.

arguably its complicated governance arrangements – quickly led the Commission to propose an alternative funding instrument, in the form of the MFA+. Grounded on a different Treaty legal basis – and justified also in light of the EU grant of candidate status to Ukraine – the MFA+ enabled the Commission to raise EUR 18bn on the financial markets on behalf of the EU, and, in 2023, to transfer these to the Ukrainian government as concessionary loans subject to standard conditionality.

While the EPF presents features that resemble the traditional EU budget, the MFA+ rather tracks the solution that the EU adopted to tackle the Covid-19 pandemic. As previously noticed, the EU general budget – the MFF – is mostly funded by Member States' transfers (based on GNI), and as pointed out above, the same is true for the EPF. On the contrary, in response to the Covid-19 pandemic the EU experimented with novel financial instruments, legally engineering a constitutional transformation in the EU architecture of economic governance. As explained in chapter 3, in particular, the EU set up the SURE mechanism, worth EUR 100bn and subsequently NGEU, worth EUR 750bn. Under SURE, the Commission was empowered to raise EUR 100bn on the financial markets by issuing common debt on behalf of the EU, subject to EUR 25bn of Member States' guarantees.¹⁵⁶ Instead, in the case of NGEU, the Commission was empowered to raise EUR 750bn by issuing common debt on behalf of the EU, with the general EU budget serving as a back-up through an increase of the ORD's ceiling.¹⁵⁷

From this point of view, the MFA+ follows in the footsteps of SURE and NGEU. In particular, the MFA+ scheme tracks SURE, to the extent that both mechanisms rely on Member States' guarantees to empower the Commission to issue EU common debt. Moreover, just like SURE, the MFA+ provides loans rather than grants. At the same time, the MFA+ also draws from the example of NGEU – and specifically the RRF. The RRF requires Member States to design NRRPs, with specific targets, milestones and objectives to be achieved in order to receive NGEU funds, and empowers the Commission to assess them. As previously explained, then, the rule of law conditionality regulation subjects disbursement of funding to the respect of basic rule of law principle, which again the Commission is empowered to evaluate. Along the same lines, as mentioned, the MFA+ regulation foresees that Ukraine and the Commission will enter into a MoU outlining the specific objectives to be achieved with EU funding, and empowers the Commission to evaluate compliance as a condition for the payment of instalments. At the same time, while the EPF conditions funding to continuing respect of international human rights law and humanitarian law, the MFA+ requires Ukraine to abide by democratic and rule of law principles to receive cash, effectively replicating – albeit arguably in a lighter form – the EU rule of law conditionality rules.

Therefore, the adoption of the MFA+ reveals the importance of path dependency in the functioning of the EU. As political science literature on historical institutionalism,¹⁵⁸ and legal scholarship research on emergency legislation¹⁵⁹ have both pointed out, once norms are adopted in time of emergency and become entrenched, they set a precedent for future action. As mentioned before, all measures enacted by the EU to address the Covid-19 pandemic had a sunset. The SURE regulation foresaw that its funding 'shall end on 31 December 2022'.¹⁶⁰ Similarly, the NGEU Recovery Fund was designed to be a one-off, exceptional tool: as stated by the European Council 'the powers granted to the Commission to borrow

¹⁵⁶ SURE regulation, Art.s 11 and 12.

¹⁵⁷ ORD, Art. 5(1).

¹⁵⁸ See Kurt Dopfer, 'Toward a Theory of Economic Institutions: Synergies and Path Dependency' (1991) 25 *Journal of Economic Issues* 535

¹⁵⁹ See Oren Gross & Fionnuala Ní Aoláin, *Law in Times of Crises: Emergency Powers in Theory and Practice* (Cambridge University Press 2006).

¹⁶⁰ SURE regulation, Art. 12(3).

are clearly limited in size, duration and scope'¹⁶¹ with the RRF designed to run 'until 31 August 2026.'¹⁶² Yet, SURE and NGEU offered the policy template and legal technique which the EU could resort to in order to address a new crisis arising even before the Covid-19 pandemic dissipated. From this viewpoint, in conclusion, the explosion of the war in Ukraine confirms that external threats are one of the strongest drivers of the consolidation of centralised fiscal powers in federal unions of states.¹⁶³

4.5. Challenges

Nevertheless, the road towards the consolidation of fiscal integration in the EU remains fraught with difficulties and uncertainties. Indeed, as also the approval of the MFA+ highlights, the EU is hampered by governance problems and constitutional constraints which severely undermine its capacity to raise a fiscal capacity and rise to the geopolitical challenges it is facing. A rough comparison between the EU and the United States (US) funding to Ukraine in the first year of the war drives home the point. The EUR 3.1bn of EPF funding combined with additional smaller EU grants and the EUR 18bn of MFA+ support (which however applies to 2023) pale in comparison to the USD 54bn of spending the US provided to Ukraine in just three months, between March and May 2022,¹⁶⁴ which were further increased by an additional USD 44bn in December 2022 as part of a stunning USD 858bn military bill for 2023.¹⁶⁵ Even accounting for the additional spending that EU Member States provided on their own, how can we make sense of this embarrassing imbalance?

To begin with, there are a number of constitutional constraints on the ability of the EU to raise fiscal resources. On the one hand, Article 41(2) TEU explicitly prohibits charging to the EU budget 'expenditure arising from operations having military or defense implications', which means that CSDP expenses have to be covered by separate funds, like the EPF, set up outside the MFF. On the other hand, Title II of Part VI of the TFEU, which sets the 'Financial Provisions' of the EU, lays out daunting rules. In particular, according to Article 310(1) TFEU, the revenues and expenditures of the EU budget 'shall be in balance'. Moreover, Article 312 TFEU states that the MFF, which is to be approved by the Council unanimously with the consent of the EP, must set 'the amounts of the annual ceilings on commitments appropriations by category of expenditures and of the annual ceilings on payment appropriations.' Finally, Article 311 TFEU requires the EU budget to 'be financed wholly from own resources' – to be approved by the Council unanimously, and ratified by each Member State in accordance with its constitutional requirements. The combined effect of the abovementioned provisions is therefore that every time the EU wants to increase spending, and borrow money a cumbersome amendment to the MFF and ORD is needed. This is why in the MFA+ case, national guarantees had to be used to empower the issuance of EUR 18bn of EU debt.

A second main structural obstacle towards the development of a permanent fiscal capacity in the EU – admittedly also flowing from the EU Treaties – is the governance problem. As scholars have

¹⁶¹ European Council Conclusions, 17-18-19-20-21 July 2020, EUCO 10/20, para. A4.

¹⁶² RRF Regulation, Art. 18(4)(f).

¹⁶³ See Miguel Centeno & Elaine Enriquez, *War & Society* (Polity 2016), Margareth McMillan, *War: How Conflict Shaped Us* (Profile Books 2020), and famously Charles Tilly (ed), *The Formation of National States in Western Europe* (Princeton University Press 1975).

¹⁶⁴ See Bianca Pallaro & Alicia Parlapiano, 'Four Ways to Understand the \$54 Billion in U.S. Spending on Ukraine', *The New York Times*, 20 May 2022.

¹⁶⁵ See Catie Edmonson, 'Congress Passed an \$858 Billion Military Bill. Here is what's in it', *The New York Times*, 16 December 2022.

emphasized, CFSP and CSDP are by design fully intergovernmental policies. According to the EU Treaties supranational institutions like the EP and the Commission have hardly a role – and decision-making power is fully vested in the Member States in Council and European Council. These arrangements however constantly subject EU actions to Member States' vetoes, and as a result the EU has so far punched well below its weight in foreign relations.¹⁶⁶ In fact, the institutional features of the EPF, detailed above, reflect this state of affairs. As mentioned, the EPF has a highly cumbersome governance structure, with a 27-member FC at the helm, and Member States still have multiple prerogatives, including the right to opt-out of funding operations they dislike. While in the end Member States unanimously agreed to deploy the EPF to support Ukraine in 2022, it is clear that this is not congenial to fast and vigorous decision-making.

Otherwise, intergovernmental governance also afflicts the core decision-making procedures about EU public finances. As noted previously, Member States' governments must unanimously approve the MFF, or amendments thereof, and the ORD – which must also be ratified by each Member State in accordance with its constitutional requirements (usually parliamentary procedure). This again means that a single Member State can veto efforts by the others to enable further EU borrowing and spending – even for unrelated, idiosyncratic reason. This is exactly what happened in the case of the MFA+: as explained above, Hungary vetoed an amendment to the MFF, which was needed to raise the EU budget ceiling required to issue EUR 18bn of new common debt, seeking to leverage its vote in order to obtain the Council endorsement of its NRRP overcoming the Commission's rule of law concerns.¹⁶⁷ The shrewd blackmail by the Hungarian government forced the other Member States to resort to Member States' guarantees (and ultimately payed off, as before the approval of the MFA+ the Council also gave its conditioned green light to the Hungarian NRRP). Clearly however, the dependence on the consent of 27 Member States for any financial operation is bound to continuously create challenges for the EU in the long term.

¹⁶⁶ Sergio Fabbrini, "Intergovernmentalism and its Limits" (2013) 46 *Comparative Political Studies* 1003

¹⁶⁷ See Kim Lane Scheppele, "The Treaties Without a Guardian: The European Commission and the Rule of Law" (2023) *Columbia Journal of European Law*.

5. PROSPECTS: TOWARDS A MORE EFFECTIVE AND LEGITIMATE FISCAL GOVERNANCE

5.1. Introduction

As the prior two chapters have pointed out, the EU's responses to the Covid-19 pandemic and the war in Ukraine have led to major advances in fiscal integration, with important consequences for EMU. Nevertheless, the responses to the Covid-19 pandemic and to the war in Ukraine have also exposed the limits of the current EU constitutional set-up. While a fiscal capacity could be established, and consolidated, within the current EU Treaty framework, there are a number of substantive and institutional shortcomings which limit the effectiveness and legitimacy of the EU's fiscal responses to crises such as a pandemic or a war. In this context, therefore a number of constitutional and institutional reforms are clearly needed to increase both the EU capacity to act and its democratic nature. As such, this chapter discusses both necessary reforms of the EU constitutional architecture of economic governance, and options to achieve them.

5.2. Need for reform

From a policy viewpoint, the EU must reform its governance system as way to legitimate the consolidation of a centralised fiscal capacity.¹⁶⁸ As a priority, this requires enhancing the role of the EP – either through the use of *passerelle* clauses¹⁶⁹ or through an outright amendment of the EU Treaties. As previously underlined, today the EP is only consulted on the adoption of EU tax legislation,¹⁷⁰ and has no voice on the adoption of the ORD.¹⁷¹ Moreover, the EP has no role in the approval of emergency measures for EMU,¹⁷² and has a marginal voice also with regard to the adoption of legislation specifically related to the Eurozone.¹⁷³ While the EP approved the RRF, therefore, it is unsurprising its role in the governance of NGEU is limited.¹⁷⁴ Pursuant to Article 48(7) TEU, the European Council, acting by unanimity and with the consent of the EP, can adopt a decision allowing for the adoption of acts on the basis of ordinary legislative procedure, when the Treaties mandate a special legislative procedure. Such *passerelle* clause could be applied to Articles 113 and 311 TFEU. An amendment to the Treaties would instead be necessary with regard to Articles 122 and 136 TFEU. Either way, it is clear that the current state of affairs must be changed to make the EP fully participate on equal grounds to the Council on decisions about financial matters, and exercise budgetary scrutiny on the treasury action of the EU executive branch.

¹⁶⁸ See also Paul Dermine, *The New Economic Governance of the Eurozone* (Cambridge University Press 2022).

¹⁶⁹ On the potential of the *passerelle* clauses to induce reforms within the framework of the existing Treaties, see Giuliano Amato, "Future Prospects for a European Constitution" in Giuliano Amato et al. (eds), *Genesis and Destiny of the European Constitution* (Bruylant 2007) 1271.

¹⁷⁰ Art. 113 TFEU.

¹⁷¹ Art. 311 TFEU.

¹⁷² Art. 122 TFEU.

¹⁷³ Art. 136 TFEU.

¹⁷⁴ See European Parliament resolution of 20 May 2021 on the right to information of the Parliament regarding the ongoing assessment of the national recovery and resilience plans (2021/2703 (RSP)).

In fact, the legitimacy of a centralised fiscal capacity cannot be secured exclusively by the Member States' parliaments. Clearly, national parliaments remain essential to legitimise *national* taxing and spending and, in *intergovernmental* contexts (such as the ESM), interstate transfers. Moreover, obviously, national parliaments jointly and severally play a crucial role in approving the ORD,¹⁷⁵ which allows the EU to indebt itself by correspondingly increasing the spending ceiling. Nevertheless, for the limited share of taxing and spending transferred at the *supranational* level (in accordance with the principles of subsidiarity and proportionality), it is essential that corresponding mechanisms of legitimacy are developed at that level of government. This is consistent with the philosophical and political foundation of legitimacy.¹⁷⁶ And this is after all what happens in federal, multilevel regimes, where state action is legitimated at state level and federal/supra-state action is legitimated at the federal/supra-state level. As such, this point has not only been defended by the EP,¹⁷⁷ as one could expect, but also enshrined in the influential Four Presidents' Report towards a genuine EMU,¹⁷⁸ and accepted by the European Council.¹⁷⁹

Besides the role of the EP, however, constitutional changes should also tackle other inefficiencies in the EU decision-making system. Unanimity requirements hamper the ability of the Council to adopt tax legislation¹⁸⁰, amend the MFF/ORD, and generally to react to developments on the international scene. Moreover, a supranational balanced-budget requirement in the EU Treaties¹⁸¹ constrains the ability of the EU to borrow debt, unless this is accompanied by a simultaneous increase in the spending ceiling. Lastly, the possibility of the EU to harmonise 'turnover taxes, excise duties and other forms of indirect taxation'¹⁸² – but the inability for the EU to raise direct taxes – reduces its tax base, constraining its sources of funding. Also in this regard, *passerelle* clauses could help. Pursuant to Article 48(7) TEU, the European Council, by unanimity and with the consent of the EP, can take a decision introducing qualified majority voting in the Council in areas where the Treaties foresee unanimity. This could apply to Article 113 TFEU – as indeed the Commission proposed.¹⁸³ Instead, amendments to the EU Treaties would be needed to remove the EU balance-budget requirement, and introduce a new EU power to set direct taxation.

All in all, therefore, the growing economic integration resulting from the EU post-Covid-19 recovery plan – and the prospect of further consolidation of a fiscal capacity in the EU in response to the war in

¹⁷⁵ See Art. 311 TFEU.

¹⁷⁶ See e.g. Arthur I. Applbaum, *Legitimacy: The Right to Rule in a Wanton World* (Harvard University Press 2019), and Peter Lindseth, *Power & Legitimacy* (Oxford University Press 2010).

¹⁷⁷ See European Parliament resolution of 12 December 2013 on constitutional problems of a multitier governance in the European Union, P7_TA(2013)0598, para. AO (stating that 'democratic legitimacy and accountability must be assured at the level at which decisions are taken').

¹⁷⁸ See European Council President, 'Towards a Genuine Economic & Monetary Union', interim report, 12 October 2012, 8 (stating that as 'a general principle, democratic control and accountability should occur at the level at which the decisions are taken. This implies relying on the European Parliament as regards accountability for decisions at European level but also maintaining and securing the pivotal role of national parliaments, as appropriate').

¹⁷⁹ See European Council conclusions, 14 December 2012, EUCO 205/12, para 14 (stating that 'the process, the general objective remains to ensure democratic legitimacy and accountability at the level at which decisions are taken and implemented.')

¹⁸⁰ Art. 113 TFEU.

¹⁸¹ Art. 310 TFEU.

¹⁸² Art. 113 TFEU.

¹⁸³ See also European Commission Communication, 'Towards a more efficient and democratic decision making in tax policy', 15 January 2019, COM(2019)8 final.

Ukraine – push in favour of a rethinking of the EU constitutional set-up in the area of EMU.¹⁸⁴ This can only be addressed through a series of reforms that match the new substantive EU fiscal powers with new institutional mechanisms of democratic legitimacy and accountability at that same level of government. This is also the prospect which is opened by the Conference on the Future of Europe, which has recently proposed a number of solutions to address the weaknesses of the EU resulting from limited competences and financial resources and a cumbersome governance structure.

5.3. Options for reform

The Conference on the Future of Europe – originally envisaged by French President Emmanuel Macron in March 2019¹⁸⁵ as a way to relaunch the project of European integration in the aftermath of Brexit, the UK’s withdrawal from the EU¹⁸⁶ – took off, with delays due to the Covid-19 pandemic, on 9 May 2021, and came to a close a year later on 9 May 2022, when the war in Ukraine was already raging.¹⁸⁷ The Conference was organised as a citizen-focused, bottom-up exercise designed to gain input from European citizens on the key questions facing the EU. This innovative participatory process unfolded through a multi-layered structure. The core of the Conference was represented by four European citizens’ panels of 200 participants each, selected randomly to reflect the socio-demographic reality of the EU which met both in person and remotely over several months. The input from the European citizens’ panel – together with that resulting from analogous national process – were then reported to the Plenary of the Conference on the Future of Europe, which deliberated on it. Ultimately, the Plenary endorsed 49 proposals with a list of 326 detailed recommendations, which were submitted to the Executive Board and released in a final report published on Europe’s Day 2022.¹⁸⁸

The Conference on the Future of Europe’s final report explicitly identified a number of shortcomings in the current EU constitutional structure and made the case for several substantive and institutional amendments to the EU treaties. The Conference, in particular, called for a strengthening of the EU powers, with the expansion of EU competences among others in the fields of health, energy, digital technology, migration and foreign affairs. Moreover, the Conference requested an overhaul of the EU decision-making system, with the overcoming of unanimity rule, particularly in the field of foreign affairs and defence, and a clarification of the roles of the EU Institutions. Finally, the Conference also underlined the importance of endowing the EU with the financial means to back up its actions, including by reproducing the NGEU funding model beyond the Covid-19 pandemic. At the same time, the Conference pleaded for ‘reopening the discussion about the [EU] constitution’¹⁸⁹ on the understanding that ‘A constitution may help to be more precise as well as involve citizens and agree on the rules of the decision-making process.’¹⁹⁰ All in all, therefore, the Conference called for a more sovereign federal EU.

¹⁸⁴ See from different perspectives, Sergio Fabbrini, *Europe’s Future: Decoupling and Reforming* (Cambridge University Press 2019); Christian Calliess, ‘The Future of Europe after Brexit: Towards a Reform of the European Union and its Euro Area’ (2021) 40 *Yearbook of European Law* 3.

¹⁸⁵ French President Emmanuel Macron, *Lettre Pour Une Renaissance Européenne*, 4 March 2019.

¹⁸⁶ Federico Fabbrini, *Brexit and the Future of the European Union: The Case for Constitutional Reforms* (Oxford University Press 2020).

¹⁸⁷ See also Conference on the Future of Europe digital platform, available at <https://futureu.europa.eu/>

¹⁸⁸ Conference on the Future of Europe, *Report on the Final Outcome*, 9 May 2022, p 93.

¹⁸⁹ *Ibid.*, Proposal 39, recommendation 7.

¹⁹⁰ *Ibid.*

In fact, a number of policy-makers immediately embraced the ambitious outcome of the Conference on the Future of Europe. Both French President Emmanuel Macron, and Italian Prime Minister Mario Draghi endorsed the idea of amending the EU treaties;¹⁹¹ Commission President Ursula von der Leyen voiced support for this prospect;¹⁹² and the EP called for a comprehensive follow up to the Conference's outcome, including via treaty changes.¹⁹³ Nevertheless, in a joint non-paper, 13 Member States from Northern and Eastern Europe chilled this enthusiasm indicating that they did 'not support unconsidered and premature attempts to launch a process towards Treaty change.'¹⁹⁴ As a result, the implementation of the Conference's outcome has stalled: while some of its recommendations have been implemented within the current EU treaty framework, a year after the Conference's end its most ground-breaking proposals remain on hold.

Yet, the debate about EU constitutional reforms has increasingly interplayed with that of EU enlargement, which the war in Ukraine has brought back to the forefront. Reacting to the brutal Russian war of aggression, the EU reactivated its enlargement process. On 23-24 June 2022 – just six weeks after the conclusions of the Conference on the Future of Europe – the European Council granted to Ukraine, and Moldova, the status of EU candidate country, while also recognizing the European perspective of Georgia.¹⁹⁵ At the same time, in the awareness that the process of enlargement may take a while, on the same occasion the European Council also endorsed the idea to create a European Political Community as a forum to engage with the wider Europe.¹⁹⁶ All in all, however, it seems that the EU is increasingly projected towards a new Eastward expansion. Yet this raises profound internal constitutional challenges for the EU.

Among the constitutional options more recently debated in the EU to prepare for a larger union are changes to the decision-making rules through the use of *passerelle* clauses, particularly on CFSP.¹⁹⁷ In particular, on 4 May 2023, 9 Member States – Belgium, Finland, France, Germany, Italy, Luxembourg, the Netherlands, Slovenia, and Spain: all but one from Western Europe – released a joint statement launching the group of friends of QMV in CFSP.¹⁹⁸ This was followed by a supportive resolution of the EP on 11 July 2023, which called for using *passerelle* at the earliest.¹⁹⁹ Yet, the strategy to leverage the *passerelle* clauses has its hurdles. On the one hand, triggering a *passerelle* would still require unanimity in the European Council, which is not a given, due to the hold-out position of several Member States. Furthermore, Article 48(7) TEU empowers a single national parliament to block the use of a *passerelle*, even if approved by heads of state and government in the European Council, within six months. On the other hand, there is no escaping that the *passerelle* can achieve only so much. As mentioned above, the EU governance structure suffers of a number of shortcomings, and enhancing the legitimacy and effectiveness of the EU requires adjustments that can only be addressed through proper treaty

¹⁹¹ Italian Prime Minister Mario Draghi, Speech at the European Parliament, 3 May 2022, official English translation available at <https://www.governo.it/en/articolo/prime-minister-mario-draghi-s-address-european-parliament/19748>

¹⁹² Commission President Ursula Von der Leyen, speech, Strasbourg, 9 May 2022, SPEECH/22/2944.

¹⁹³ European Parliament resolution of 4 May 2022 on the follow-up to the conclusions of the Conference on the Future of Europe, P9_TA(2022)0141.

¹⁹⁴ Government of Sweden, press release, 9 May 2022.

¹⁹⁵ European Council Conclusions, 23-24 June 2022, EUCO 24/22, para 10.

¹⁹⁶ Ibid para 1.

¹⁹⁷ See Ramses Wessel & Viktor Szép, "The implementation of Article 31 of the TEU and the use of qualified majority voting", Policy Department for Citizens' Rights and Constitutional Affairs, Directorate-General for Internal Policies, European Parliament, November 2022.

¹⁹⁸ Joint Statement of the Foreign Ministries on the Launch of the Group of Friends on Qualified Majority Voting in EU Common Foreign and Security Policy, 4 May 2023.

¹⁹⁹ European Parliament resolution of 11 July 2023 on the implementation of the *passerelle* clauses in the EU Treaties, P9_TA(2023)0269.

changes. For example, a greater role for the EP in fiscal and budgetary matters is a democratic need, after the establishment of the NGEU, but this can be achieved only through revisions of several treaty provisions.

As such, a more courageous embrace of constitutional amendment seems to be necessary— as stated by the EP, which has called to establish a convention under Article 48(3) TEU.²⁰⁰ Otherwise, institutional adjustments to the EU and its functioning can also be achieved in the framework of new accession treaties, as envisaged by Article 49 TEU. Yet, more drastic options are also in the cards, particularly if the states dragging their feet on treaty changes are those experiencing rule of law backsliding. If this were to happen, it may create an incentive for groups of vanguard Member States to conclude a separate inter-se intergovernmental agreement, on the side of the EU. Along this line, a proposal which I had advanced to the AFCO of the EP in the past, would be to adopt a Political Compact among willing Member States.²⁰¹

²⁰⁰ See European Parliament resolution of 9 June 2022 on the call for a Convention for the revision of the Treaties, P9_TA(2022)0244.

²⁰¹ See further Federico Fabbrini, Possible Avenues towards Further Political Integration, Policy Department for Citizens' Rights and Constitutional Affairs, Directorate-General for Internal Policies, European Parliament, June 2020.

6. CONCLUSION

This study examined the impact of the Covid-19 pandemic and the war in Ukraine on the EU constitutional architecture of economic governance, focusing specifically on EU fiscal policy. The study argued that the EU's responses to these recent crises led to profound transformations in EMU, which contributed to rebalancing the original asymmetry dating back to the Maastricht Treaty. In response to the pandemic, the EU adopted the SURE mechanism and NGEU, which established a fiscal capacity in the EU. The latter in particular, allows the EU to issue a large amount of common debt to raise funds, which are then transferred to the Member States as both loans and grants, and will be repaid in the long term by raising new EU taxes. As such, NGEU endows the EU with borrowing, spending and taxing powers. Moreover, while the instruments designed to address Covid-19 were formally set up to be temporary, in response to the war in Ukraine, the EU adopted the EPF and the MFA+. The latter, in particular, re-uses the legal technology of SURE and NGEU to fund the Ukrainian government, and as such contributes to consolidate a fiscal capacity in the EU.

However, advances in EU fiscal integration have so far not been equally matched by corresponding constitutional adjustments. While all legal instruments adopted to respond to the pandemic and the war in Ukraine could safely be established within the current treaty framework, a number of structural challenges surround the abovementioned developments. In particular, from an institutional viewpoint, the EP – the only directly elected EU institutions – continues to be mostly excluded by decisions of borrowing, spending and taxing – a state of affairs which is not sustainable as the EU fiscal union expands. Moreover, from a substantive viewpoint, the primary law rules on the approval of the ORD, MFF and tax legislation hamper the capacity of the EU to raise resources when necessary – a state of affairs which is not sustainable given the growing domestic and foreign EU's fiscal responsibilities. Moving forward, therefore, several constitutional reforms would be needed to enhance the EU's legitimacy and effectiveness. The Conference on the Future of Europe has outlined a path, but most likely the prospect of enlargement will offer a window of opportunity to move in the direction of a political union.

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This study, commissioned by the European Parliament’s Policy Department for Citizens’ Rights and Constitutional Affairs at the request of the AFCO Committee, examines the fiscal responses of the European Union (EU) to the Covid-19 pandemic and the war in Ukraine. It claims that the law & policy tools developed to address these crises have led to the establishment, and consolidation, of an EU fiscal capacity —contributing to overcoming the original imbalance of the EU’s Economic & Monetary Union. Nevertheless, the study claims that these developments now require appropriate institutional adjustments, and considers options to achieve them.

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