

# Trial by Fire: The Legal and Constitutional Implications of Member State Bailouts

Oskari Juurikkala

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Polity, 21 March 2011

## Overview

- Background: debt crisis
- What's going on now
- Bailouts: legality
- Treaty change
- Member state perspectives
- "An ever closer union..."

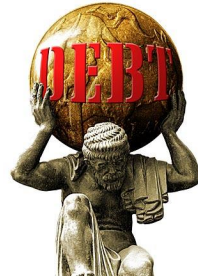
Oskari Juurikkala / Center of Excellence in Foundations of European Law and Polity, 21 March 2011

## PART 1

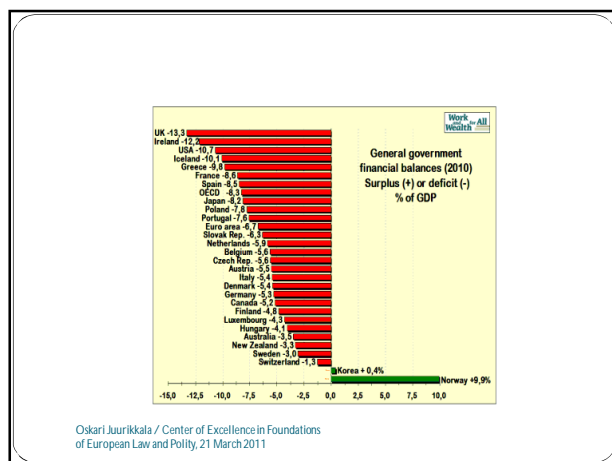
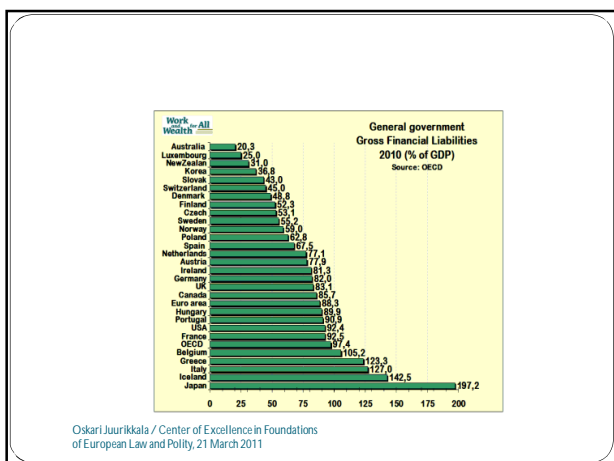
- Background: debt crisis
  - A mountain of debt
  - Greece
  - Ireland
- What's going on now
- Bailouts: legality
- Treaty change
- Member state perspectives
- "An ever closer union..."

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Polity, 21 March 2011

## Background: debt crisis



Oskari Juurikkala / Center of Excellence in Foundations of European Law and Polity, 21 March 2011





Oskari Juurikkala / Center of Excellence in Foundations of European Law and Polity, 21 March 2011



Oskari Juurikkala / Center of Excellence in Foundations of European Law and Polity, 21 March 2011



Oskari Juurikkala / Center of Excellence in Foundations of European Law and Polity, 21 March 2011

## 2007- financial crisis



Oskari Juurikkala / Center of Excellence in Foundations of European Law and Polity, 21 March 2011



Oskari Juurikkala / Center of Excellence in Foundations of European Law and Polity, 21 March 2011

## In the past...

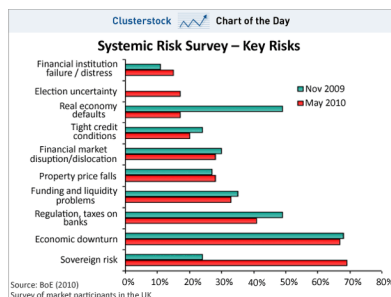


Oskari Juurikkala / Center of Excellence in Foundations of European Law and Polity, 21 March 2011

... and today



Oskari Juurikkala / Center of Excellence in Foundations of European Law and Polity, 21 March 2011



Oskari Juurikkala / Center of Excellence in Foundations of European Law and Polity, 21 March 2011



Oskari Juurikkala / Center of Excellence in Foundations of European Law and Polity, 21 March 2011



Oskari Juurikkala / Center of Excellence in Foundations of European Law and Polity, 21 March 2011



Oskari Juurikkala / Center of Excellence in Foundations of European Law and Polity, 21 March 2011

## PART 2

- Background: debt crisis
- What's going on now
  - Loans to Greece
  - ECB bond purchases
  - European Financial Stability Facility (EFSF)
  - European Stability Mechanism (ESM)
- Bailouts: legality
- Treaty change
- Member state perspectives
- "An ever closer union..."

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Polity, 21 March 2011

## Loans to Greece

- Coordinated bilateral loans
- EU (80 bn.) + IMF (30 bn.)
- Around 5% interest
- Currently being renegotiated?

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Polity, 21 March 2011

## ECB bond purchases

- To Greece and Ireland
- About €76 bn. by now?

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Polity, 21 March 2011

## EFSF

- European Financial Stability Mechanism
  - Intergovernmental fund, kind of "eurobond" backed by euro zone Member States
  - Initial plan €440 bn.
  - In force until 2013
- Also European Financial Stabilisation Mechanism (EFSM)
  - Commission using EU budget as collateral (all Member States would pay extra if default)
  - €60 bn. facility
  - Reviewed every 6 months

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Polity, 21 March 2011

## EFSF: guarantees issue

- Current debate: insufficient guarantees
  - Problem: complexity and lack of transparency → markets find it difficult to assess creditworthiness
- Opposition in Finland

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Polity, 21 March 2011

## ESM

- European Stability Mechanism
- Like "permanent EFSF"
- A way to "Eurobonds"?
  - ALDE group in Parliament pushing for this explicitly
  - Heavily criticized in Germany

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Polity, 21 March 2011

## PART 3

- Background: debt crisis
- What's going on now
- Bailouts: legality
  - "No bailout" clause
  - Arguments pro/contra
  - Legal cases
  - ECB operations
- Treaty change
- Member state perspectives
- "An ever closer union..."

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Polity, 21 March 2011

## "No bailout" clause

- Article 125 TFEU: positive and negative partitioning
- "The Union shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of any Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project.
- "A Member State shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of another Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project."

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Policy, 21 March 2011

## "No bailout" clause: interpretation

- Literal meaning
  - Obviously "not liable" in literal sense
  - What does "assuming commitments" mean?
- Teleological interpretation
  - Maastricht Treaty negotiations: worries about monetary union with fiscally less disciplined states
  - Economics of bailouts: "moral hazard" problem → need to "tie the hands" of Union and other Members
  - Germany: strictly against a fiscal transfer union (*Transferunion*)
  - Lisbon Treaty: meant to guard against creeping federalism?

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Policy, 21 March 2011

## Arguments pro/contra (1)

- "Not bailouts, but interest paying loans."
- Greece: about 5% (slightly more than current debt-servicing costs of less indebted Members)
  - "Interest rates will be non-concessional, i.e. not contain any subsidy element." (EU leaders agreement in April)
- Calculation of a "fundamental" market price
  - Long term interest rate: Before euro? Before admitting cooking the books?
  - Interest rates of countries with similar credit ratings?

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Policy, 21 March 2011

## Counterarguments

- If ordinary loans – why all the hassle?
- Clearly not market rate of interest
  - Greek argument unscientific
  - Now a major default ("restructuring") expected on these loans
- ECB bond purchases manipulate market prices
  - CDS market tells a different story

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Policy, 21 March 2011

## Arguments pro/contra (2)

- Bailouts come within Article 122(2) TFEU exception
- "Where a Member State is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or *exceptional occurrences beyond its control*, the Council, on a proposal from the Commission, may grant, under certain conditions, Union financial assistance to the Member State concerned. The President of the Council shall inform the European Parliament of the decision taken."
- Argument that Greek crisis was caused by a "market conspiracy" or "financial mafia" that wanted to destroy euro

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Policy, 21 March 2011

## Counterarguments

- Literal interpretation: doubtful whether a debt crisis is an "exceptional occurrence beyond the control" of the state.
  - "Conspiracy" and "mafia" arguments not serious
  - Subsequent event show that Greek crisis was not result a momentary speculation
- Teleological interpretation: Art. 122 was intended to deal with natural and energy catastrophes.
  - Applying it to Member state debt problems (Art. 125) would water-down the latter beyond recognition.
  - Would also reinforce perverse incentives to cook the book and get country into real trouble by surprise

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Policy, 21 March 2011

## Further arguments contra

- German legal scholars: strong consensus that bailouts violated EU treaty (and possibly German law too)
- EU sees necessity of treaty change to justify ESM = implicit admission of the illegality of ongoing bailouts?

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Policy, 21 March 2011

## Legal cases

- German Constitutional Court (Prof. Wilhelm Hanke)
  - Claim: violation of EU law and German Constitution (GG)
  - Decision: state can decide?
  - EU aspect not forwarded to ECJ?
- EU: Ax v Council (Case T-259/10, 8 June 2010)
  - Claim: EFSF violates Art. 125 TFEU
  - Not decided yet?

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Policy, 21 March 2011

## ECB interventions: Art. 123

- European Central Bank interventions (in support of Ireland)
- Article 123 TFEU:
  - "Overdraft facilities or any other type of credit facility with the European Central Bank or with the central banks of the Member States (hereinafter referred to as 'national central banks') in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States *shall be prohibited, as shall the purchase directly from them by the European Central Bank or national central banks of debt instruments.*"

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Policy, 21 March 2011

## ECB interventions: assessment

- Huge uproar in Germany (especially Axel Weber)
- ECB would not, at first, admit the purchases
- Arguments in favour:
  - Purchased through secondary markets?
  - Threat to euro zone – intervention to protect euro
- Arguments against:
  - Meaning of "purchase directly...?"
  - Favouring certain Member states
  - Political pressure – loss of independence

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Policy, 21 March 2011

## PART 4

- Background: debt crisis
- What's going on now
- Bailouts: legality
- Treaty change
  - Why?
  - How? Procedure + change options.
- Member state perspectives
- "An ever closer union..."

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Policy, 21 March 2011

## Treaty change: Why?

- Objective: to guarantee legality of bailout mechanisms
- Threat of future legal challenges to European Stability Mechanism (ESM)
  - ESM especially problematic constitutionally, because creates permanent system
  - Details of ESM decision making and triggers yet to be seen (current proposals use strong but legally vague language)
- Treaty change might also retrospectively justify ongoing bailouts

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Policy, 21 March 2011

## How? Treaty change options (1)

- Article 125 TFEU (“no bailout” clause)
  - No: lot of opposition (including Finland and Germany)
  - German Constitutional Court would never accept
- Article 122 (catastrophe measures clause)
  - 122(1) (energy supply): refers to “spirit a solidarity” – hard to reconcile with “no bailout” clause
  - 122(2): refers to individual Member States – but ESM should only guard euro zone, and not to assist individual States but to protect stability of euro zone

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Polity, 21 March 2011

## How? Treaty change options (2)

- Article 143 (crisis assistance to euro accession State)
  - But only deals with non-euro States (and is located in Chapter 5: Transitional Provisions)
- Final choice: Article 136 (euro zone coordination and guidelines clause)
- Proposed new paragraph:
  - *“The Member States whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the euro area as a whole. The granting of any required financial assistance under the mechanism will be made subject to strict conditionality.”*

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Polity, 21 March 2011

## How? Procedure options

- Four amendment options (Article 48 TEU):
  - a) Ordinary revision procedure (ORP)
    - Problems: time, attention, and ratification procedures
  - b) Simplified revision procedure (SRP)
    - Tougher requirements
  - c) General “passerelle clause” [not relevant]
  - d) Accession treaties [not relevant]

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Polity, 21 March 2011

## Simplified revision procedure (SRP)

- Requirements:
  - Limited to Part Three of TFEU: i.e. Internal policies, not institutional reforms (OK)
  - Does not alter Union competences (OK?)
- Procedure:
  1. European Council *evaluates* whether proposal meets criteria
  2. European Council *consults* Commission and EP (and ECB in changes to monetary policy)
  3. European Council adopts proposal by *unanimity*
  4. Member States *ratify* amendment according to national procedures

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Polity, 21 March 2011

## SRP: issues and implications

- Choice of procedure and substance are interlinked
- German and Czech Constitutional Courts have expressed reservations about the simplified revision procedure (may be used in dubious attempts to pass controversial amendments)
- Fundamental that new provision is not seen as increasing Union competences
  - Intergovernmentalism?
  - “Eurobond” proposal unlikely?
- SRP = “small” treaty change → *less likely to require referenda?*

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Polity, 21 March 2011

## PART 5

- Background: debt crisis
- What's going on now
- Bailouts: legality
- Treaty change
- Member state perspectives
  - Germany
  - Ireland
  - UK
  - Netherlands
  - Finland
- “An ever closer union...”

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Polity, 21 March 2011

## Germany

- Initially very strong opposition to bailouts
  - "We have a Treaty under which there is no possibility of paying to bailout states in difficulty" (Angela Merkel, 1 March 2010)
  - "Aid for Greece would be the wrong signal. (...) It cannot be possible that German taxpayers have to pick up the bill for mismanagement in Greece and elsewhere." (German Economy Minister, Rainer Brüderle, 24 March 2010)
- Political pressure mounting
  - CDU party has been suffering electoral setbacks (including losing their seat in Hamburg)
  - 27 March: regional elections in Baden-Württemberg

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Policy, 21 March 2011

## Constitutional Court

- German Constitutional Court watching carefully EU evolution
  - Lisbon Treaty case (2009) – sovereignty of Germany
  - Maastricht Treaty case (1993) – right to monitor EU legal evolution and its compatibility with German Constitution
- Greek bailouts case: loans accepted?
- January 2011: new case against bailout facility (ESM) and ECB bond purchases (led by Prof. Markus Kerber)
- Changing EMU to a fiscal transfer union (*Transferunion*) would be a major change

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Policy, 21 March 2011

## Ireland

- *Lenfante terrible* of deeper integration?
- Problem: legal requirement of referendum if any change to the "essential scope and objectives" of the EU
- May be avoided:
  - "Small" treaty change = no essential change?
  - SRP = no increase in Union competences?

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Policy, 21 March 2011

## United Kingdom

- Not euro – not hugely interested in this specifically
- Problem: treaty change etc. must be accepted there too
- New "*referendum lock*" (European Union Bill, is being passed)
  - Increase of competences must be subject to referendum → important that no new competences
  - In practice, largely depends on government

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Policy, 21 March 2011

## Netherlands

- Political opposition to bailouts
- November 2011: two parties proposed referendum on changing EU treaty
  - Right-wing Dutch Freedom Party
  - Socialist Party (opposition)

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Policy, 21 March 2011

## Finland

- Among the best-doing Member States fiscally; banks also strong
- Political opposition to EU and bailouts rising (True Finns Party)
- Parliamentary elections in April → government tries to avoid discussing the bailout issue
- 10 March: Parliament's Grand Committee (*suuri valiokunta*) voted against giving the government a mandate to increase the loan guarantees (despite government not yet asking for mandate)

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Policy, 21 March 2011

## PART 6

- Background: debt crisis
- What's going on now
- Bailouts: legality
- Treaty change
- Member state perspectives
- "An ever closer union..."
  - Fiscal union (Stability and Growth Pact III)
  - "Pact for the Euro"

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Policy, 21 March 2011

## Fiscal union

- ESM
- New Stability and Growth Pact
  - Budget control in Brussels?
  - ...

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Policy, 21 March 2011

## "Pact for the Euro"

- SGP-III
- Tax harmonization? (contra Ireland)
- Labour market harmonization?
- Pension systems?
- ...

Oskari Juurikkala / Center of Excellence in Foundations of European Law and Policy, 21 March 2011

## Eurocrats will save us...



Oskari Juurikkala / Center of Excellence in Foundations of European Law and Policy, 21 March 2011