Constitutional Innovation, Democratic Stagnation?

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This week, the European Commission published the much-awaited financing details and legal paperwork for the recovery fund proposed by the Eurogroup in April. After the Merkel-Macron proposal had received a chilling response from the "Frugal Four", insisting on loans instead of grants, the recovery plan of the Commission entitled "Next Generation EU" proposes a compromise that goes beyond the ominous lowest common denominator. With a package of EUR 750bn in total, comprising EUR 250bn in loans and the rest in grants, the Commission paves the way for both forward-looking public finance and constitutional innovation. This contribution will focus on the latter. The proposals are masterpieces of high-tech legal engineering. Again, European constitutional law evolves through crisis. Yet, again, it stands to reason how far the proposed instruments will shift the European Union towards enhancing solidarity and democracy.

The Legal Basis: Divide and Rule

The legal basis the Commission would use was the one-million-dollar question. Many different proposals came up ever since the need for a fiscal response emerged. The proposal by the Commission splits the Recovery Fund into several legal acts.

Their centerpiece is the so-called European Union Recovery Instrument (ERI) to be adopted under Article 122 (2) TFEU, the Council's competence for emergency measures. Substantially, however, it is only a shell, the constitutional equivalent to a letterbox firm. Unlike prior vehicles adopted under Article 122 (2) TFEU like the European Financial Stability Mechanism or the recent SURE proposal to support employment, the ERI neither empowers the commission to borrow funds on the financial markets, nor does it specify how the money should be disbursed. Rather, it "delegates" the borrowing to the new Own Resources Decision pursuant to Article 311 TFEU, and determines the allocation of the EUR 750bn to no less than eleven Union programmes, earmarking for each programme the respective amount of grants, loans, and guarantees. The programmes comprise both old and new ones that significantly prolong the list of EU acronyms. The proposed Recovery and Resilience Facility (RRF), to be adopted under Article 175 TFEU, will disburse the largest slice of the pie.

What is the logic behind this legal high-wire act? Although the Treaty text is not entirely clear, it is generally assumed that Articles 310 and 311 TFEU prohibit the Union from indebting itself to fund its general budget. Union programmes have to be financed through the Union's Own Resources, i.e. genuine EU revenues like tariffs and fines, and GNI-based Member State contributions. The Union may issue debt only for specified purposes, such as the vehicles established under Articles 122 (2), 143 (2), or 352 TFEU. Such debt instruments usually receive guarantees from the Member States to ensure

they have no impact on the Union's Own Resources. The vehicles established so far are managed by the Council or by the Council and the Commission without involving the European Parliament.

Given the much larger volume of the recovery instrument, this familiar institutional model may seem inappropriate. Funding the ERI through Own Resources allows on the one hand escaping the need to ask the Member States for financial guarantees and the actual or potential constitutional implications this may cause. On the other hand, it allows getting the European Parliament involved.

Courts may have to test at some point if this legal construction is waterproof or – God help us – *ultra vires*. Some might suggest that it effectively circumvents the prohibition of EU to incur debt. However, we believe that this construction reflects yet another incremental development of the Treaties in line with fundamentally changing contexts. Similar to the shifts in understanding Article 125 TFEU in the course of the European debt crisis, the Corona crisis may reshape views about the extent of permissible Union emergency assistance. While one should be wary of reconstructing a constitution through emergency provisions like Article 122 (2) TFEU, the limits of permissible emergency responses are ambiguous. The current crisis laid bare and exacerbated underlying economic and social vulnerabilities. There is therefore an intrinsic relation between sustainable emergency measures and long-term strategies for economic development. Consequently, the Union programmes funded by the ERI will address both short-term and long-term needs. In light of the latter, one may understand the combination of Articles 122 (2) with Own Resources and Union programmes as an expression of the proportionality principle, mitigating the institutional implications of using an emergency clause by aligning the facility with regular Union procedures.

The End of Juste Retour?

Handouts from the RRF will be allocated based on need, in accordance with a formula reflecting population, the inverse per-capita GDP, and the relative unemployment rate. However, as the funds are part of the Own Resources, RRF expenditure will have an impact on the *juste retour* principle. This is a political rule guiding EU budgetary negotiations. Accordingly, Member States fiercely guard their operating budgetary balances, i.e. the net balance of their contributions to the Union's Own Resources and the expenditure allocated to them.

Juste retour has been under heavy fire as it entirely ignores indirect benefits such as those deriving from higher growth levels in other Member States. RRF will aggravate the concerns about *juste retour* as it bears a redistributive character. It therefore seems high time for the Member States to drop the principle. In fact, as it originated in the need to calculate the UK rebate, this would be one of the few problems which Brexit actually helped solving. Moreover, as repayments starting in 2028 are supposed to tap on new sources of EU revenue such as green and digital taxes, the operating budgetary balance would become even more obsolete.

The Expenditure Side: The Resilience and Recovery Facility within the European Semester

The RRF as the main vehicle for the disbursement of the funds is embedded in the European Semester, a framework bringing together different strains of EU policy coordination and surveillance. The Semester starts each year in November, when the Commission adopts the Annual Growth Survey (AGS). After endorsement by the European Council, it should feed into Member States' National Reform Programmes (NRPs) and Stability or Convergence Programmes (SCPs). In May, the Commission evaluates national reform and fiscal plans and issues Country-Specific Recommendations (CSRs) that set out the actions to be taken by the concerned State. In July, CSRs are finally approved by the ECOFIN Council.

A State wishing to obtain the funds made available through the RRF has to make a request and submit a national recovery and resilience plan. This plan will constitute an annex of the NRP to be submitted by 30 April, but a draft can already be handed in starting from 15 October of the preceding year, together with the draft budget law. The plan should explain how the Member State intends to pursue the objectives set by Article 4 RRF Regulation. It has to be consistent with the relevant country-specific challenges and priorities identified in the context of the European Semester. Moreover, it should align with the information included by the Member State in the NRP under the European Semester as well as in other plans requested by Union law.

Unlike in the case of the adoption of CSRs, Article 16 RRF Regulation entrusts exclusively the Commission with the power of assessing the plan submitted by the Member State. The assessment requires the Commission to take into consideration a long list of criteria, so to establish if the envisaged measures effectively follow the CSRs issued in the context of the Semester and contribute to the achievement of the objectives seen above. At the end of this process, the Commission issues a decision, taking the form of an implementing act and setting out the reforms and investment projects to be implemented by the Member State, including the milestones and targets, and the financial contribution allocated. If the Member State requested a loan, such decision also details the amount of the loan and the conditions of its use (Article 17(2) RRF Regulation). A point worth highlighting is that Article 17(3)(c) RRF Regulation gives to the Commission the power to reject a request by a Member State, if it considers that the plan is not satisfactory.

Funds disbursed through the RRF are, thus, conditional transfers. To obtain them, Member States have to commit to pursuing a closed set of objectives established by the RRF Regulation. This is one of the features that set the RRF apart from other types of transfers, such as the one taking place through the Structural Funds. One cannot but welcome the fact that this set of objectives is sensibly different from the one that has traditionally dominated the economic and social policy coordination within the European Semester. Especially during its early cycles, the European Semester tended to focus on a narrow set of policy objectives, such as budgetary discipline and

competitiveness, prioritizing them over potentially conflicting goals, such as social ones. Conversely, as seen above, the RRF should be geared toward cushioning the economic and social impact of the crisis, promoting the green and digital transitions, by promoting a sustainable growth and fostering employment creation. This is not to say that the act marks the end of the obsession with austerity and internal devaluation strategies that characterized the European economic governance since the sovereign debt crisis, but it certainly brings it more in line with Article 3 TEU, at least on paper. Much will depend on how the Commission will define the above-mentioned objectives and how it will manage conflicts and tradeoffs between them.

While budgetary discipline is not explicitly mentioned among the objectives of the RRF, the RRF Regulation does not fully get this (un)holy cow off the ice. Article 9 RRF Regulation allows the Council, acting on a proposal by the Commission, to suspend payments in the event of significant non-compliance with the obligations set by the Stability and Growth Pact, the Macroeconomic Imbalance Procedure or a macroeconomic adjustment programme.

Lastly, it is highly unfortunate that the respect for the rule of law does not figure in the list of objectives that Member States have to commit to, in order to be eligible to obtain funds disbursed by the RRF. The Commission's Proposal makes a very passing reference to this issue in Recital 39, which deals with implementation and operational arrangements. The Recital recognizes that "the respect for the rule of law is an essential precondition for sound financial management and effective EU funding", but otherwise the RRF Regulation is silent on this issue.

Institutional Implications and Consequences for European Democracy

The proposal empowers two actors in particular, the European Commission and national governments. On the revenue side, the Own Resources Decision is the central instrument, adopted under Article 311 TFEU by the Council alone, after hearing the European Parliament. On the expenditure side, connecting the RRF with the European Semester enormously enhances the Commission's capacity to exercise policy formulation, supervision and guidance on key issues of economic and social policies. It is easy to predict that the Commission will not idly wait for the Member States to submit their resilience and recovery plan, but will play an active part already in their formulation. The RRF Regulation admits this – indeed quite openly – when allowing the Member States to submit a draft version of the plan already on 15 October of the previous year and that the Commission "may make observations or seek additional information", whereupon the Member State "may revise the plan if needed, prior to its official submission" (Article 16(1) RRF Regulation). In this bilateral relationship, the Commission will be in a stronger position than the Member State, as it controls the financial resources desired by the other party.

Despite proposing Article 175 TFEU as the legal basis for the RRF Regulation – which entails adoption in accordance with the ordinary legislative procedure – the role of the European Parliament will be rather limited. The rescue plan will be characterized by intergovernmental bargaining and technocratic bickering. As long as the ERI lasts, the ordinary budgetary process under Article 314 TFEU, which gives Parliament and commission an equal role, gets relegated to a back seat. This may result to a considerable extent from the need to navigate a labyrinth of treaty provisions with budgetary relevance, rather than from deliberate design. Of course, the ERI is only of limited duration. But it might create path dependencies for future borrowings of the EU. Perhaps only the establishment of large, genuinely European projects would shift the Union from an intergovernmental logic of decision-making towards a more solidary institutional framework.

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