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The future of common borrowing

A legal analysis

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Winner of the 2022 Jacques Delors Prize for the best thesis on a subject relating to European integration

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Abstract

While common borrowing has been part of the EU policy toolbox since the times of the European Coal and Steel Community, it has only recently regained some public prominence. First, the pandemic brought about a truly novel feature in borrowing operations: the possibility to finance common EU expenditure. Later, the war in Ukraine has led the EU to engage in common borrowing to provide the country with macro-financial assistance.

The legal design of these operations is to be admired, particularly given the previous –and widespread– belief that the EU could not engage in borrowing to finance its own expenditure. Nevertheless, the current legal understanding of common borrowing does not solve all the challenges that lie ahead. For instance, the rules that guide the level of financial caution in the EU are slowing down the disbursement of

aid to a country in dire need of it. Further, the possibility of resorting again to borrowing for spending is now more limited after the NGEU, given the introduction of an explicit prohibition on borrowing to finance operational expenditure in the 2020 amendment of the Own Resources Decision.

This policy paper tackles the future challenges of common borrowing from a legal perspective. In particular, it deals first with the level of caution that the EU should take when engaging in these operations and, secondly, with the future of borrowing for spending.

In so doing, it will discuss the legal nature of the requirements on balanced budget and fiscal discipline, examine their historical evolution and compare their application to debt borrowing in the EU with that of US States. In the hope of providing more clarity to future borrowing operations, it also identifies all the applicable rules and principles and tries to systematise them according to the stage of the operation to which they apply (issuance, authorisation to borrow and use of proceeds). Moreover, it tackles the particularities of borrowing for spending, including the consequences of its prohibition in the last amendment of the Own Resources Decision. When applicable, the paper provides alternative interpretations, in the hope that they can open up new possibilities for the use of common borrowing and even speed up the process of providing financial assistance to Ukraine.

Résumé

Si l'émission d'une dette commune fait partie des outils dont l'UE dispose depuis la Communauté européenne du charbon et de l'acier, le sujet n'est revenu que récemment au centre du débat public. D'abord, la pandémie a apporté une nouveauté en matière d'opérations d'emprunt, à savoir la possibilité de financer les dépenses communes de l'UE. Ensuite, la guerre en Ukraine a conduit l'UE à recourir à des emprunts communs afin de fournir à l'Ukraine une assistance macro-financière.

La conception juridique de ces opérations est en elle-même remarquable, en particulier compte tenu de la conviction passée et très répandue que l'UE ne pouvait pas emprunter des fonds pour financer ses propres dépenses. Néanmoins, le cadre juridique qui régit l'emprunt commun, telle que nous le concevons aujourd'hui, ne nous permettra pas de relever l'ensemble des défis à venir. Par exemple, les règles européennes de prudence financière freinent le versement des aides accordées à l'Ukraine, alors que le pays en a urgemment besoin. De plus, la possibilité pour l'UE de recourir une nouvelle fois à des emprunts communs pour des dépenses est davantage limitée depuis l'approbation de *NextGenerationEU*, à cause de l'introduction d'une interdiction explicite d'emprunter des fonds sur les marchés pour le financement de dépenses opérationnelles dans la modification en 2020 de la décision sur les ressources propres.

Ainsi, ce *policy paper* s'intéresse d'un point de vue juridique aux défis futurs en matière d'emprunt commun. Il traite en particulier du niveau de prudence que l'UE devrait adopter lorsqu'elle a recours à de telles opérations, et aborde également la question de l'avenir de l'emprunt pour les dépenses.

Pour ce faire, nous nous pencherons d'abord sur la nature juridique des exigences en matière d'équilibre budgétaire et de discipline fiscale, examinerons leur évolution dans le temps, et comparerons leur application à l'émission de dette commune dans l'UE et aux États-Unis. Dans la perspective de guider les futures opérations d'emprunt, nous nous attacherons ensuite à identifier l'ensemble des règles et principes en vigueur dans l'UE en matière d'emprunt, et en proposerons une catégorisation

fondée sur l'étape de l'opération à laquelle ils interviennent (émission, autorisation d'emprunt, et utilisation des fonds). Enfin, nous analyserons les spécificités de l'emprunt pour les dépenses, notamment les conséquences de son interdiction dans la dernière décision sur les ressources propres de l'UE. Lorsque cela est possible, nous soumettrons des interprétations alternatives à même d'offrir de nouvelles perspectives quant au recours à l'emprunt commun ou bien d'accélérer la procédure d'assistance financière à l'Ukraine.

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Introduction: the future challenges of common borrowing

Issuing debt at the EU level came to the spotlight during the covid-19 pandemic when the need to provide fiscal support to Member States and prevent an asymmetric recovery led to the approval of the Next Generation EU and the SURE programmes. It has also regained some public prominence with the recent efforts to provide macro-financial assistance to Ukraine and to cope with the energy crisis.[1]

The case of macro-financial assistance to Ukraine is a paradigmatic example of the challenges that common debt faces. According to Ukrainian representatives, the country is in dire need of between €3.5[2] to €5 bn[3] a month to keep on running. In order to contribute to bridging that gap, the Commission proposed in May 2022 a €9bn package of financial assistance financed via common debt.[4] Nevertheless, only €1 bn has been disbursed so far.[5] The following tranche of €5 bn was approved on 20 September 2022[6] (four months after the Commission announced the package) and it is not yet disbursed. The remaining €3 bn still require action from the Commission to be adopted. This slow pace of disbursements is creating tensions with Washington, which has already sent €8.4 bn to the country under attack and is calling on the EU to speed up the process.[7] The Commission seems to be justifying the delay based on budgetary considerations, pointing out that the risks associated with this assistance in the context of a war require an adequate budgetary cover that takes time to be put in place.[8]

This policy paper will thus try to analyse what the restrictions on the raise and use of common debt are. What kind of budgetary coverage does financial assistance to Ukraine need and why does it take time to be put in place? And more importantly, are there any other legal interpretations of the provisions that guide the level of budgetary caution that could speed up the process of providing economic assistance to this country? This will be the subject of discussion in the **first part of this paper, the focus of which will be the concepts of balanced budget and fiscal discipline**.

This paper will analyse the constraints they impose on borrowing (budget neutrality and backing by EU own resources), delve into their legal nature and rethink some of the elements of the current legal understanding on these concepts. It will be discussed whether they are merely rules or, rather, principles of law, for which a historical evolution of the applicable EU provisions (and of balanced budget rules in Member States) will be provided. This overview will also try to find similarities and differences with the legal framework guiding debt issuance in US States.

1 At the moment of drafting this paper, some voices within the College of Commissioners have suggested to resorting to common debt to face the energy crisis [*Cf.* BRETON and GENTILONI, 'Germany's latest response to energy crisis raises questions', *The Irish Times*, 03.10.2022 [link]].

2 FOY, POLITI and SMITH, 'US presses EU to speed up financial aid to Ukraine', *Financial Times*¸ 28.09.202 [link]. Figure attributed to the Prime Minister of Ukraine.

3 SHEVCHENKO, 'Ukraine's war economy urgently needs more international support', *Financial Times*, 12.09.2022 [link]. Figure attributed to the Finance Ministry of Ukraine.

4 European Commission, Communication on Ukrainian relief and reconstruction, COM(2022) 233 final [18.05.2020]. This arrives in addition to the €1.2 bn approved in Council Decision (EU) 2022/313 of 24 February 2022 providing macro-financial assistance to Ukraine, [2022] O.J. L55/4

5 While Council Decision (EU) 2022/1201 providing exceptional macro-financial assistance to Ukraine, [2022] O.J. L 186/1 was approved on 12 July 2022, actual disbursements took place on the first and second of August 2022 [*Cf.* European Commission, Proposal for a Decision providing exceptional macro-financial assistance to Ukraine, COM(2022) 557 final [7.9.2022]].

6 Decision (UE) 2022/1628 of 20 September 2022 providing macro-financial assistance to Ukraine, [2022] O.J. L 245/1.

7 FOY, POLITI and SMITH, *Cf.* footnote 2.

8 *Ibid.*

The **second part of this paper will focus on the future of borrowing for spending**. One of the reasons why NGEU is so revolutionary in the eyes of so many is that for the first time the EU is financing common expenditure by issuing its own debt. Prior to that, the classic mantra was that the EU could not engage in borrowing for spending but only in back-to-back lending (using common debt to provide loans).

The belief that the EU could not issue debt to finance its own expenditure was so widespread that, prior to the pandemic, the Council and Commission's websites allegedly stated that '*EU borrowing was only permitted to finance loans to countries*'.[9] Moreover, the fact that the Council Level Service (hereinafter, 'CLS') made public its Opinion on the compatibility of the instrument with the treaties[10] (contrary to its usual practice)[11] and that the Commission elaborated a dedicated section of 'questions and answers' on the legal construction of NGEU[12] might show that there was indeed a high degree of uncertainty about the legality of NGEU. In a true exercise of legal engineering, NGEU managed to show that borrowing for spending is very well possible. Nevertheless, many questions remain unanswered about its future.

Some of those questions have to do with the procedure to issue new debt. Will the EU always need to amend the Own Resources Decision (hereinafter, the 'ORD') and hence face the potential veto of all Member States and their national parliaments? Some others turn around the use of proceeds. Is article 122 TFEU the only option or could other legal bases be used to allocate proceeds of common debt? But the most crucial question is whether it is even possible to resort to borrowing for spending again. This incognita is based on the ironic fact that the ORD, the same piece of legislation that authorises the first borrowing for spending operation in the EU's history, also states that '[t]*he Union shall not use funds borrowed on capital markets for the financing of operational expenditure* (Article 4 ORD)'.[13] As the ORD is a norm of quasi-constitutional importance,[14] this provision raises the question of whether there is any future for borrowing for spending at all.

The second part of this policy paper will thus dig into these questions and the implications of Article 4 ORD in the general scheme of principles that guide debt issuance in the Union. In so doing, this paper will provide an overview of all the rules and principles applicable to borrowing in the EU beyond budgetary balance and fiscal discipline (for instance, the no-bailout clause, the principles of unity and universality and the integrity of the own resources system). It will also try to systematise them according to the stage of the borrowing operation to which they apply (issuance, empowerment to borrow and use of proceeds), in the hope that it can guide future borrowing operations with more clarity.

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9 LEINO-SANDBERG, 'Who is ultra vires now?', (2020) *Verfassungsblog*, [18.06.2020], [link].

10 Opinion of the Council Legal Service 9062/20 on the proposal on NGEU, [24.05.2020] (hereinafter, 'Opinion').

11 DE WITTE, 'The European Union's COVID-19 Recovery Plan: the legal engineering of an economic policy shit', (2021) 58 CMLR, 663.

12 Q&A of the European Commission on the legal construction of NGEU, [09.06.2020] [link] (hereinafter, 'Q&A').

13 Council Decision 2020/2053 of 14 December 2020 on the system of own resources of the European Union, [2020] O.J. L 424/1.

14 DE GREGORIO MERINO, A. 'The Recovery Plan: Solidarity and the living constitution', in D. UTRILLA and A. SHABBIR (eds), *EU law in times of pandemic*, EULawlive Press, 2021, 39.

I . Finding the right level of caution

Two main notions guide the level of caution to which the EU subjects itself when it issues debt: 'budget neutrality' and fiscal discipline. Budget neutrality requires borrowing operations to be counterbalanced by an asset that covers the principal, interests and costs associated with the borrowing in order to ensure that the borrowing operation does not have any impact on the budget.[15] Fiscal discipline in the context of borrowing entails that the amount that the EU is allowed to borrow is capped at the available margin between the approved expenditures and the own resources ceiling.

Budget neutrality is at the heart of the difficulties that the EU is encountering to provide financial assistance to Ukraine. While one could think that a back-to-back lending operation such as macro-financial assistance is organically neutral (in the sense that the claim against Ukraine already provides the counterbalancing asset needed to keep it budgetarily neutral), the EU does not seem to understand it in that way in all cases.

When the assistance is directed towards Member States, the EU does not require any other counterbalancing asset for the operation, aside from the commitment of the Member State to repay. That was the case for instance of the assistance provided to Member States through the European Financial Stabilisation Mechanism (hereinafter, EFSM).

However, when the assistance is directed towards a third country, an additional guarantee is required to keep the operation budgetarily neutral. That is why the Guarantee Fund for External Actions was created in 1994.[16] It was aimed at providing an additional guarantee from the EU budget for macro-financial assistance operations to third countries (hereinafter, 'MAF'). Now under the name of 'External Action Guarantee', the Commission must use this instrument to provision these operations at a rate of 9% of the loans provided to the recipient.[17]

In the current context of war in Ukraine, the Commission has estimated that loans to this country require a higher provision of 70%.[18] This new estimation takes up most of the available amounts of the External Action Guarantee. That is why only €1 bn has been able to be covered and disbursed to Ukraine, out of the €9 bn package announced by the Commission in May.[19] That is also why the next tranche of €5 bn will require additional guarantees from the Member States to complement the provision of the Guarantee Fund.[20]

Budget neutrality is also the reason why any new own resource that the EU might approve in the coming years will serve to repay NGEU debt instead of financing different EU programmes. Indeed, given that NGEU was a borrowing for spending operation, the 'trick' to keep it budgetarily neutral was to provide an assurance of payment that would ensure that it would not affect future budgets. That assurance

15 Opinion, n(10), §25.
16 Council Regulation (EC, Euratom) 2728/94 of 31 October 1994 establishing a Guarantee Fund for external actions, [1994] O.J. 293/1
17 Article 31(5) of Regulation (EU) 2021/947 of 9 June 2021establishing the Neighbourhood, Development and International Cooperation Instrument – Global Europe, [2021] O.J. 209/1
18 Recital 12 of Council Decision (EU) 2022/1201 of 12 July 2022 providing exceptional macro-financial assistance to Ukraine, [2022] O.J. L 186/1.
19 European Commission, Proposal for a Decision providing exceptional macro-financial assistance to Ukraine, COM(2022) 557 final [7.9.2022], 4-5. See also GARICANO, 'Financial assistance to Ukraine can't wait', *Politico*, 18.08.2022 [link].
20 *Ibid.*

of payment came from amending the ORD, which expressly established that the increase of the own resources ceiling had to exclusively serve to repay the debt. In practice, that means that NGEU will need to be repaid either through new own resources or, failing that, contributions of Member States.

But where does the notion of 'budget neutrality' comes from? And why does it need to be interpreted in that way? Are there any other alternative interpretations? Those are the questions that will be explored in subsections I and III of this first part.

On the other hand, the second notion that is crucial to understand the level of caution adopted by the EU in its borrowing operations is fiscal discipline. Some of the choices that the EU has made in the last decade regarding the Economic and Monetary Union as well as some the policy debates that we are having today can be explained on the basis of this concept. For instance, why did Member States establish in 2010 a private entity in Luxembourg to provide financial assistance to Member States in distress (the EFSF) when the EU had already created the EFSM under the EU legal framework, which allowed it to do exactly the same thing? Or why did NGEU raise the own resources ceiling, thus exposing itself to the veto not only of Member States but also their national parliaments?

The answer to these questions lies in the understanding of the concept of fiscal discipline, embodied in Article 310(4) TFEU. The way in which the EU has traditionally interpreted this provision in the context of common debt is that, while debt issuance is not prohibited, the full amount borrowed must be able to be repaid by the EU's own resources.[21]

In practice, this means that the amount that the EU is allowed to borrow is capped by the own resources ceiling, which is established in Article 3 of the Own Resources Decision. This ceiling sets the maximum authorised budgetary expenditure; as a result, the total expenditure decided by the co-legislators during the budgetary procedure must always remain below that cap. The ceiling also acts as a limit to the maximum amount that Member States can be called upon to contribute to the EU budget.[22]

The current understanding of the concept of fiscal discipline is that the EU cannot issue debt without a guarantee that Member States would step in to repay the debt in case of need. Given that Member States are not obliged to contribute more than the own resources ceiling, the ceiling caps the maximum amount of borrowing allowed. On the other hand, a significant part of the revenues foreseen in the ORD are already committed to EU expenditure in the budget and MFF. Therefore, borrowing cannot exceed the difference between the own resources ceiling and the approved expenditures (the 'headroom').

This is a key difference with the way in which Member States –and most countries in the world– issue debt. They underpin their credibility on their sovereign power to raise taxes[23] and thus they do not need any ex ante commitment to back their own debt that may limit the maximum amount of borrowing. On the contrary, the EU seems to understand that, given that the final say on how it finances itself depends

21 Opinion, n(10), §29.
22 The EU budget is financed by specific resources established in the ORD; nevertheless, if they are not sufficient to cover the whole budgetary expenditure approved by the legislators, Member States must step in to cover the gap via contributions based on their GNI, pursuant to Article 14(2) of Council Regulation 609/2014 of 26 May 2014 on the methods for the making available the traditional, VAT and GNI-based own resources [2014] O.J. L168/39 (hereinafter, 'MAR').
23 Q&A, n(12).

on Member States (the ORD requires unanimity of all Member States and approval in accordance with their constitutional requirements pursuant to Article 311 TFEU), it must limit its debt commitments to the maximum amount that Member States have accepted to back.

This particularity of the EU legal construction explains why all borrowing operations are constrained by the own resources ceiling. This includes even back-to-back lending operations, where there is theoretically another guarantee of payment from the recipient of the loan. That is why, for instance, the firepower of the EFSM (back-to-back lending) was capped at €60 bn in 2010: it was the headroom available between the approved expenditure by the legislators and the own resources ceiling. Therefore, further assistance needed the establishment of the EFSF –and later on the ESM– outside the EU legal framework.[24] This same reason explains the need to amend the ORD in 2020 to make the NGEU happen: more headroom was needed to be able to issue €750 bn of common debt.[25]

In this context, the question that arises again is why does the EU take such a cautious approach regarding fiscal discipline? Is there any room to provide alternative legal interpretations? And what is the relationship between fiscal discipline and budget neutrality? Subsections II and III will deal with these questions.

I BUDGETARY BALANCE

Article 310(1)(3) TFEU establishes a balanced budget rule (hereinafter, 'BBR') for the EU's accounts: '*the revenue and expenditure shown in the budget shall be in balance*'. This 'balanced budget rule' ('BBR') is part of the reason that explains the widespread belief that the EU could not engage in borrowing for spending –and for many, in any kind of borrowing–. In principle, such a provision entails that the EU cannot incur a deficit through borrowing.[26]

Indeed, if the Union were to issue debt, the profits of such debt would be revenues for the Union; those profits would then appear as an expenditure in the budget when used for their foreseen purpose; however, an additional expenditure would result from such operation: the repayment of the principal and its interest. In the case of borrowing for spending or most back-to-back lending, this would entail that the budget would have an expenditure not balanced with a corresponding revenue, thus incurring an operating deficit and breaching the budgetary balance rule.

The provisions on budgetary balance do not just exist in the TFEU but also in the Financial Regulation ('FR').[27] Under the notion of 'principle of equilibrium', Article 17(1) FR reinstates that '*revenue and payment appropriations shall be in balance*', which does not add much to what the TFEU states. Nevertheless, Article 17(2) FR does introduce further constraints, establishing that the EU '*shall not raise loans within the framework of the budget*'. This outright prohibition makes it seem like the EU cannot engage in borrowing of any kind, not just the one that gives rise to an expenditure.

24 *Cf.* DE WITTE, n(11), 649.
25 Article 6 ORD of Council Decision 2020/2053 of 14 December 2020 on the system of own resources of the European Union, [2020] O.J. L 424/1 temporarily increases the OR ceiling by 0.6% of the GNI of all Member States.
26 Opinion, n(10), §12; Recital 10 Regulation 2018/1046 of 18 July 2018 on the financial rules applicable to the general budget of the Union, [2018] O.J. L193/1.
27 Regulation 2018/1046 of 18 July 2018 on the financial rules applicable to the general budget of the Union, [2018] O.J. L193/1. The Financial Regulation is an act of special nature, given that albeit being secondary law, all other acts of secondary legislation must comply with it [*Cf.* DE WITTE, n(11), 661].

However, none of these provisions has been an absolute obstacle to debt issuance in the EU. On the contrary, the EU has been issuing debt since the times of the European Coal and Steel Community (ECSC) and the Euratom Community. In fact, the Treaty establishing the ECSC contained a specific provision (Article 49) that empowered the High Authority to borrow. The Euratom Treaty, while it contained a BBR in Article 171(1), it also foresaw the possibility of resorting to common debt to finance research and investment (Article 172(4) Euratom Treaty). In the European Economic Community (hereinafter, 'EEC'), on the other hand, the treaty required the budget to be in balance (Article 1999 Treaty of Rome) and did not contain any provision on debt issuance. Nevertheless, that did not prevent the Council to make wide use of the flexibility clause (back then, Article 235 EEC Treaty) to authorise the Community to raise funds in the markets.

Indeed, the Council has been using the flexibility clause since the 1970s to redirect Community debt towards countries that were experiencing difficulties in their balance of payments (either Member States[28] or third countries)[29] and to promote investment in energy, infrastructure and industrial projects.[30] Later on, the EU started relying on provisions relating to financial assistance to authorise the Commission to issue debt on behalf of the Union. For instance, Article 122(2) TFEU, which was introduced in Maastricht as Article 103a EC Treaty, was the basis for establishing the EFSM in 2010.[31] This mechanism helped Greece, Ireland, Portugal, Spain and Cyprus to deal with their economic difficulties during the financial crisis. Further, Article 212 TFEU, which includes financial assistance as part of the Union's competence on external action since the Lisbon reform, has been used to authorise ad hoc Decisions on macro-financial assistance to third countries via common borrowing.[32]

However, up until NGEU, all the borrowing of the Union was used to lend money to Member States, third countries or even companies (back-to-back lending), not to provide grants. For instance, while the ECSC Treaty empowered the High Authority to borrow, Article 51(1) limited the use of proceeds to provide loans to companies. Euratom debt, despite not being constrained by a similar provision in its corresponding treaty, was also used to provide loans only.[33] Finally, the rest of examples of the above-mentioned EEC debt was limited to back-to-back lending pursuant to the same legislative acts that authorised them.

Therefore, the true novelty brought by NGEU was, aside from the size of the borrowing, the fact that it is destined to finance common EU expenditure, most notably the Recovery and Resilience Facility (hereinafter, 'RRF'),[34] whose grant component

28 Council Regulation (EEC) 297/75 of 17 February 1975 concerning Community loans, [1975] OJ L 46/1. This system of Community assistance to Member States merged later on in Council Regulation 1969/88 with a system of assistance *between* Member States already foreseen in Article 108 EEC Treaty. Such Regulation also empowered the Commission to borrow.

29 Macro-financial assistance Decisions started taking place in the 90s, the first Decision being Council Decision 90/83/EEC of 22 February 1990 providing medium-term financial assistance for Hungary, [1990] OJ L 58/7.

30 Council Decision 78/870/EEC of 16 October 1978 empowering the Commission to contract loans for the purpose of promoting investment within the Community, [1978] OJ L 298/9 ('New Community Instrument').

31 Council Regulation 407/2010 of 11 May 2010 establishing a European financial stabilisation mechanism, [2010] O.J. L118/1.

32 See, for instance, Decision 534/2014/EU of 15 May 2014 providing macro-financial assistance to the Republic of Tunisia, [2014] OJ L 151/ 9.

33 Special Report of the Court of Auditors on loans and borrowings, [06.12.1982] O.J. C319/1 (hereinafter, 'Special Report'),§1.2.

34 Regulation 2021/241 of 12 February 2021 establishing the Recovery and Resilience Facility, [2021] O.J. L57/17.

(€390 bn)[35] –despite being directed towards Member States– constitutes a common expenditure of the Union.

The question that must be answered, however, is how the EU has been able to engage in any kind of borrowing operation if it has always had a balanced budget rule enshrined in the treaties.

– **How to borrow? The 'off-budget' trick**

The way in which the EU has engaged in such borrowing operations while having balanced budget provisions in place is by treating them as rules of pure budgetary technique. Indeed, both Articles 310(1)(3) TFEU and 17 FR (both paragraphs) are very explicit as to their application only in the framework of the budget. Borrowing operations were thus possible because they were designed off-budget.

The idea was to make sure that borrowing proceeds did not form part of the budget revenue and their use was not recorded as an expenditure appropriation in the sense of Article 7(2) FR. That way, the operation could not be contrary to Articles 310(1)(3) TFEU and 17 FR.

That has been the case, for instance, of all back-to-back lending so far.[36] For borrowing for spending operations, keeping them off-budget requires an additional step. In NGEU, the part of the borrowing that is given in the form of loans (€360 bn) is off-budget and the part that is destined for EU programmes (€390 bn) is considered '*external assigned revenue*'.[37] Pursuant to Article 21 FR, such kind of revenue is not subject to budgetary approval procedures and the expenditure is not considered part of the appropriations provided by the budget, leading to a comparable situation to off-budget operations.[38]

However, the CLS states that resorting to off-budget operations is an extraordinary solution that must be justified because, otherwise, it would be very easy to overcome the limits imposed by the rules on budgetary balance. In their view, the lack of justification would be contrary to the ***principle of budgetary balance***, which underpins those provisions.[39] Therefore, it is not as easy as to just keeping the operation 'off-budget'. What matters for the purpose of budgetary balance seems to be the principle underpinning the provisions and not the rules as such.

The principle of budgetary balance, contrary to the rule as such, does not forbid borrowing operations. In the view of the CLS, the principle just requires them to be **budgetarily neutral**. The *rationale* is that if the resulting debt is counterbalanced by an asset that covers the principal, interests and costs associated with the borrowing, the operation is budgetarily neutral because it does not affect the budget.[40] Therefore, keeping it off-budget is justified. In turn, this avoids entering into direct conflict with Article 310(1) TFEU and 17 FR because their scope of application is limited to the budget.

35 Council Regulation 2020/294 of 14 December 2020 establishing a European Recovery Instrument to support the recovery in the aftermath of the COVID-19 crisis, [2020], O.J. LI433/23, Article 3(1).
36 Opinion, n(10), §24.
37 Article 3(1) of Council Regulation 2020/294 of 14 December 2020 establishing a European Recovery Instrument to support the recovery in the aftermath of the COVID-19 crisis, [2020], O.J. LI433/23.
38 Opinion, n(10), §34.
39 *Ibid.*, §38.
40 Opinion, n(10), §25.

Up until NGEU, back-to-back lending was considered to be budgetarily neutral because there was a counterbalancing asset: the claim against the recipient of the financial assistance.[41] The EU budget did not need to input those operations because actual expenditure was contingent on an actual default; borrowing in that case just gave rise to a 'contingent liability' as defined in Article 2(15) FR, which is recorded in the budget as an expenditure only if there is a default. That is why Article 220(1) FR explicitly foresees that back-to-back lending in the context of financial assistance is allowed and Recital 150 reminds of its off-budget character.[42]

However, as it has been pointed out above, an additional guarantee from the Union budget has been required in cases of macro-financial assistance to third countries when the Commission deems that the claim towards the recipient third country is not a sufficiently safe counterbalancing asset. The *rationale* for that is to make sure that the EU does not run an operating deficit in case of a default, which seems to be considered more likely for third countries than for Member States.

In the case of borrowing for spending, choosing a counterbalancing asset was more challenging, given that it constitutes a deficit by nature (it is not linked to a claim of the recipient of the funds but rather, it is an actual expenditure). The way in which NGEU dealt with this requirement is by 'creating' a new counterbalancing asset: a ring-fenced increase of the EU future own resources.

As it has already been hinted, NGEU was rooted in the approval of a new Own Resources Decision on December 2020. One of the reasons was to ensure that the increase of the own resources ceiling is ring-fenced, this is, it is dedicated exclusively to cover the liabilities taken by the Union through its borrowing. When the time of the repayment comes, this increase can be filled with new own resources approved in accordance with Article 311 TFEU or via Member States contributions (or a combination of both).

In other words, Member States become the last resort guarantors of the borrowing for spending incurred by NGEU: if no other new own resources are introduced by the time the repayment of the debt is due, Member States will have the obligation to step in.[43] As a result, the borrowing of the Union is counterbalanced by an irrevocable, definitive and enforceable guarantee of payment (the guarantees of the Member States).[44] In the view of the CLS, this renders the operation budgetarily neutral, which justifies its off-budget character.[45]

In essence, this reading of the applicable provisions would relegate the ***provisions*** on budgetary balance to **rules of budgetary technique**, which could be overcome by taking the operation off-budget. Nevertheless, the ***principle*** of budgetary balance would **ensure the non-circumvention of these provisions by requiring them to be budgetarily neutral**. Therefore, borrowing operations could still be allowed as long as there is a counterbalancing asset that covers the principal, interests and costs of the debt.

This understanding of the rules and principles applicable to budgetary balance in the EU draws many parallelisms to the issuance of debt in many States of the USA, where balanced budget rules have not entailed an absolute prohibition of borrowing either.

41 *Ibid.*, §25.
42 The same applies to the acquisition of buildings, for which raising debt is allowed pursuant to Article 266(6) FR.
43 Article 14(2) of the Making Available Regulation n(22).
44 Opinion, n(10), §43.
45 *Ibid.*, §40.

In 1979, right after the Revolutionary War, the Secretary of the Treasury Alexander Hamilton decided to assume and restructure the debt of the states. That decision significantly departs from what happened next. The banking and subsequent economic crisis of 1837 (where eight States and the Territory of Florida defaulted on the massive debt amassed in the post-war period) led to the development of a tacit 'no-bailout' commitment of the federal government in the US legal system.[46] This fuelled the need for balanced budget rules at the state level, which were introduced in the 1840s.[47]

Nowadays, aside for Vermont, all States in the US have some kind of BBR.[48] Whereas not all of them require expenditures and revenues to be in balance like the cited EU provisions,[49] those which do have similar provisions have found their way to keep on issuing debt.[50] Some of the techniques that they have used are specific to particular States.[51] Nevertheless, the most common way for US states to engage in borrowing is by not pledging 'full faith and credit'.[52]

The notion of 'full faith and credit' means that debt is guaranteed by the state's power to raise taxes; by not pledging 'full faith and credit' when issuing debt, US States manage to escape from the BBR, which only applies to debt backed by the budget.[53] Under such a construction, the rationale of the BBR is to ensure that future budgets are not affected by the repayment of debt, which is not the case if the State does not back it with its budget in the first place.

This notion was originally endorsed by US courts under the 'special fund' doctrine, according to which a State was able not to pledge 'full faith and credit' and thus escape from BBRs if the debt was issued for a specific project that would generate revenues in the future (*e.g.* building a bridge and setting up a toll). Those revenues (rather than the taxation power of the State of the 'full faith and credit' technique) would back the debt issued by being ring-fenced to the repayment.

46 VAN MALLEGHEM, '(Un)Balanced Budget Rules in Europe and America', in M. ADAMS *et al.* (eds.), *The Constitutionalization of European Budgetary Constraints*, 2014, 153-155.

47 *Ibid.*

48 *Ibid.*, 157.

49 Some just take the form of state aid limitations, tax and expenditure restrictions, debt caps (*e.g.* Arizona limits its maximum borrowing to $350.000) or obligations to save when there are fiscal surpluses [*Cf.* VAN MALLEGHEM, n(46), 157-158]. Even strict BBRs are sometimes just of a procedural nature: in some states, borrowing cannot be proposed by the Governor in the budget but can be allowed via parliamentary amendments (*e.g.* Rohde Island); in others, it is only allowed if approved by supermajority (*e.g.* Delaware), referendum (*e.g.* Pennsylvania) or a combination of both (*e.g.* Michigan); and some other BBRs apply solely ex ante (according to projected revenues), therefore allowing balancing the budget during the year via debt issuance [*Cf.* VAN MALLEGHEM, n(46), 159-160].

50 In fact, rather than preventing States from engaging in debt, some authors have even argued that BBRs have had the side effect of creating more borrowing. The best example is California, which was close to bankruptcy in the 2000s and has not managed to reduce its debt, despite amending its Constitution to make its BBR stricter in 2005. [*Cf.* VAN MALLEGHEM, n(46), 167].

51 For instance, where BBRs are of statutory nature (as opposed to constitutional), borrowing can be included in budgetary laws, which have the same rank and thus, are just a derogation of the *lex anterior* where the balanced budget rule is stated [*Cf.* VAN MALLEGHEM, n(46), 159, 164]. In States where BBRs are enshrined in the Constitution but have flexible constitutional revision procedures, debt is routinely issued via constitutional amendments (*e.g.* Texas) [*Cf.* VAN MALLEGHEM, n(46), 164]. Finally, in many cases, debt issuance has just been shifted to local governments, 'special purpose governments' created with the aim of borrowing and even to private entities with which the government contracts [*Cf.* VAN MALLEGHEM, n(46), 166-167].

52 BRIFFAULT, 'The Disfavoured Constitution: State Fiscal Limits and State Constitutional Law', (2003) 34 *RLJ*, 918.

53 *Ibid.*

The ‘special fund’ doctrine seems quite similar to the logic of ‘off-budget’ borrowing operations in the EU: given that there is a source of revenues generated by the proceeds of the debt that could be in charge of the repayment (counterbalancing asset, in the EU jargon), the operation does not have an impact on the budget and thus escape the balanced budget rule. Moreover, US courts have progressively loosened the need for a link between future revenues and repayment, allowing the latter to be made through other sources of revenues.[54] To some extent, NGEU could be also seen as a step in that direction, in the sense that it loosens the concept of counterbalancing asset to include the ring-fencing of the own resources ceiling.

Moreover, the US and EU experiences also show that both federated entities actually engage in the process of justifying the off-budget character of their borrowing operations, by ensuring that they are budgetarily neutral or that they comply with the ‘special fund’ doctrine. This is crucial because it shows that they believe that they cannot escape from the need to keep their budgets balanced just via ‘budgetary gymnastics’. On the contrary, they seem to believe that balanced budget rules are the expression of a broader principle of budgetary balance which applies even when the operation escapes the scope of application of the rules themselves. A natural question could be whether this principle actually exists in EU law and where it comes from.

– Balanced budget: technical rule or principle of law?

One of the sources of principles in EU law is the common constitutional traditions of the Member States. However, BBRs in the EU were not that common before the entry into force of the fiscal chapter of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (‘Fiscal Compact’) in 2013; and even when they existed, they did not constitute real substantive interdictions to borrow.[55]

The entry into force Fiscal Compact did not change much in the overall picture. It obliged Member States to introduce a BBR in their Constitutions (or any equivalent legal instrument) but, according to Article 3(1), a budget would be deemed balanced if the structural deficit was below 0.5% GDP (or 1% for Member States with debt to

54 *Cf.* VAN MALLEGHEM, n(46), 169.

55 The oldest example can be found in the German Basic Law. Nevertheless, before 2009 it only limited borrowing by ensuring that most of the proceeds were destined to finance investment. In 2009, to cope with the financial instability in some *Länder* –in particular the application for bailout of the Berlin *Land*– the financial part of the Basic Law (*Finanzvefassung*) was amended again to introduce a strict BBR requiring the budget to be balanced, without the possibility of borrowing. However, new Article 115(2) also established that the BBR was deemed to be satisfied when revenues from the borrowing accounted for less than 0.35% GDP [*Cf.* DELLEDONNE, ‘A legalization of Financial Constitutions in the EU? Reflections on the German, Spanish, Italian and French experiences’, in ADAMS *et al.* (eds.), *The Constitutionalization of European Budgetary Constraints*, 2014, 185-187].
Spain, Poland and Hungary also had pre-Fiscal Compact BBRs requiring revenues and expenditures to be in balance [In the case of Spain, Articles 3 and 7(3) of Ley 18/2001, de 12 de diciembre, General de Estabilidad Presupuestaria; in Poland, Article 216 of the 1977 Constitution; in Hungary, Articles N and 37 of the 2012 Hungarian Fundamental Law]. However, as in the German case, they acted as debt breaks rather than interdictions of borrowing, given that they were deemed to be complied with if debt was below a certain threshold [*Cf.* DELLEDONNE, *Ibid.*, 187-188; ANTOŠ, ‘Fiscal Stability Rules in Central European Constitutions’, in M. ADAMS *et al.* (eds.), *The Constitutionalization of European Budgetary Constraints*, 2014, 213-215]. In other Member States, balanced budgets were just an objective not legally constraining (such as in France after the 2008 constitutional reform) [DELLEDONNE, *Ibid.*, 190] or constituted norms to which governments self-adhered as a result of political commitments (such as The Netherlands since 1994) [DIAMANT and VAN EMMERIK, ‘Mandatory balanced budget in Dutch legislation following examples abroad?, in ADAMS *et al.* (eds.), *The Constitutionalization of European Budgetary Constraints*, 2014, 256].

GDP ratios below 60%). Therefore, BBRs in Member States have never constituted substantive interdictions of borrowing but rather, debt brakes. In their absence, together with MS recurrent borrowing and even the lack of avenues to enforce their actual debt brakes rules,[56] it is not possible to argue that there is a principle of budgetary balance common to the constitutional traditions of Member States.

Therefore, if there is a principle of budgetary balance applicable to the EU, it needs to be specific to EU law. A study of the historical evolution of treaty –and related– provisions shows that the main rationale for the **principle** (for instance, that operations must remain budgetarily neutral) has **always been there** since the ECSC Treaty. Interestingly enough, however, its **concretisation into financial rules has progressively tightened over the years**, going from explicit authorisations of borrowing in the ECSC and Euratom Treaties to explicit prohibitions.

The ECSC Treaty is a very interesting example. It did not contain any explicit provision requiring the budget to be in balance and it even had a specific provision allowing the Commission to engage in borrowing (Article 49 of the ESCS Treaty).[57] Nevertheless, the fact that the proceeds could only be used to provide loans to companies supports the view that there was indeed a principle of budgetary balance requiring the operation to be budgetarily neutral.

The Euratom Treaty, on the contrary, had both a balanced budget clause (Article 171(1)) and an explicit empowerment to borrow to finance research and investments (Article 172(4)). This empowerment, with no reference to being limited to back-to-back lending, contrasts with the express balanced budget rule. A possible interpretation is that the Euratom BBR was just of a purely technical nature while not posing any substantive obstacles to borrowing; another view could be that both provisions (the BBR and the empowerment for borrowing) were the concretisation of the principle of budgetary balance, allowing the borrowing as long as it was budgetarily neutral, as it is the current understanding today.

Subsequent developments seem to privilege the second reading. For instance, the Council Decision of 29 March 1977 only empowered the Commission to engage in back-to-back lending,[58] which shows that the understanding at the time might be similar to the one that legal services of the institutions have today: borrowing is possible, even when there is a rule requiring the budget to be balanced, as long as there is a counterbalancing asset that keeps the operation neutral (the claim against the recipient of the loan in that case).

After the entry into force of Chapter III of the Treaty of Brussels in 1967, which merged the budgets of the three Communities, the empowerment to borrow disappeared and the only provisions that remained were those on budgetary balance of the Euratom and EEC Treaties. Nevertheless, the broader principle on which it was based seems to have subsisted, given that resorting to borrowing was still possible.

For instance, the 1973 Financial Regulation[59] (and its subsequent versions of the pre-Maastricht era) did not include an interdiction of raising loans as the current one, not even explicit prohibitions of borrowing for spending. On the contrary, it

56 DELLEDONNE, *Ibid.*, 191-193.

57 POTTEAU, 'Le budget de l'Union européenne à la croisée des chemins. Une crise sanitaire puis économique révélatrice et inspiratrice', (2020) 11 *RTD*, 576.

58 Council Decision 77/270/Euratom of 29 March 1977 empowering the Commission to issue Euratom loans for the purpose of contributing to the financing of nuclear power stations, [1977] *O.J.* L88/9.

59 Financial Regulation of 28 December 1973 applicable to the general budget of the European Communities, [1974] O.J. L30/20.

contained specific provisions on borrowing, such as requiring a table and a statement showing '*the state of the Community borrowing and lending*' (Article 82(5)). Further, a Council decision requiring borrowing mechanisms between 1975 and 1981 to finance loans only[60] reinforces the idea borrowing was possible as long as it was budgetarily neutral.

The following practice of back-to-back lending in which the EU has recurrently engaged in the past[61] supports this understanding of the principle of budgetary balance and its interplay with the balanced budget rule embedded in Articles 310(1) TFEU and 17 FR. Thus, despite the requirement on maintaining revenues and expenses in balance and the express prohibition of raising loans in the context of the budget, borrowing is still possible. Nevertheless, it might be safe to argue that there is indeed a principle of budgetary balance that requires those operations to have a counterbalancing asset in order to remain budgetarily neutral.

FISCAL DISCIPLINE

Article 310(4) TFEU states that '[w]*ith a view to maintaining* ***fiscal discipline, the Union shall not adopt any act which is likely to have appreciable implications for the budget without providing an assurance that the expenditure arising from such an act is capable of being financed within the limit of the Union's own resources*** *and in compliance with the multiannual financial framework referred to in Article 312*'.

The distinction between budgetary balance (Article 310(1)(3) TFEU) and fiscal discipline (Article 310(4) TFEU) has not been very neat among academic commentators and even the legal services of the institutions. Is it a principle in itself? Is it the expression of the principle of budgetary balance as it has been described so far? Or does it add something else to the scheme of rules and principles applicable to common borrowing?

Fiscal discipline is often described as a principle in itself (the principle of fiscal discipline),[62] finding its rationale in the need for budget neutrality (meaning that the Union can only engage in borrowing that will be able to honour, this is, an operation that may affect the budget requires an assurance of payment).[63] Nevertheless, it is not cited as a principle in the Financial Regulation.[64] Sometimes, Article 310(4) TFEU is described as being the 'corollary of the principle of budgetary balance'[65] or the expression of the principle of budgetary balance from a multi-annual perspective.[66] However, those descriptions fail to establish a clear separation between budgetary balance and fiscal discipline and what each of those concepts entails.

Therefore, it is difficult to ascertain what Article 310(4) TFEU really is and entails. In my view, the best reading of this provision is based on a systematic interpretation (in the context of the whole legal framework of the treaties). When read together with Article 310(1) TFEU, it provides an additional basis to argue that there is a principle of budgetary balance underpinning Article 310(1) TFEU: an operation that may affect the budget requires an assurance of payment; therefore, borrowing is possible, even when facing a BBR, as long as there is a counterbalancing asset.

60 Special Report, n(33), §2.1.
61 See above, Subsection I.
62 Opinion, n(10), §29; Q&A, n(12).
63 Opinion, n(10), §29.
64 Article 6 FR.
65 Opinion, n(10), §39
66 DE GREGORIO MERINO, n(14), 38.

Nevertheless, a systematic interpretation would also require giving an *effet utile* to Article 310(4) TFEU. This is, a particular meaning that would go beyond just supporting the interpretation of Article 310(1)(3) TFEU. That is why, in my view, the key part of the article is that the assurance of payment must be provided '***within the limit of the Union's own resources***'. That significantly adds more restrictions to borrowing operations in the Union because it limits the borrowing capacity of the Union to the own resources ceilings established in the ORD.

In turn, this **makes budget neutrality more difficult to attain**. Indeed, by making sure that any borrowing operation remains under the limit of the Union's own resources, the operation is *de facto* guaranteed by the EU budget or the Member States (the own resources ceiling can be used by the legislators to fund the budget and, in case actual expenditures exceed the budget, Member States must step in to cover the gap up to the own resources ceiling).[67] This is crucial to understand the legal framework applicable to EU borrowing because it leads to the conclusion that **budget neutrality requires a double guarantee**:

- The **guarantee from the operation itself**: for instance, the claim against the recipient of the loan in the case of back-to-back lending; or, NGEU's invention of ring-fencing the increase of the own resources ceiling to provide a counterbalancing asset for a borrowing for spending operation; and

- The **headroom** (the difference between the appropriations of the budget and the own resources ceiling): it can be covered later for the repayment of the debt by future own resources or Member States' contributions as last resort.

- As argued above, in some cases (such as MAF operations towards third countries) the EU understands that it needs to provide not just a double but even a triple guarantee: the claim against the recipient third country, the headroom and an additional **provision** from the EU budget (in the case of MAF, the Guarantee Fund for external actions).

This logic significantly departs from the approach US States take towards debt issuance. Firstly, it prevents the EU from the possibility of not pledging 'full faith and credit' on its debt. Contrary to US States, the EU must make sure that it has sufficient means to cover its debt in full; there is no possibility of default. Secondly, the double (and even triple) guarantee needed to keep an operation budgetarily neutral in the EU is significantly more stringent than in US States, which can just loosely link their debt issuance to the revenues generated by the proceeds.

Whether Article 310(4) TFEU enshrines a principle (rather than just a rule) and whether this is the correct interpretation of its content is difficult to ascertain. Nevertheless, a historical approach to the evolution of relevant provisions in this topic might support that indeed there is a principle of fiscal discipline that requires the EU to back its borrowing with own resources *ex ante*.

For instance, the ECSC Treaty provided that loans to companies had to be backed, either through Member States guarantees (Article 51(1)(3)) or the ECSC budget as last resort (Article 50(1)(3)). The Euratom Treaty, on the other hand, did not contain any provision on how borrowing should be guaranteed. Thus, it could be envisaged, for instance, a back-to-back lending system with no backing from the Community's own resources.[68] Nevertheless, subsequent legal texts made explicit that borrowing operations had to be guaranteed by the Communities. Indeed, the 1977 version of

67 Pursuant to Article 14(2) of the Making Available Regulation n(22).

68 Based on Member States' contributions (Article 172(2) Euratom Treaty).

the Financial Regulation[69] established that the budget should show '*the financial guarantee given by the Communities in respect of those [borrowing and lending] operations*' (Article 16(3)(a)(2)). The 1982 Special Report of the Court of Auditors also confirms that 1975-1981 borrowing for lending operations were backed by a budget guarantee.[70]

This shows that the possibility of having a US-inspired possibility of not pledging 'full faith and credit' was not perceived as an option for EU issuances and thus budget neutrality would require a double claim (one against the recipient of the loan and another one against the budget).

The next step was the introduction in the Maastricht Treaty of a similar version to what is today Article 310(4) TFEU.[71] While perhaps not changing already existing practice, its explicit introduction in the Maastricht Treaty might have been an attempt to tighten the potential resort to borrowing in the future. In fact, the Treaty of Maastricht marked a new period where financial provisions of the EU were progressively more explicit in their reluctance to admit the possibility of resorting to debt issuance. This tightening can be observed from the Treaty of Maastricht to the Lisbon Treaty.[72]

For instance, while the wording of Articles G(B)(72) and Article I(20) of the Maastricht Treaty only applied fiscal discipline to Commission's proposals and implementing measures ('[w]*ith a view to maintaining fiscal discipline,* ***the Commission shall not make any proposal*** *for a Community act, or alter its proposals,* ***or adopt any implementing measure*** *which is likely to have appreciable implications for the budget without providing the assurance* [...]'), the Lisbon Treaty currently in force extended it to 'all Union acts', which therefore binds all borrowing operations and not just the proposed operations.

Moreover, the Treaty of Lisbon further introduced Article 323 TFEU, which states that the Commission, Parliament and Council '*shall ensure that the financial means are made available to allow the Union to fulfil its legal obligations in respect of third parties*'. This provision, which can be read together with Article 310(4) TFEU,[73] seems to reinforce the cautious approach of the EU towards budget neutrality and the need for having enough own resources available to back the repayment even when an additional claim is available.

This understanding of fiscal discipline, according to which the headroom must back –and cap– the borrowed amounts in all cases, is further reinforced by the principle of sound financial management. This principle is enshrined in Articles 310(5), 317 TFEU and 33 FR and requires appropriations to be used at the best price. Part of the reason why EU's borrowing enjoys good ratings is that it has the 'full faith and credit' of the EU, this is, it is backed by the EU's own resources through the headroom.[74] Deviating from that practice might increase the rates and thus could be contrary to the principle of sound financial management.

69 Financial Regulation of 21 December 1977 applicable to the general budget of the European Communities, [1977] O.J. L356/1.
70 Special Report, n(33), §2.3.
71 Article G(B)(72) and Article I(20) Treaty of Maastricht.
72 This tightening can also be observed in the parallel evolution of the Financial Regulation, which did not include any explicit interdiction of borrowing until 2002, with Council Regulation 1605/2022 of 25 June 2002 O.J. L248/1.
73 Explanatory Memorandum of the Commission Proposal for a Council Decision on the system of own resources of the European Union, COM(2020) 445 final [28.05.2020], 3.
74 See, for instance, FitchRatings commentary on EU debt [28.18.2018], retrieved 01.05.2022 [link].

NEW AVENUES IN THE RESPECT OF BUDGETARY BALANCE AND FISCAL DISCIPLINE

The legal analysis made so far helps to provide an answer to some of the questions that were raised at the beginning of this part. For instance, the need to respect the own resources ceiling derived from Article 310(4) TFEU explains why the EFSF and the ESM were established outside the EU legal framework or why NGEU had to amend the Own Resources Decision to increase the headroom. Further, the analysis on the principle of budgetary balance also explains why the increase of own resources during the pandemic had to be ring-fenced for the repayment of NGEU and why, out of the €9 bn programme planned to assist Ukraine since May 2022, only €1 bn is backed by the necessary guarantee to remain budgetarily neutral while the rest needs additional contributions of Member States to the External Action Guarantee.[75]

Nevertheless, some elements of the underlying legal construction could be revisited and even challenged. Some of those elements are listed and discussed here below.

BOX 1. The full backing of borrowing

- Borrowing in the EU is backed by the headroom in full.
- The Commission argues that the headroom needs to be large enough to ensure that it covers '*all of its financial obligations and contingent liabilities in any given year and under any circumstances*'.[76]
- However, that **might go further than what Articles 310(4) and 323 TFEU require**. They only require an assurance that the expenditure is '***capable***' of being financed within the own resources ceiling and that the Union has 'sufficient' financial means to honour its commitments with third parties. Although the Commission's reading of those articles is reasonable, other interpretations of 'capable' and '***sufficient***' –based on economic analysis for each operation– might be possible as well. This would allow for less strict coverages, especially in cases of back-to-back lending.

BOX 2. The nature of the own resources used to back the borrowing

- Article 310(4) TFEU is very clear about the nature of the resources that must back EU's borrowing: own resources. This is why when there was no available headroom, borrowing mechanisms (such as the EFSF and the ESM) had to be built outside the EU legal framework. Nevertheless, while part of the EU legal framework, borrowing in the SURE program was not backed by own resources but rather ad hoc guarantees provided by Member States.[77] While Article 310(4) TFEU refers to 'own resources', ad hoc guarantees are very close in nature to the headroom (which entails, in essence, a legal commitment from Member States to step in) that they can be seen as 'complementary' to own resources.[78]
- The **SURE program opens up new sources of guarantees to back Union debt**. It could be explored whether other guarantees could be 'complementary' in nature to own resources (for instance, binding commitments of the ESM or the EIB).

75 European Commission, Proposal for a Decision providing exceptional macro-financial assistance to Ukraine, n(19).

76 European Commission, Proposal for a Council Decision on the system of own resources of the European Union, COM(2020) 445 final [28.05.2020], 2.

77 Article 11 of Council Regulation 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, [2020] O.J. L159/1.

78 Recital 9, *Ibid.*

BOX 3. The triple guarantee required to provide macro-financial assistance to third countries

- MAF to third countries currently requires a triple guarantee to remain budgetarily neutral: the headroom, the claim against the recipient state and an additional provision from the EU budget (External Action Guarantee). This is why current disbursements of MAF to Ukraine is being so slow.
- This cautious approach towards is legit and reasonable but **it might not be a legal requirement deriving from the principle of budgetary balance**, given that there are already two other assurances of payment that ensure that the operation remains budgetarily neutral.
- **If the situation in a given country makes particularly unlikely the recovery of the funds, the situation would be similar to an operation of 'borrowing for spending', which does not require provisioning.** That would entail that MAF to Ukraine might not be limited to the available funds in the External Action Guarantee. It might nevertheless, require ring-fencing the headroom as it was done in NGEU but even that could be contested (see below).

BOX 4. The choice of counterbalancing assets in borrowing for spending operations

- Contrary to back-to-back lending, there are not claims against the recipient in borrowing for spending operations. According to the CLS, that is why **ring-fencing the headroom is needed**, given that it is an irrevocable, definitive and enforceable commitment of Member States to step in,[79] which keeps the operation budgetarily neutral.
- Nevertheless, **there might not be a need to ring-fence the headroom (and thus, amend the ORD when there is still space in it)**. Member States' commitments to step in would still exist even in the absence of ring-fencing, given that they must release their contributions if guarantees are called upon, pursuant to Article 14(2) MAR.[80]
- Finally, it should be explored whether a **similar doctrine to the US 'special fund'** could be applied to the EU. This is, whether the revenue of a project in which the proceeds of common debt are invested could be deemed a sufficient counterbalancing asset. That would **open up new possibilities to use borrowing for spending in to finance revenue-generating investment**.

79 Opinion, n(10), §43-44.

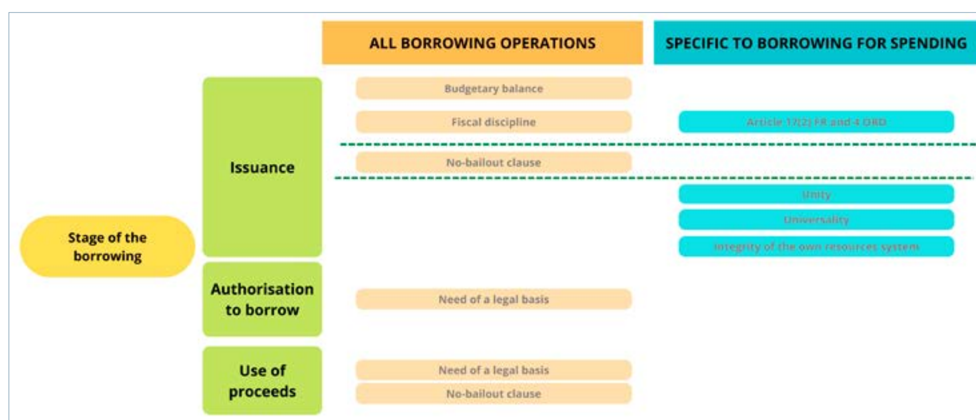
80 While it is true that the need for ring-fencing is also there to make sure that future budgets do not consume the headroom in charge of the repayment, that does not apply when the repayment lasts less than one MFF. In that (unlikely) case, budgetary ceilings would already be set in the MFF and there would be no risk of affecting the headroom. If the issuance has a longer time to maturity than the MFF, future repayment could be provisioned within the MFF.

II • The future of borrowing for spending

NGEU is particularly relevant because the introduction of borrowing for spending operations is an issue of constitutional importance. This is particularly the case because it is linked to three elements traditionally associated with fiscal federalism: the possibility of having a substantial fiscal capacity capable of financing a sizeable budget;[81] the opportunity to have a countercyclical economic policy tool to face asymmetric shocks;[82] and thirdly, it shows parallelisms with the construction of the United States of America, when the US Secretary of State consolidated the debts of the States at the federal level.[83]

However, the future of borrowing for spending in the EU is still full of unknowns. Some of them have to do with the specific prohibition of financing EU expenditure through debt introduced by Article 4 ORD.[84] Some others (such as the instrument needed to authorise the borrowing or the legal basis that can be used to allocate proceeds) are common to all types of borrowing operations, not just borrowing for spending. That is why it might be useful to analyse the legal feasibility of future borrowing for spending at each stage of the operation and to identify the rules and principles that are applicable to all type of borrowing operations and those that are specific to borrowing for spending.

FIGURE 1.



I ISSUANCE: IS THE OPERATION ALLOWED UNDER EU LAW?

For an issuance to be allowed under the EU legal framework, any borrowing operation must comply with:

- The principle of budgetary balance and the provisions on fiscal discipline. They have been explained at length in part I. However, the question of budgetary balance and fiscal discipline in the context of borrowing for spending is further complicated by the new Article 4 ORD;
- Article 125 TFEU (the so-called 'no-bailout' clause);
- Additional constraints specific to borrowing for spending. Given that these operations are aimed at financing common expenditure, they need to deal with budgetary principles traditionally associated with the revenue side of the EU budget (unity, universality and the integrity of own resources).

81 VAN MALLEGHEM, n(46), 178-179.
82 *Ibid.*, 174-175.
83 DE GREGORIO MERINO, n(14), 33.
84 Article 4 ORD, n(13).

– Budgetary balance and fiscal discipline after Article 4 ORD: the future of borrowing for spending

This paper has consistently argued that borrowing is possible, even to fund common EU expenditure, as long as it is counterbalanced by an asset (budgetary balance) and it is backed by own resources through sufficient headroom (fiscal discipline). That is the case even when Article 17(2) FR explicitly forbids raising loans, the reason being that such provision only applies in the context of the budget while borrowing operations remain off-budget or, at least, they are not subject to the budgetary approval procedure.

However, the newly added Article 4 ORD, which states that '[t]*he Union shall not use funds borrowed on capital markets for the financing of operational expenditure*',[85] does not make any reference to being limited to the context of the budget. This naturally raises the question of whether NGEU will be the first but also last borrowing for spending operation which the EU will ever undertake.

Before delving into its future, it might be worth looking at the past. How could the ORD establish a prohibition of borrowing for spending while at the same time authorise the issuance of €750bn to precisely fund common expenditure? The 'trick' lies in Article 5(1)(b), which immediately clarifies that '*by way of derogation of Article 4*', €390bn of NGEU grants are authorised.

Article 5(1)(b) might point towards the right direction when it comes to drawing conclusions on the future of borrowing for spending: derogations are possible. The provision is completely obscure on the conditions under which a derogation is possible but at least it shows that it is possible to derogate from the prohibition of Article 4 ORD. It is not thus affecting the underlying principle of budgetary balance and fiscal discipline, which do allow borrowing for spending under certain conditions. Article 4 ORD has just become *lex specialis* to them. **Only if another ORD provision derogates from Article 4, borrowing for spending would be possible.**

This understanding might be supported by looking at the explicit prohibitions of borrowing present in the EU through historical lenses. For decades, and up until 2002, the Financial Regulation did not include any explicit prohibition on raising loans in the context of the budget. It was Article 14(1) of the 2002 FR that introduced it (Article 46(4)).[86] Subsequent Financial Regulations, such as the current one, kept such an explicit prohibition (Article 17(2)) and even further restricted the possibility to resort to it by just admitting its use for financial assistance (Article 220(1)). However, this tightening did not change the legal compatibility of borrowing in the EU, given that borrowing operations were still designed off-budget (such as the EFSM, for instance). The underlying principle of balanced budget, therefore, remained the same.

Article 4 ORD might be part of the effort of making the rules on EU borrowing seemingly more tight when, in fact, the underlying principles remain the same. In my view, this process started in the Treaty of Maastricht with the introduction of Article 310(4) TFEU and has been accompanied by the progressive inclusion of explicit prohibitions on raising loans in the successive Financial Regulations, the change

85 In the EU, 'operational expenditure' is understood as the budget allocated to finance its actions and programmes, as opposed to administrative expenditure related to the implementation of those programmes (technical assistance, agencies and human resources) [*Cf.* European Parliament, factsheet 'The EU's expenditure', [link].

86 Council Regulation 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Communities, [2002] *O.J.* L248/1.

of wording of Article 310(4) TFEU and the introduction of Article 323 TFEU in the Treaty of Lisbon. Article 4 ORD might be the last step of this process. Nevertheless, while it imposes additional procedural constraints for future borrowing for spending operations, it might not introduce any change on substance, as any of the preceding prohibitions of borrowing have.

From a procedural standpoint, however, its inclusion in the ORD is very relevant, given that the ORD is a norm of quasi-constitutional status.[87] This entails that only an instrument of the same or superior ranking can derogate from it. In practice, this means that **any future borrowing for spending operation will require amending the ORD in order to delete the provision or derogate from the explicit prohibition included in 2020**. The ORD requires unanimity of all Member States in the Council and their ratification according to their own constitutional requirements (Article 311 *third sub-paragraph* TFEU). Thus, although the current ORD is the main building block of NGEU, it has become the main obstacle for it to happen again.

It could be argued that this is not a relevant constraint, given that it is common practice to approve a new ORD with every MFF. However, in my view, this is a crucial point. Firstly, because nothing guarantees that the next crisis will coincide with the negotiation of a new MFF (as it was luckily the case when NGEU took place); and, secondly, because it significantly limits some of the possibilities that this paper has put forward and that would allow borrowing for spending operations without the need to amend the ORD.

For instance, it has been argued above that there could be a possibility of resorting to other guarantees (different from own resources) to back borrowing for spending operations; that small issuances might not need an ORD amendment if there is enough space in the headroom; or that there might not be a need to ring-fence the headroom. However, Article 4 ORD prevents those options in the absence of its derogation.

This is particularly concerning given that the introduction of the prohibition of borrowing for spending in the ORD might have been driven by political reasons rather than legally solid analysis. The basis of this argument lies in the fact that Article 4 ORD was adopted –as part of the process of amending the ORD– using Article 311 *third sub-paragraph* TFEU as a legal basis, which establishes the procedure to establish the '*provisions relating to the system of own resources*'. However, the prohibition to finance operational expenditure through borrowing does not have any direct relation to the system of own resources.

While acknowledging that, the CLS justifies its inclusion in the ORD on its contribution to defining '*the ultimate limits and conditions for making available the financing and may, therefore, be considered as ancillary to the general set-up*'.[88] This explanation is quite unconvincing, particularly because it shows that its inclusion was a '*condition*' to make NGEU happen. That has little to do with the system of own resources. Rather, it points to a political interest to design the scheme in a way that any other operation of 'borrowing for spending' in the future would need an amendment of the ORD,[89] an effort in which –according to some authors– Germany was particularly interested during NGEU design process.[90] Therefore, it seems that the choice of legal basis of the provision at stake, which has significant consequences for the feasibility of future borrowing for spending operations, was driven by political consi-

87 DE GREGORIO MERINO, n(14), 39.
88 Opinion, n(10), §88.
89 *Cf.* POTTEAU, n(57), 580.
90 *Cf.* DE WITTE, n(11), 641, 663.

derations, something that the Court of Justice has sanctioned in the past, as the CLS itself acknowledges.[91]

The Council might have a chance now to take back the prohibition introduced by Article 4 ORD. Indeed, in December 2021 the Commission put forward a proposal for amendment of the ORD[92] as part of the commitment to introduce new own resources that it assumed during the NGEU negotiation process. The proposal modifies the list of own resources but leaves Article 4 ORD untouched. Nevertheless, once the proposal for amendment is on the table, the rest of the ORD can be modified as well. Therefore, Member States' representatives have a unique opportunity now to ease the possibility of resorting to borrowing for spending in the future.

– **The no-bailout clause**

Any future issuance of debt should also respect the so-called 'no-bailout clause'. Article 125(1) TFEU establishes that neither the Union nor any Member State shall be '*liable for or assume the commitments of (...) any* [other] *Member state, without prejudice to mutual financial guarantees for the joint execution of a specific project*'.

This provision is relevant for all kind of borrowing operations because, as it has been shown, the current understanding is that Member States need to back the operation in all circumstances through the headroom in the ORD. In the context of debt issuance,[93] Article 125(1) TFEU might be breached if Member States guarantee the operation via joint and several responsibility.[94]

Both SURE and NGEU have complied with this requirement by ensuring that each Member State remains the only responsible for its share of the guarantees provided.[95] This *pro rata* system of guarantees is a key constitutional element of those programmes, given that it drives the Union away from a true fiscal Union.

Indeed, many politicians have depicted NGEU as a 'Hamiltonian' moment of the construction of the EU,[96] drawing a parallelism with the creation of a common Treasury in the US in 1790 under the impulse of US Secretary of State Alexander Hamilton. In the US, this decision significantly increased its fiscal capacity and was thus key to its process of state construction.[97] However, that view usually forgets that a key element of the process in the US was the consolidation of federal and State debts into a single credit.[98] On the contrary, NGEU does not foresee neither consolidation nor joint and several guarantees.

91 Opinion, n(10), §76. Judgment of 23 February 1988, *UK v. Council*, C-68/86, EU:C:1988:85, §38; Judgment of 19 July 2020, *Parliament v. Council*, C-130/10, EU:C:2012:472, §19-81.

92 European Commission, Proposal for a Council Decision amending Decision (EU, Euratom) 2020/2053 on the system of own resources of the European Union, COM(2021) 570 final [22.12.2021].

93 The application of this provision to the use of proceeds is discussed in sub-section III.

94 *Cf.* Opinion, n(10), §157.

95 Article 11(4) SURE n(77); Article 9(5) *first sub-paragraph* ORD. In the case of NGEU, this is actually a redundant provision, given that the general system applicable to the call of guarantees of the headroom is already pro rata, pursuant to Articles 14(2) and (4) MAR. The CLS nevertheless wanted to avoid any risk, given that pursuant to Article 14(3) there could be a remote possibility of calling Member States to step in solitarily. That is why Article 9(5) second sub-paragraph ORD makes sure that exception cannot be made in the context of NGEU.

96 HALL *et al.*, 'Is the Franco-German plan Europe's 'Hamiltonian' moment?', *Financial Times* [21.05.2020], retrieved 01.05.2022 [link].

97 LIONELLO, 'Next Generation EU : has the Hamiltonian moment come for Europe?, (2020) 4 Eurojus, 22-23.

98 Alexander Hamilton's words were: '*an assumption of the debts of the particular states by the union, and a like provision for them, as for those of the union, will be a measure of sound policy and substantial justice*' (First Report on Public Debt, 1790). *Cf.* DE GREGORIO MERINO, n(14), 33; VAN MALLEGHEM, n(46), 153.

From the perspective of the future challenges of common borrowing, there is still an open question on whether Article 125(1) TFEU is applicable to borrowing operations that have a specific purpose (such as NGEU, which is in place '[f]*or the sole purpose of addressing the consequences of the COVID-19 crisis*').[99] In that regard, it could be argued that NGEU constituted a '*joint execution of a specific project*', which constitutes an exception the prohibition established in Article 125(1) TFEU.

However, the notion of '*joint execution of a specific project*' remains quite obscure. In Pringle,[100] the Court of Justice missed the opportunity to interpret the meaning of those words; some commentators in the past have argued that the joint guarantee of Member States to EIB or ESM bonds constitute a '*joint execution of a specific project*'[101] and some have defended that 'Corona bonds' –as the idea of a common issuance was known before NGEU proposal– would qualify as a '*specific project*' as well.[102] However, these words remain unclear and further analysis would be needed to develop new avenues on this basis.

– **Additional principles applicable to borrowing for spending**

Principle of unity

According to Article 310(1) TFEU, '*all items of revenue and expenditure [...] shall be shown in the budget*'. This provision enshrines the principle of budgetary unity. Its main rationale is to ensure that all actions with budgetary implications are contained in the same instrument and authorised according to the budgetary process, which safeguards inter-institutional balance.[103]

However, it only applies to actual revenues and expenditures; fully off-budget operations such as back-to-back lending do not give rise to actual expenditure and therefore can be left outside of the budget.[104] Borrowing for spending, on the contrary, does give rise to an actual expenditure: the debt raised is an actual liability that will need to be repaid by the EU itself, not by the recipient of a loan.[105] That is why the principle of unity is only relevant regarding borrowing for spending operations. According to the principle of unity, an operation of borrowing for spending should thus be included in the budget.

Nevertheless, NGEU has made use of a legal exception to the principle of budgetary unity: **external assigned revenue**. Pursuant to Article 21 FR, expenditures of external assigned revenue do constitute authorised appropriations of the kind foreseen in Article 7(2)(e) FR but they are not 'provided' by the budget in the sense of Article 7(2)(a) FR. Thus, although they are accommodated into the budget through specific techniques (the revenue side has a 'p.m.' –*pro memoria*– entry and has a remark indicating which budget line will receive appropriations), they are not truly part of the budget and are not subject to its particular voting procedure.[106]

99 Article 5(1) *ORD*.
100 Judgment of 27 November 2012, *Thomas Pringle v. Government of Ireland*, C-370/12, EU:C:2012:756.
101 MICOSSI *et al.* 'On the tasks of the European Stability Mechanism', (2011) CEPS Policy Brief, retrieved 01.05.2022 [link], 9.
102 GOLDMANN, 'The case for Corona Bonds', (2020), *Verfassungsblog*, retrieved 01.05.2022, [link].
103 Opinion, n(10), §62.
104 In practice, they do appear in the budget, although not as revenues and appropriations (see for instance, the 2013 budget, [2013] O.J. L66/1 (44, 75)). They appear just for the sake of fostering transparency and providing a stronger protection of the financial interests of the EU (Recital 150 FR).
105 *Cf.* Opinion, n(10), §29.
106 *Ibid.*, §34.

Principle of universality

Articles 7 ORD and 20 FR state that revenues from own resources (including contributions from Member States) '*shall be used without distinction to finance all expenditure entered in the Union's annual budget*'. This is, in principle, specific revenue cannot be assigned to specific expenditure. In the case of borrowing for spending, nevertheless, the need to comply with the principle of budgetary unity requires to make use of external assigned revenue, which entails assigning specific revenue (debt proceeds) to specific expenses (EURI).

Nevertheless, the principle of universality enshrined in Article 7 ORD only applies to own resources whereas debt proceeds do not constitute own resources but rather '*other revenues*'.[107] The scope of Article 20 FR, on the other hand, does include other revenues (as it refers to 'total revenues') and thus might include debt proceeds. Nevertheless, Article 21 FR regulates assigned revenue as an exception to the principle of universality. Therefore, borrowing for spending operations can make use of external assigned revenue as a legal exception to both the principles of unity and universality.

The integrity of the own resources system

While resorting to external assigned revenue provides a way for borrowing for spending to escape from the application of the principles of unity and university, making use of this option is not fully discretion; rather, according to the CLS, it must comply with Article 311 TFEU, which states that '*without prejudice to other revenue, the budget shall be financed wholly from own resources*'.[108] This enshrines the notion of integrity of the own resources system, according to which the primary source of financing of the EU must come from own resources established under the ORD.[109] Other sources of revenue (such as external assigned revenue) can be used but only in a **complementary manner**.[110]

Therefore, borrowing for spending, which is only possible by considering the debt proceeds external assigned revenue, needs to comply with Article 311 TFEU. In other words, it needs to be shown that the debt raised and assigned as external revenue is complementary in nature to the own resources of the Union.

Several authors consider that, given the size of the borrowing, NGEU is a derogation of such principle.[111] Nevertheless, they believe it is a justified derogation due to its temporary nature and the need to comply with another treaty imperative provided in that same article: '*the Union shall provide itself with the means necessary to attain its objectives and carry through its policies*'.[112]

However, the CLS does not even acknowledge the existence of a derogation. It considers that NGEU is in full compliance with Article 311 TFEU because the complementarity of 'other revenue' must be understood not only in quantitative but also on qualitative terms and in the context it is put in place.[113] In particular, the fact that the mechanism is **exceptional** (Article 5 of the ORD establishes that it constitutes an exception to the general prohibition of borrowing for spending), **temporary**

107 *Ibid.*, §57 and fn.(39).
108 *Ibid.*, §70.
109 *Ibid.*, §57.
110 *Ibid.*, §62.
111 CROWE, 'The EU Recovery Plan: New Dynamics in the Financing of the EU budget', in BARRET *et al.* (eds), The Future of Legal Europe: will we trust in it?, 2021, 135; DE WITTE, n(11), 663.
112 *Ibid.*, 135.
113 Opinion, n(10), §63.

(borrowing will be possible only until 2026 and support is designed as a one-off contribution) **and single-purposed** (Article 6 ORD establishes exactly how proceeds will be allocated with the only aim to fight the covid-19 pandemic) shows the complementary nature of the borrowing.[114]

The Commission seems to share the other view, according to which NGEU does constitute a derogation from the integrity of the own resources system. Nevertheless, it seems to believe that the fact that debt proceeds are assigned trough a mechanism based on Article 122 TFEU (the European Union Recovery Instrument –hereinafter, 'EURI'–),[115] which is deemed to apply only to exceptional situations, justifies such derogation.[116] In practice, this understanding would entail that proceeds of any operation of borrowing for spending cannot be assigned directly to EU programmes but rather, they need an 'intermediary' instrument based on the financial assistance provisions of the Treaty (EURI further assigns the proceeds to the RRF and other EU instruments).

That understanding, however, might not be the most appropriate. Firstly, because Article 311 TFEU does not seem to admit derogations in its wording; thus, the notion of 'qualitative additionality' developed by the CLS might be a better interpretation of the provision. Secondly, because in such an analysis of complementarity, the fact that the instrument is based on Article 122 TFEU might reinforce its exceptional and temporary character[117] but it does not mean that other operations of borrowing for spending cannot be exceptional and temporary without using Article 122 TFEU as a legal basis for the assignment of the expenditure. And finally, because 'qualitative complementarity' only plays a role in case there is not 'quantitative complementarity'. This is, if the issuance is small, debt proceeds can be deemed to be complementary to own resources, without the need to delve into whether the borrowing is complementary in nature to the own resources system. Thus, small borrowing programmes would not need to be temporary to be compliant with Article 311 TFEU.

There was an alternative way to derogations or 'qualitative complementarity' interpretations to ensure compliance with Article 311 TFEU: considering debt proceeds as own resources. The idea might seem far-fetched but it is relevant, given that integrating debt proceeds in the ORD as own resources would allow, in principle, to establish permanent, recurrent and general-purposed mechanisms of borrowing.

A historical review of the meaning of 'own' resources would not necessarily exclude such an approach. For instance, Article 49 ECSC Treaty, despite not using the words 'own resources', integrated the proceeds of its borrowing into the funds necessary to accomplish its mission, together with levies on the production of coal and steel. Further, the term 'own resources' in Article 201 EEC Treaty was used in opposition

114 *Ibid.*, §63-68.

115 Council Regulation 2020/294 of 14 December 2020 establishing a European Recovery Instrument to support the recovery in the aftermath of the COVID-19 crisis, [2020], *O.J.* LI433/23 (EURI Regulation).

116 Q&A, n(12).

117 For instance, by limiting the use of those funds to face temporarily and exceptionally the consequences of covid-19, even if they are channelled through other instruments subject to different substantive rules (*Cf.* Opinion, n(10), §140).

to the national contributions that they were intended to substitute.[118] This implies that own resources were viewed as proceeds resulting from common Community policies and attributed directly to the EEC, even if collected at the national level.[119] In that regard, there could be room to argue that the proceeds of debt issued by the EU to finance its own expenditure could be considered 'own resources'.

Nevertheless, the Commission and the CLS have been very clear, and most probably rightly so, in denying them such status based on the fact that debt proceeds are not final (they have to be repaid), contrary to the rest of own resources.[120] Moreover, considering debt proceeds as own resources face the likely insurmountable obstacle of the principles of unity and universality because an own resource cannot be at the same time external assigned revenue.

AUTHORISING THE BORROWING: WHICH INSTRUMENT SHOULD BE USED?

Pursuant to the principle of conferral enshrined in Article 5(2) TEU, the EU can only act within the limits of the competences conferred to it by the treaties. However, contrary to the ECSC and the Euratom treaties, the EEC Treaty and its following modifications do not foresee a general empowerment for the EU to issue debt. Therefore, as it has already been argued, the EU has resorted to 'policy' legal bases (such as Article 212 TFEU), provisions on financial assistance (Article 122 TFEU) and the flexibility clause of Article 352 TFEU (formerly, 235 EEC Treaty) to authorise the Commission to issue debt on behalf of the Union.

The EFSM or SURE are examples of the former, resorting to Article 122 TFEU to establish the mechanisms and authorise the borrowing. However, NGEU adopted a different approach. Instead of including the authorisation to borrow in the Regulation establishing EURI, which is based on Article 122 TFEU and would have replicated what has been done for the EFSM and SURE, the NGEU empowered the Commission to borrow in Article 5(1)(a) ORD.

However, the fact that the ORD was used to authorise the Commission to borrow in the context of NGEU does not mean that all borrowing for spending in the future needs to use this instrument as well. In fact, its use in the context of NGEU could be put into question. For instance, the CLS justifies its inclusion in the ORD because it is an '*incidental component*', a '*logical and necessary part of the specific, and novel,*

118 Originally, the EU budget was financed by contributions from Member States pursuant to Article 200 EEC Treaty. However, in accordance with Article 201 EEC Treaty, the Council Decision 70/243 of 21 April 1970 O.J. L94/19 introduced three own resources (agricultural levies, custom duties and uniform rate on the VAT), which replaced Member States' contributions by 1975. The Delors' reform of 1988 reintroduced such contributions as a fourth own resource via the Council Decision 88/376 of 24 June 1988 O.J. L185/24 (which was somehow contrary to the original meaning of 'own' resources, which Article 201 EEC Treaty used in opposition to national contributions – POTTEAU, n(57), 581–). The current wording of Article 311 TFEU was introduced in the Maastricht Treaty, thus including already national contributions as part of the notion of 'own resources'.

119 A large part of the academic literature only considers custom duties as true own resources, given that the VAT-based own resources is still calculated as a national contribution based on the VAT revenues of the Member State (which is applicable as well to the plastic packaging waste contribution of the current Article 2(1)(c) ORD) (*Cf.* MONTI *et al.*, Final Report and Recommendations of the High Level Group on Own Resources [12.2016], retrieved 01.05.2022 [link], 22-23). This is supported by the fact that the 1970 Council Decision on the replacement of financial contributions from Member States by the Communities' own resources only listed in its Article 2 the two revenues resulting from common policies: agricultural levies and custom duties. The VAT contribution was introduced by Article 4, which assimilated it to 'own resources'.

120 Q&A, n(12); Opinion, n(10), fn(39). The Commission adds that the lack of regularity of the debt proceeds also prevent them from qualifying as such but that seems a weaker argument, given that it could be easily overcome by establishing recurrent borrowing operations.

construction foreseen for the financing of NGEU';[121] but this explanation is not fully satisfactory.

Article 311 *third sub-paragraph* TFEU, which is the legal basis for enacting the ORD, states that the Council shall '*adopt a decision laying down the provisions relating to the system of own resources of the Union*'. As argued above, the proceeds of the borrowing do not constitute '*own resources*' but '*other revenue*' and thus, they do not form part of the '*system of own resources*'. Precisely, one of the advantages of 'other revenue', as the Monti report recalled, is that it does not need to be established in the ORD.[122] Borrowing has indeed a relation with the new ORD, in the sense that it is the reason why the own resources ceiling must be raised; but the centre of gravity of the measure is to generate the necessary means to finance EURI, which is established in a separate instrument and under a different legal basis. Therefore, choosing the ancillary legal basis rather than the principal legal basis seems contrary to the centre of gravity test.[123]

The reason why the empowerment was included in the ORD, which entails a more burdensome procedure, are not fully clear. The Commission has clearly expressed that it was '*the result of a political choice, while respecting legal constraints*';[124] the Council has also acknowledged that it would have been legally feasible to include the empowerment in the EURI.[125] Thus, its inclusion in the ORD was a deliberate choice, perhaps related to the interests of some Member States to embed the whole operation into the ORD and thus make sure that it was absolutely exceptional so any new attempt of borrowing for spending in the future would also require a reform of the ORD.[126]

Nevertheless, it might also be due to the choice at the EU level to deepen into, rather than using the opportunity to move away from, budget sovereignty. This is, Member States might be reaffirming that the EU cannot provide itself with the means to carry out its policies as it sees fit but that it needs the previous acceptance of all Member States, which is possible only if the empowerment is included in the ORD (given that it needs the approval of Member States according to their own constitutional requirements).

A Director of the CLS wrote extra-officially that '*the existence of a self-standing capacity of the EU to finance itself through the issuance of debt outside the system of own resources would threaten to deconstruct that system*'.[127] Albeit it was said in the context of the integrity of the own resources system rather than the empowerment to borrow, it might show that the reason behind its inclusion could be Member States' fear of losing their prerogative to give their final say on how the EU truly finances itself, irrespective of technical considerations on whether the borrowing qualifies as 'other revenues' or true 'own resources'. The ORD is the vehicle through which Member fundamentally control the European integration process.[128] Therefore, despite the novelty and the genuine solidarity that NGEU represents, the inclusion of the empowerment to borrow in the ORD might show that Member States are still very reluctant to let the EU turn into a fully self-determined political project.

121 Opinion, n(10), §98.
122 Monti Report, n(119), 69.
123 *Cf.* Judgment of 23 February 1999, *Parliament v. Council*, C-42/97, EU:C:1999:81, §40,43.
124 Q&A, n(12).
125 Opinion, n(10), §92.
126 DE WITTE, n(11), 663.
127 DE GREGORIO MERINO, n(14), 8.
128 Neither Representation nor Taxation? Or, 'Europe's Moment' – Part I', Editorial, (2020), 5 *European Papers*, 703.

In any case, what is clear is that, as it has been already mentioned, the choice of legal basis cannot be based upon political considerations or the convenience of the procedure. Irrespective of whether such considerations played a fundamental role on the choice to use the ORD to empower the Commission to borrow, what it is clear is that other legal basis are available, even in the context of borrowing for spending.

USE OF PROCEEDS: OLD LIMITS AND NEW AVENUES

– The need for a legally binding act

Article 310(3) TFEU states that any expenditure of the budget '*shall require the prior adoption of a legally binding Union act providing a legal basis for its action and for the implementation of the corresponding expenditure* […]'.

As the Court of Justice has pointed out, this entails that the implementation of an expenditure needs two legal bases: one for the entry of the appropriation into the budget (this is, the budget itself, adopted pursuant Article 314 TFEU) and a different one for the act of secondary legislation from which the expenditure derives, which must be legally binding.[129]

As off-budget operations, back-to-back lending and borrowing for spending do not need to be adopted using the legal basis of the budget. They just need '*a legally binding Union act providing a legal basis for its action*'. The legal basis for previous borrowing programmes has been, as for the empowerment for borrowing, Article 108 and 235 EEC Treaty for assistance in the case of difficulties of the balance of payments,[130] Article 212 TFEU for assistance to third countries and Article 122 for financial assistance to Member States.

Article 122(2) TFEU allows the Council to grant financial assistance to Member States '*with severe difficulties caused by natural disasters or exceptional occurrences beyond its control*' and has been used to establish the EFSM[131] or a programme to grant emergency support in case of disasters.[132] In line with the judgment of the Court of Justice clarified in *Pringle*, this legal basis can in principle only be used for *ad hoc* temporary assistance.[133]

Article 122(1) TFEU, on the other side, gives the possibility to the Council to decide '*in a spirit of solidarity between Member States, upon the measures appropriate to the economic situation, in particular if severe difficulties arise in the supply of certain products, notably in the area of energy*'. According to the CLS, it is based on previous Article 103 EEC Treaty,[134] which referred to 'conjunctural policies' adopted by Member States, and should thus be interpreted as being temporary in nature, similarly to Article 122(2) TFEU.

Both SURE and EURI were based on both paragraphs of Article 122 TFEU. This dual legal basis did not entail procedural problems given that they both foresee the same

129 Judgment of 12 May 1998, UK v. Commission, C-106/96, EU:C:1998:218, §22; Judgment of 30 May 1989, *Commission v. Council*, C-242/87, EU:C:1989:217, §18.
130 Council Regulation 397/75 of 17 February 1975 concerning Community loans, [1975] O.J. L46/1; Council Regulation 1969/88 of 24 June 1988 establishing a single facility providing medium-term financial assistance for Member States' balance of payments, [1988], O.J. L178/1.
131 Council Regulation 407/2010 of 11 May 2010 establishing a European financial stabilisation mechanism, [2010] O.J. L118/1.
132 Council Regulation 2016/369 of 15 March 2016 on the provision of emergency support within the Union, [2016] O.J. L70/01.
133 Judgment of 27 November 2012, *Pringle*, n(100), §65.
134 Opinion, n(10), fn(70).

legislative procedure. The SURE proposal[135] explains that the second paragraph is the basis for the financial assistance while the first paragraph enables the collective guarantees.[136] The EURI proposal,[137] however, does not explain the rationale of the choice of both legal bases. The CLS argued at that time that the right legal basis should be Article 122(1) TFEU because EURI itself was not granting financial assistance but rather distributing funds into Union's programmes (the RRF, EU4Health, RescEU, just to cite a few),[138] which are at the same time regulated in other instruments under their own legal basis.[139] However, that view did not prevail and both provisions remained.

The legal construction of the use of proceeds in the context of NGEU raises the question of whether future operations of borrowing for spending will require an intermediary instrument based on Article 122 TFEU to distribute the proceeds or rather, they could be assigned directly to spending programmes based on the legal basis of sectoral policies. This is relevant not just for the sake of procedural efficiency but also because it would provide a way-out from the need for temporality that Article 122 TFEU seemingly requires.

From the point of view of the rules applicable to the use of proceeds, there is nothing preventing the direct assignation of funds through other instruments based on other sectorial legal bases, given that they already constitute the '*legally binding Union act*[s] *providing a legal basis for its action*'. NGEU was a complex instrument that might have needed a central distributing element for the sake a clarity but not as a legal requirement.

It could be argued, nevertheless, that using Article 122 TFEU can help preserve the integrity of the own resources system, given that it ensures that the measure is temporal and exceptional, which are key elements of the notion of 'qualitative complementarity'. However, that argument is not particularly convincing because it is possible to envisage other programmes that are also single-purposed, exceptional and temporary without needing to resort to Article 122 TFEU. Moreover, if we accept that small issuances would not need to comply with the notion of 'qualitative complementarity' because they would already be complementary on the basis of their size, they would not be required to be temporary. Thus, they would not need to make use of Article 122 TFEU to reinforce their temporary character.

– **The no-bailout clause**

The so-called no-bailout clause of Article 125(1) TFEU has already been analysed in the context of the joint and several liability of the guarantees provided by Member States to secure the borrowing operation. Nevertheless, this provision has another application in the context of the use of proceeds: they should not be used in a way that renders the Union liable for MS commitments.

The CJEU clarified in Pringle that, rather than being a true 'no-bailout clause', what Article 125(1) TFEU prohibits is '*granting financial assistance as a result of which the incentive of the recipient Member State to conduct a sound budgetary policy is dimi-*

135 Explanatory Memorandum of the Commission Proposal for a Council Regulation establishing SURE, COM(2020) 139 final [02.04.2020].
136 *Cf.* DE WITTE, n(11), 654.
137 Explanatory Memorandum of the Commission Proposal for a Council Regulation establishing the EFSM, COM(2020) 441 final/2 [28.05.2010].
138 Opinion, n(10), §119.
139 For instance, the RRF is based on the cohesion legal basis Article 175 third sub-paragraph TFEU; EU-4Health is based on the health policy legal basis of Article 168(5) TFEU; and RescEU rests on Article 196 TFEU relating to civil protection.

nished'.[140] The Court understood that a borrowing operation aimed at providing financial assistance (even if outside the EU framework) was compliant with such principle provided the recipient Member State '*remains responsible for its commitments to its creditors' and 'the conditions attached to such assistance are such as to prompt that Member State to implement a sound budgetary policy*'.[141] Thus, strict conditionality has been identified as the condition to ensure that the assistance provided with the proceeds of the borrowing was compatible with Article 125(1) TFEU.[142]

Nevertheless, neither NGEU nor SURE seem to be subject to the conditionality imposed by this provision. These mechanisms come with attached conditions but they are derived from the political will on the design of the instruments, not from a legal requirement.[143] In that regard, the understanding of the CLS is that NGEU (although the same logic could be apply to SURE) did not need conditionality because it falls outside the scope of Article 125(1) TFEU. In its view, NGEU does not constitute financial assistance destined to replace financial market access for Member States (contrary to the financial crisis, EU countries could still borrow on their own during the pandemic).[144] Rather, NGEU was intended to counterbalance the asymmetric negative effects of the pandemic[145] and to pursue other policy objectives of the EU, most notably cohesion (through the RRF).[146]

If this line of argumentation is correct, it would entail that Article 125(1) TFEU would be relevant and thus, conditionality will be required, only for certain uses of the proceeds; more in particular, when they diminish the recipient Member State's incentives to maintain a sound budgetary policy.

Conclusion

This paper has tried to analyse from a legal perspective how the future of common borrowing in the Union looks like.

The first part has shown that while borrowing has always been possible under the applicable framework of principles and rules, the EU's approach to borrowing is remarkably cautious. This might be one of the reasons, for instance, why the current assistance for Ukraine is so limited in size and the disbursements so difficult. This paper has thus tried to challenge some of the elements of this legal construction, in the hope that it can stimulate the discussions around new avenues for borrowing in the Union.

Furthermore, the second part of this paper has delved into the future of borrowing for spending in particular, which faces both the legal challenges that any borrowing entails but also additional difficulties related to its specific nature. This has served to identify all the rules applicable to borrowing operations and systematise them according to the stage of the operation to which they apply, while at the same time exploring other new avenues for the future. More importantly, it has discussed the impact of the Article 4 of the current ORD on the possibility to resort to borrowing for spending in the future. It has concluded that, while this new provision imposes

140 *Pringle*, n(100), §136.
141 *Ibid.*, §137.
142 Opinion, n(10), §159.
143 *Cf.* STEINBACH, 'The Next Generation EU – Are We having a Hamiltonian Moment?', in UTRILLA and SHABBIR (eds.), *EU law in times of pandemic*, 2021, 30.
144 Opinion, n(10), §161.
145 STEINBACH, n(143), 30.
146 Opinion, n(10), §162.

a significant procedural burden in future operations of that kind –the modification of the current ORD–, the substantive provisions that rule and allow common borrowing remain unaltered.

Main takeaways of part I

Current understanding	New avenues to explore
The balanced budget rule of Article 310(1)(3) TFEU and 17 Financial Regulation requires borrowing operations to be 'off-budget'. The principle of budgetary balance requires borrowing operations to be budgetarily neutral	
Macro-financial assistance to third countries needs a triple guarantee to remain budgetarily neutral: the claim against the recipient country, the headroom between the OR ceiling and committed expenditures and the provision of the External Action Guarantee	The provisioning of the External Action Guarantee **might not be a legal requirement** deriving from the principle of budgetary balance and fiscal discipline. This might speed up MAF to Ukraine.
Fiscal discipline of Article 310(4) TFEU requires all borrowing operations to be fully backed by the headroom	**Partially backing borrowing operations** (rather than fully) might still comply with fiscal discipline requirements; **Other guarantees** aside from Member States' contributions (such as other institutional guarantors) might comply with the provisions on fiscal discipline

Main takeaways of part II

Stage	Current understanding	New avenues to explore
Issuance	**Borrowing for spending is allowed** as long as it is budgetarily neutral and backed by own resources. **No clear understanding of what Article 4** of the 2020 Own Resources Decision entails	**Any borrowing for spending operation will need an amendment of the ORD** to delete the provision or derogate from it. **MS have now an opportunity** to do so in the ongoing amendment process of the ORD.
	Borrowing for spending operations need a **ring-fenced increase of the own resources ceiling** to comply with both budgetary balance and fiscal discipline	**Ring-fencing might not be needed** in view of Article 14(2) of the Making Available Regulation. In the absence of Article 4 ORD, **small issuances** fitting within the available headroom would not need any amendment of the ORD
	Article 125 TFEU requires that Member States, as guarantors of any borrowing operation, are **not joined and severally liable**	Joint and several liability might be possible for **specific uses of debt**
	To remain off-budget, debt proceeds need to be treated as '**external assigned revenue**', which ensures compliance with the principles of unity and universality. External assigned revenue requires compliance with the integrity of the OR system. In turn, this requires **debt proceeds to be complementary to the rest of own resources.** Complementarity can be qualitative if borrowing is **exceptional, temporary** *and* **single-purposed**	Explore the notion of quantitative complementarity: **small issuances** fitting within the available headroom might be possible even if they are done on a **permanent basis**.
Authorisation to borrow	Non consistent practice regarding the legal basis chosen to authorise the borrowing (flexibility clause, art. 122 TFEU, art. 212 TFEU, ORD)	The **ORD is not the only legal basis that can be used to authorised the borrowing** Nevertheless, the need to derogate from Article 4 ORD will make the amendment of the ORD **inevitable** to engage in borrowing for spending
Use of proceeds	Proceeds can only be allocated using Article 122 or 352 TFEU	Allocation of proceeds might be allocated directly under **any sectorial legal basis**

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