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On the Amato et al. proposal for a European Debt Agency: a preliminary legal analysis

Rosalba Famà
Maria Antonia Panascì

Università Bocconi
IEP@BU
Institute for European Policymaking

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1. Introduction[1]

This working paper provides a legal analysis of the proposal for a European Debt Agency as elaborated by Massimo Amato, Everardo Belloni, Carlo Favero, and Lucio Gobbi.[2] This research is placed within a broader discussion on the future of public debt management in the EU that flourished in recent years. Especially after the outbreak of Covid-19 and given the need to quickly and jointly react to the symmetric shock caused by the pandemic, a fertile debate on possible avenues for the management of public debt of the Eurozone arose. On the one hand, Giavazzi and Tabellini advocated the issuance of perpetual Eurobonds,[3] while Micossi[4] and Avgouleas proposed to transfer the sovereign bonds purchased by the European Central Bank (ECB) to the European Stability Mechanism (ESM) to tackle the recessive effects of the Covid-19 pandemic and the low growth of inflation.[5]

This contribution does not intend to engage with these alternative proposals. Instead, this working paper pursues several purposes. First, it aims to verify whether the proposal for a European Debt Agency (hereafter "EDA") put forward by a team led by Massimo Amato[6] is compatible with the legal framework of the European Union as established in the Treaty on the Functioning of the European Union (TFEU) and the Treaty on the European Union (TEU). Second, considering the system of conferred competences that governs the EU constitutional framework, this working paper investigates potential legal bases and alternative legal architectures on which EDA could be built. This study presents several scenarios for how EDA could be set up and governed. Our overall objective is to provide a solid legal background for EDA, which so far has been studied only from an economic and financial feasibility perspective. The proposal for the EDA, if adopted, would represent a "Copernican revolution" for the Eurozone. Therefore, we believe that such an initiative deserves deep scrutiny also from a legal perspective.

[1] About the Authors: Doctoral of law and Postdoctoral Researcher at Bocconi University, Law Department, respectively. Rosalba Famà is the author of sections 1, 2, 3.5., 4.6., 5,6. Maria Antonia Panascì is the author of sections 3.1., 3.2., 3.3., 3.4., 4.1., 4.2., 4.3.,4.4., 4.5.,7.
[2] Amato and others, "Creating a Safe Asset without Debt Mutualization: the Opportunity of a European Debt Agency" CEPR Discussion Paper No 17217/2022; Amato and others, "Europe, public debts, and safe assets: the scope for a European Debt Agency" (2021) Economia Politica 323 ff.
[3] Giavazzi and Tabellini, "Covid perpetual Eurobonds: Jointly guaranteed and supported by the ECB", (*VoxEu*, 24 March 2020) <https:// voxeu. org/ artic le/ covid- perpe tual- eurob onds.>
[4] Micossi, "Sovereign debt management in the euro area as a common action problem" Luiss SEP Policy Brief 38/2020.
[5] Avgouleas and Micossi, "On selling sovereigns held by the ECB to the ESM: institutional and economic policy implications" Luiss SEP Policy Brief 5/2021; Tosato, "Legal considerations on the Avgouleas-Micossi proposal" Luiss SEP Policy Brief 16/2021.
[6] The full team includes Massimo Amato, Everardo Belloni, Carlo A. Favero and Lucio Gobbi.

This contribution proceeds as follows. Section 2 summarizes the structure and functioning of EDA; section 3 places EDA within the EU constitutional architecture and analyses the relevant legal ramifications of the introduction of EDA; section 4 reflects on potential legal bases backing the construction of EDA; section 5 discusses proposals for a sound governance of EDA; section 6 reflects on the compatibility of EDA with the European fiscal rules; section 7 concludes and highlights potential routes for future research.

2. The aims and functioning of the European Debt Agency

The European Debt Agency (EDA) aims to coordinate the management of sovereign debts of Member States whose currency is the Euro, both past and future debts.[7] To grasp the EDA's rationale, it is worth clarifying what EDA will not be, i.e. a device for endowing the mutualisation of Member States' debts. Instead, EDA's goal is to pool Eurozone countries' debts to allow more efficient management thereof with respect to their financing, i.e. their relationship with the sovereign bond market.

The architecture of the European Debt Agency represents an example of financial engineering and requires to be accompanied by a solid legal construction in compliance with the Treaties' framework. The proponents of EDA had to deal with a trade-off. On the one hand, a need to build up a European Debt Agency whose functioning would reduce the cost of financing of all the MSs without incentivizing moral hazard.[8] On the other hand, addressing the segmentation of the sovereign debt market, which is currently incapable of providing a supply of European safe assets.

First, within EDA each State will remain responsible for its own debt and the pricing applied will vary according to the fundamental risk of the Member State concerned.[9] Second, EDA will provide the market with a safe asset: filtering the liquidity risk in a structural way (i.e. addressing the market with the issuance of its own bond then using the money raised to finance MSs with perpetual loans priced differently according to their creditworthiness), and protecting Eurozone Member States from undue pressure amplified by market segmentation.[10] As we will see, EDA can manage sovereign debts of the Eurozone without mutualising them.

[7] Amato and others, 'Europe, public debts, and safe assets: the scope for a European Debt Agency' (2021) Economia Politica, 825.
[8] Ibid, 837.
[9] Ibid, 838.
[10] Amato and others, "Europe, public debts, and safe assets: the scope for a European Debt Agency" (2021) Economia Politica, 830.

EDA's framework leverages the potential irredeemable nature of sovereign debts. To understand the functioning of EDA, it is important to stress the difference between States and private actors, be they natural persons or legal entities. While private actors have a finite time horizon for their income capacity, States do not.[11] Therefore, the concept of solvency should be substituted with debt sustainability as a guiding principle in public debt management. Indeed, as argued by Amato in another contribution, "What is crucial about public debt are the effective conditions for its refinancing".[12]

The European Debt Agency will progressively absorb Member States' debt.[13] This will happen in the following way. First, EDA will incur debt on the financial markets by issuing bonds with finite maturity on primary markets according to a current market price, and its high rating. Second, EDA will lend on the proceeds with infinite maturity loans to the Member States. EDA will thus become gradually the only borrower from markets and the only lender to Eurozone States, whose borrowed money will be used either to cover new public deficits or to refinance expiring bonds.[14] The new loans will be repaid following an irredeemable mortgage scheme. The whole process will be based on an adequate insurance scheme equivalent to a solvency capital endowment.[15] In so doing, EDA will apply to MSs' loans an interest rate that varies according to each MS's fundamental risks. In other words, for each Member State, the cost of the loan fluctuates based on a rate of perpetual amortization scheme coherent with its own creditworthiness.[16] The pricing EDA applies also includes an amortization charge, which increases EDA's reserves as long as Member States do not default. This reserve consists of a "sinking fund" that allows EDA to write off parts of the debt in case of need.[17] EDA's approach differs from other tools that involve the issuance of common bonds, such as within the SURE programme.[18] Here, the Commission applied the same interest rate at which the Commission itself borrowed, granting the financed Member State huge savings, but in fact not avoiding some sort of mutualization.[19]

[11] Amato and Saraceno, "Squaring the circle: How to guarantee fiscal space and debt sustainability with a European Debt Agency", Bocconi Working Paper 172/2022,8 and 9.
[12] Ibid, 8.
[13] Amato and others, "Europe, public debts, and safe assets: the scope for a European Debt Agency" (2021) Economia Politica, 831.
[14] Ibid, 831 ff.
[15] Ibid, 831.
[16] Ibid, 839.
[17] Ibid, 854.
[18] Council Regulation (EU) 2020/672 on the establishment of a European instrument for temporary support to mitigate unemployment risks in an emergency (SURE).
[19] Croonenborghts, 'The European instrument for temporary support to mitigate unemployment risks in an emergency (SURE) – an innovative (social) approach to EU financial assistance', EU Law Live Weekend edition 19/2020.

Put in other words, the EDA will allow Member States to finance themselves by enjoying the benefits of a perpetual bond - that is an alleviation of the terms of repayment through the systematic filtering of liquidity and refinancing risk, as reminded below - without recurring to it. Indeed, the financial markets have little appetite for perpetual bonds. Instead, EDA exploits its joint borrowing capacity to lend on the proceeds from its own borrowing to the Member States via perpetual loans. In this way, Member States are better placed in servicing their debt. To be more accurate, EDA's loans to Member States can be renewed at the discretion of each Member State through a perpetuity scheme and each Member State remains free to liquidate its expiring debt positions.[20]

As it was anticipated, the main objective of EDA consists of sheltering Member States' fiscal budgets from market liquidity risks. Thanks to its framework, EDA will filter the risk of refinancing public debt and guarantee its rollover under improved conditions.[21] The repayment plan for loans to States avoids an explosive growth in perpetual loans. The EDA will progressively absorb all the debt issued by the States so far, while States will pay a periodic instalment each year whose value is periodically recalculated considering only Member States fundamental risk and the prevailing risk-free rate of interest on markets, thus sterilizing the price dynamics in the financial markets from the 'global market sentiment'.[22] Applying a different rate per each Member State that is coherent with its fundamental risk, EDA avoids any form of debt mutualization. The EDA will use the overall flow of instalments to pay its bondholders. Finally, EDA will bear market risk with regard to its own debt issued on the market, a risk which is mitigated by both its initial capital endowment and the accumulation of reserves. It will not purchase MSs' securities on the market, and it will not be liable for the commitments of any Member State.
The graph below illustrates how EDA works.

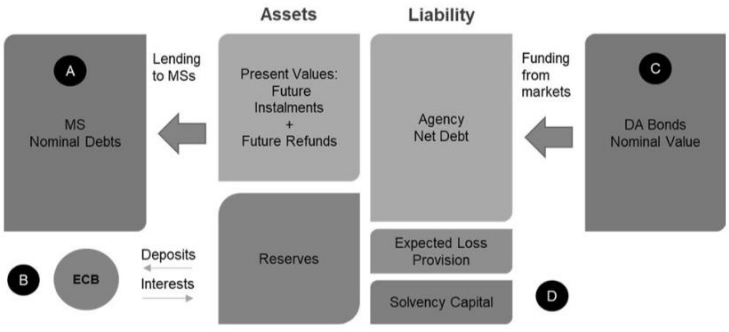

Fig. 1 From Amato and others, 'Europe, public debts, and safe assets: the scope for a European Debt Agency' (2021) Economia Politica, p. 834. All rights reserved.

[20] Amato and others, "Europe, public debts, and safe assets: the scope for a European Debt Agency" (2021) Economia Politica, 831.
[21] Ibid.
[22] Ibid, 832-833.

The European Central Bank will also play a key role in stabilizing the EDA mechanism. First, it will remunerate the debt agency's reserves at a long-term directory rate.[23] Second, by declaring its intention to buy EDA's bonds on the primary market, the ECB will align the EDA's bonds yield to that rate.[24]

Among the advantages of creating such an agency, the authors mention that the financial markets can rely on a safe asset as both market sentiment and liquidity risk have been filtered.[25] Also, systemic financial actors avoid a safe asset shortage. Looking at the Eurozone, it will play as a homogeneous actor issuing a common bond that does not entail any form of debt mutualization.[26]

EDA is non-mutual in the way it is built. However, EDA offers the EU a framework for creating its own segregated mutualized portfolios.[27] The EU may use these portfolios for financing European projects such as funds for the climate crisis or a common defence. In this way, EDA may also finance a European central fiscal capacity, may the political consensus be there one day.[28]

3. EDA within the EU constitutional framework

This section places EDA within the EU constitutional framework, analysing the relevant legal issues.

3.1 Principle of Conferral

The establishment of EDA raises the question of its compatibility with the current division of competences between the EU and the Member States. It might be helpful to recall that the EU is a system based on the principle of conferral, according to which "the Union shall act only within the limits of the competences conferred upon it by the Member States in the Treaties to attain the objectives set out therein. Competences not conferred upon in the Treaties remain with the Member States" (Article 5 (2) TEU). This means that the EU derives its powers from Member States, which deliberately chose to enable the EU to act in limited fields to pursue pre-identified objectives through pre-determined procedures. The Treaties encapsulate such an agreement by providing for legal bases, which are specific Treaty provisions allowing Union action in a particular field. The legal basis

[23] Ibid, 854.
[24] Ibid, 855.
[25] Ibid, 833.
[26] Ibid, 832.
[27] Ibid, 838.
[28] Ibid.

identifies the objectives, decision-making procedures, and the different institutional actors involved in the adoption of a measure.

Against this background, it should be established whether the current Treaty framework allows the creation of EDA either within or outside the EU legal order. The feasibility of establishing EDA within the EU legal framework depends upon the existence of a specific legal basis that actively empowers the Union to create it. In other words, if EDA were to be established as an agency under EU law, not only it should be compatible with the division of competences envisaged in the Treaties, but it should also satisfy a positive requirement that is a suitable legal basis. If, instead, EDA were to be created outside the EU legal framework — i.e. under international law as it was done, for instance, with the European Stability Mechanism (ESM) — it is sufficient to establish the compatibility of EDA with the current division of competences and relevant Treaty provisions.

In both scenarios, it is necessary therefore to first understand what kind of activity EDA carries out and in which policy domain it falls. The mandate of EDA is focused on (and limited to) the management of national debts, which amounts to offering different financing conditions to Member States according to their fundamental risk. The aim and instruments of EDA recall, despite some differences, those of the ESM, which the Court of Justice of the European Union (CJEU) classified as a mechanism falling within the area of economic policy.[29] Similarly to the ESM, EDA provides funding to Member States to ensure financial stability. Yet, contrary to the ESM which aims to manage debt crises, EDA would systematically act in order to *prevent* such debt crises.[30] In any event, EDA can be deemed to fall within the field of economic policy, which the Treaties designate as an area of coordination of economic policies of Member States.

According to Articles 2 (3) and 5 TFEU, Member States shall coordinate their economic policies within the Union, in particular within the Council which shall adopt broad economic policy guidelines. This competence does not fit the tripartite scheme of the Treaty, which distinguishes between exclusive, shared, and supplementary competences (Articles 2-6 TFEU). For this reason, Union competence on economic policy is described as a *sui generis* competence, as further proven by the specific Treaty chapter on economic policy which details the provisions through which Member States shall coordinate their economic policies (Articles 120-126 TFEU). This set of provisions,

[29] Case C-370/12 *Thomas Pringle v Government of Ireland and Others* [2012] EU:C:2012:756 (Hereafter "*Pringle*") para 60.
[30] In *Pringle*, the CJEU acknowledged that Treaty provisions in the chapter related to economic policy were "essentially preventive, in that their objective is to reduce as far as possible the risk of public debt crises" whereas the ESM's objective was "the management of financial crises which […] might nonetheless arise" (para 59). of establishing the regulatory framework contained in the Treaty chapter on (para 59).

however, does not only allow the adoption of soft law measures of coordination but also of legally binding instruments. In fact, although the *sui generis* coordination competence theoretically excludes pre-emption - which is the virtual impossibility for Member States to act if the Union has already done so - in practice the adoption of Union legislation in this broad policy domain could pre-empt the action of Member States with regard to certain aspects of their economic policy. This is especially true when it comes to budgetary law, where the adoption of Union regulatory instruments has resulted in the harmonization of (some) budgetary rules.[31]

As already mentioned, EDA would deal with the coordinated management of national debts allowing Member States to enhance the efficiency of their debt-servicing. One might argue that EDA implies more than mere coordination, specifically that it rather implies the issuance of debt *on behalf of* Member States. Yet, the ESM provides a valid example of how this occurrence is compatible with EU law. The ESM already envisaged the issuance of debt acting *de facto* as a protective filter between the market and the Member States. It is indeed a mechanism that provides funds to Member States to repay their debts – as EDA will do in practice – which has already been declared compliant with EU law in *Pringle*. For this reason, EDA is compatible with the system of attributed competences. The real issue, instead, would be "how much" pre-emption EDA will entail, which means to what extent Member States will remain free to issue debt. An orthodox approach would exclude the possibility of pre-emption in the economic policy area: the issuance of debt by EDA could not *legally* preclude the possibility for Member States to issue their debt. In this respect, the proposed design of EDA would be in contrast with this requirement.

In fact, one of the key points of the EDA proposal is the substitution of Member States' debt issuance with EDA's loans. According to the proponents, if Member States continued to issue bonds, the purpose of EDA would be undermined. Yet, under the current Treaties and the derived system of attributed competences, an EDA that would prevent Member States from issuing their bonds does not appear possible. There is no sufficient legal basis in the Treaty capable of curtailing this Member States' prerogative to such an extent.[32] The analysis of possible legal bases for the establishment of EDA (section 4) will further clarify the point.

Before analysing the legal basis requirement, though, it should be assessed whether EDA would be compatible with other provisions of the existing Treaty framework.

[31] See De Witte, "EMU as constitutional law" in Amtenbrink and Hermann (eds), The EU Law of Economic and Monetary Union (OUP 2021) 283.
[32] The preclusion of debt issuance at national level would likely raise constitutional tensions in Member States with a federal structure where subnational levels of government would be prevented from issuing debt as well.

3.2. Monetary policy

The ESM can also serve as a blueprint for examining EDA's compatibility with the Treaty provisions on monetary policy. When assessing the ESM's legality, the CJEU adopted a methodology based on the objectives and instruments of a given measure in order to determine its classification as monetary policy or economic policy. The CJEU held that an economic policy measure that pursues the financial stability of the euro area cannot be considered equivalent to a monetary policy measure for the sole reason that it may have indirect effects on the stability of the currency used in that area.[33] The classification of a measure is indeed crucial in terms of division of competences since monetary policy falls within the exclusive competence of the Union, whereas economic policy belongs to the shared domain of coordination.

Against this background, EDA would maintain and uphold the asymmetry between monetary and economic policy above. Not only would the EDA preserve such a distinction, but it would also relieve the ECB from the stabilization function it happened to pursue after the euro area crisis. In other words, EDA would help the ECB better serve its mandate to attain the price stability of the euro area. The ECB's response to recent crises has received criticism for having embarked on quasi-fiscal policies in contrast with its price stability-centred mandate. Starting with the OMT's announcement in 2012, the ECB has tried to cover for the lack of a fiscal stabilization mechanism at EU level. Specifically, the ECB had to intervene with its bond-buying programmes to align yield spreads with Member States' fundamentals, as the interest rates of some bonds were not reflecting the fundamental risk of the Member States issuing those bonds.[34] EDA will do exactly that: ensuring that the cost that Member States pay to service their debt is in line with their fundamentals. More importantly, it will also help the ECB abandon the capital key criterion when intervening on the secondary market, which led to the proportional purchase of Member States' bonds, including those which did not have high yields. The ECB thus will be buying, if anything, not a Member State's debt but EDA's debt. This endeavour would be much more in line with its main task outlined by the Treaty.

3.3 Economic policy coordination framework

Provided that EDA would be a mechanism falling within the Union's competence in coordinating economic policies, as argued above, it should be briefly analysed whether its establishment would affect the framework for coordination of economic policies outlined in Articles 119 to 121 TFEU and

[33] *Pringle* para 56.
[34] This was the justification provided by the ECB and referred to in Case C- 62/14 *Peter Gauweiler and Others v Deutscher Bundestag* ECLI:EU:C:2015:400 (hereafter *Gauweiler*) paras 72-78.

126 TFEU. Such a framework is basically articulated on two arms: a preventive arm, aimed at impeding *ex ante* the formation of excessive deficits through a macroeconomic surveillance procedure, and a corrective arm, consisting of the excessive deficit procedure to sanction the formation of such deficits. As suggested by its proponents, EDA will foster compliance with the fiscal rules, as the risk class to which each Member State is assigned depends on its more or less "virtuous" fiscal standing.

Besides this incentive, it should be noted that EDA does not concern the coordination of economic policies per se, but it would simply translate the results of that coordination into a technical (i.e. filtering) refinancing operation. It would simply complement the existing coordination framework, without interfering with broad economic policy recommendations or any other measures, including sanctions, proposed by the Commission and adopted by the Council.

Admittedly, a tangible concern about interference might arise if the Commission is to be entrusted with the task of assigning Member States to a certain risk class, as the EDA proponents suggest. In this way, the Commission would surreptitiously enforce economic policy recommendations by leveraging its power to determine the risk class of a given Member State. As section 5 will show, we advocate for the attribution of such power to a different institution, which is not already involved in the definition of economic policy priorities and recommendations addressed to Member States in the framework of economic governance.

3.4 Compatibility with Article 125 TFEU

The establishment of EDA, as already anticipated, will not entail mutualisation of Member States' debts, nor the creation of Union's debt in the strict sense. For this reason, EDA will not raise legal concerns as for its compatibility with Article 125 TFEU, the so-called "no-bailout" clause.
According to Article 125 TFEU, neither the Union nor a Member State shall "be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of any Member State, without prejudice to mutual financial guarantees for the joint execution of a common project." This provision has been interpreted as preventing debt mutualisation between the Union and its Member States and between

Member States themselves. The rationale of the clause, as established by the CJEU in the *Pringle* judgment, is to ensure market discipline. Member States ought to be responsible for their own public finances before the market: financial assistance measures either by the Union or by other Member States acting individually or collectively can be allowed only in exceptional circumstances for the attainment of a higher aim, i.e. financial stability, provided that "strict conditionality" is attached. The creation of a permanent mechanism

of financial assistance, the European Stability Mechanism (ESM), reflected that market logic since it did not entail the direct assumption of Member States' debt and thus of their responsibility towards their creditors.[35] EDA would replicate this pattern, as it would not act as a guarantor of Member States' debt.

The main difference with the ESM is that EDA would disburse its borrowing proceeds automatically, thus without the need to activate "ad hoc financial assistance". While the denomination "financial assistance" suggests a temporary nature, EDA disbursement would be permanent but nonetheless in line with Article 125 TFEU insofar as not redistributive. In *Pringle*, the Court stated that Article 125 TFEU does not preclude a permanent system such as the ESM, but rather implied the preclusion of redistributive financial assistance.[36]As mentioned above, EDA's payments will not be redistributive, i.e. they will not aim at income equalization between Member States. EDA will indeed distribute the proceeds of borrowing according to the fundamentals of the Member States, therefore it will maintain the different creditworthiness that Member States enjoy before the market according to their fiscal standing.

One might object that it is the "risk-filtering" function of EDA, and therefore the very purpose of its establishment, to work against market discipline. EDA would substitute the market in determining the financing conditions for Member States: the cost of loans granted to a Member State will be "in line with its *specific* creditworthiness, i.e. proportional to its degree of compliance to the agreed EU rules".[37] Yet, one has to look at the ultimate objective of market discipline which, as clarified by the CJEU in a passage of *Pringle*,[38] ought to prompt Member States to conduct a sound budgetary policy. In this respect, EDA does not elide the market discipline logic that underpins the Treaty framework but rather reshapes it. The market will not cease to be a disciplinary mechanism for Member States as they will keep paying different prices on their own debt. The difference will be that such prices will be determined by EDA according to the class of risk assigned to each Member State. In other words, EDA would enhance market discipline by ensuring the correct pricing of Member States' debt and would itself become accountable vis-à-vis the market.

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[35] *Pringle* paras 145-149.
[36] For this interpretation see Panascì, "Unravelling Next Generation EU as a transformative moment: from market integration to redistribution" (2024) 61 CMLRev 13-54, 29.
[37] Amato and Saraceno, "Creating a Safe Asset without Debt Mutualization: the Opportunity of a European Debt Agency" cit. note 11 p. 13 where the authors clarify that "EDA only finances MS' new or expiring debt, according to predetermined formulas based on the MSs' fundamental risk, i.e. on the risk of default which correspond to the possible deterioration of the fundamentals underpinning the MS' economy, which is also linked to the degree of its compliance with the (renewed) EU fiscal rules/standards".
[38] *Pringle*, para 135 " it must held that that provision prohibits […] the granting of financial assistance as a result of which the incentive of the recipient Member State to conduct a sound budgetary policy is diminished"; see also para 137, according to which the recipient Member State "remains responsible for its commitments to its creditors provided that the conditions attached to such assistance are such to prompt that Member State to implement a sound budgetary policy".

This difference could be seen as a crucial objection to the establishment of EDA. However, it is worth noting that with past borrowing experiences such as those within the ESM, the Support for Unemployment Risks in an Emergency (SURE) and Next Generation EU (NGEU),[39] the Commission has passed along the preferential rates at which it borrowed on the market to Member States, acting as an intermediary and *de facto* guarantor.[40] In other words, EDA would not be dissimilar from existing mechanisms which have already diluted the market logic underpinning Article 125 TFEU. In practice, EDA will act as a supervisory mechanism enforcing market discipline previously embodied by those "strict conditions" determined by other supervisory bodies such as the "Troika".

Provided that the logic of the market is preserved since the premia that Member States pay are justified by their fundamentals, it is helpful to examine the specific conditions that any borrowing operation has to comply with to be compatible with Article 125 TFEU. In this respect, the key concept is that of liability which in turn depends on the type of guarantees provided to back up the debt in case of non-repayment.

As past mechanisms show, Article 125 TFEU allows recourse to debt as long as the inherent mutualization of borrowing costs is not combined with a parallel mutualization of repayment costs.[41] The long-dated debate on "Eurobonds" rehearsed this argument illustrating how it is not the issuance of common debt per se to raise questions of compatibility with the no-bailout clause, but the type of liability envisaged vis-à-vis investors.[42] According to the Green Paper on the feasibility of introducing stability bonds, published by the Commission in 2011, the full as well as partial substitution of national debt with joint and several guarantees requires a Treaty amendment as both schemes imply debt mutualization.[43] The only feasible option within the current Treaty framework would be partial substitution with several but not joint guarantees. This is indeed the scheme beneath the ESM where liabilities were limited to the pro rata nature of the contributing key.[44] The full substitution with several

[39] See 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, O.J. 2020, L 159/1. For the legal architecture of NGEU see Council Decision 2020/2053 of 14 December 2020 on the system of own resources of the European Union and repealing Decision 2014/335/EU, Euratom O.J. 2020, L 424/1; Council Regulation 2020/2094 of 14 December 2020 establishing a European Union Recovery Instrument to support the recovery in the aftermath of the COVID-19 crisis, O.J. 2021, L 433I/23; Regulation 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility O.J. 2021, L 57/17. For a legal analysis of SURE and NGEU, see De Witte, "The European Union's Covid-19 Recovery Plan: The Legal Engineering of an Economic Policy Shift" (2021) 58 CMLRev 635-682.
[40] For this argument see Amato and Saraceno, "Creating a Safe Asset without Debt Mutualization: the Opportunity of a European Debt Agency" cit. note 11, 20.
[41] See Panascì, cit. note 37, 45.
[42] Ibid. See also cited Athanassiou, "Of past measures and future plans for Europe's exit from the sovereign debt crisis: What is legally possible (and what is not)" (2011) 36 ELRev 558–575, 574.
[43] European Commission, "Green Paper on the feasibility of introducing Stability Bonds" COM/2011/0818.
[44] Panascì, cit. note 37, 46.

but not joint guarantees, instead, has not been examined by the Report on the grounds that "it would not be materially different from the existing issuance arrangements".[45] This explanation corroborates the case for EDA, since this agency would entail full substitution of national debts but without the debt mutualisation implied by the several and joint guarantees.

Therefore, if EDA were to be established by using the existing ESM, as the proponents of EDA suggests as the most feasible (although not preferred) solution, there would not be any issue of compatibility with Article 125 TFEU vis-à-vis guarantees as every Member State will be liable for its own share of debt issuance. Specifically, since EDA would be limited to opening credit lines for Member States, each State will be called to pay back the loan received. In case of its insolvency, contrary to the ESM, EDA will use the reserves it will have accumulated among its assets, to cover for Member State's default. EDA will have its own absorption capital and be protected by an insurance scheme; it will bear market risk but will only be responsible for possible default on its own debt issued on the market. Consequently, EDA will not be liable for or assume the commitments of any Member State.

The crux of the problem would rather be the expected full substitution of national debts since Member States' debt-finance will progressively shift from bonds to EDA's loans. Member States' bonds will cease to exist *de facto* and/or *de iure*. This aspect seems *prima facie* at odds with the findings of the Commission's Green Paper examined above; however, the full substitution with several but not joint guarantees was not among the options examined by the Commission's Paper on the grounds that – it is helpful to recall it - although possible, "it would not be materially different from the existing issuance arrangements".[46] The approach involving full substitution backed up by several but not joint guarantees, then, has not been deemed constitutionally innovative enough to require a Treaty change, let alone reflection in a policy paper. Moreover, when discussing the option of full substitution with several and joint guarantees (i.e the most ambitious approach requiring a Treaty change and significant institutional arrangements to the EMU's design due to its incompatibility with Article 125 TFEU), the Paper mentioned the creation of a debt agency entrusted with the task of distributing the revenue flows and debt-serving costs linked to issuance of common bonds. The proposed EDA would do so without requiring a Treaty change since it would be compliant with the rationale of Article 125 TFEU: it would indeed distribute such revenues and costs not only on the basis of Member States' respective issuance shares but also on the basis of their fiscal credentials. In other words, the refinancing costs for Member States would not be the same but will depend on

[45] European Commission, "Green Paper on the feasibility of introducing Stability Bonds" cit. note 44, footnote 15.
[46] Ibid.

the condition of their national public finances. In practice, EDA would ensure the advantages identified by the Commission in the most advanced and ambitious scheme of Stability Bonds (i.e. “the first approach” consisting of the full substitution with several and joint guarantees) without the drawback of mutualisation and moral hazard.

In light of the considerations above, if EDA were to be established within the EU legal framework, as its proponents deem more appropriate, it would be necessary to carefully design the guarantee-scheme that backs up this debt-management mechanism. Such a scheme must be based on several but not joint guarantees to be fixed *ex ante*. In the scenario in which EDA succeeds to the existing ESM, once repatriated within the EU legal framework, the 80 million making up the ESM, plus the rest in callable shares, would constitute EDA’s absorption capital, to which reserves accumulated through the insurance scheme will also contribute over time. If, instead, EDA were not to be established using the ESM capital, Member States would be called to offer *ex ante* guarantees by paying in EDA’s initial capital. This solution would be a SURE-like scheme, where Member States provided additional guarantees ex ante on top of the EU budget. In any case, thanks to the idiomatic pricing mechanism that generates reserves, EDA will be, after a certain time, equipped with its own required risk capital without having budgetary implications for the EU or its system of own resources. Any option entailing the use of EU budget to back up EDA would be indeed incompatible with the current Treaty framework, as the budget is inherently redistributive not only in its expenditure side but also in its revenue side (i.e. Member States’ contributions, which constitute the majority of “own resources”, are based on their GNI). In short, no State should pay more than what it agrees to in advance and in proportion to what it received.

3.5 Compatibility with Article 310 (1) TFEU

Article 310 TFEU belongs to Part 6 of the Treaty on the Functioning of the European Union dedicated to the Institutional and financial provisions of the EU. These rules dictate how the EU institutions adopt the EU budget and its content. The institutions governing the budgetary procedure are the European Parliament and Council (called the European Budgetary Authority together) which establish the EU annual budget. The first paragraph of Article 310 TFEU deals with two key principles that are the principle of universality and the principle of budgetary balance. The first requires that

each financial year all items of revenue and expenditure must be included in estimates and shown in the budget. While the principle of budgetary balance, also called the principle of equilibrium, sets that revenue and expenditure shown in the budget must be in balance. This principle is interpreted as meaning that the EU cannot run an operating deficit to finance its expenditures and that each

year revenues must equal expenditures.[47] It is therefore worth analysing how the latter would interact with the creation of a European Debt Agency.

At first analysis, it appears clear that Article 310 TFEU refers to the European budget only. As described in the previous sections, EDA does not necessarily entail the issuance of common debt for the financing of the EU budget, rather the proceeds from EDA's borrowing are used for financing Member States' budgets, i.e. rolling-over their debt and financing new deficit. Member States remain responsible for their economic policy and the repayment of their debt. This is in line with the EMU architecture as framed in the founding Treaties, which establish a coordination competence in the field of economic policy, where Member States remain masters of their economic policies. As said, EDA is a protective gap aimed at improving the management of the Eurozone Member States' debts, by reducing some components of the cost of debt. Therefore, it does not run against the principle of budgetary balance, enshrined in Article 310 TFEU.

The future of an EU fiscal capacity and the role EDA could play in supporting it deserve a distinct reflection. As anticipated in the previous sections, EDA's structure may support the efficient management of a European public debt to be used for common projects by recurring to a separate EDA's portfolio. This evolution will be very much linked to the political process of the next years the outcome of which cannot be predicted in advance.

So far, the issue related to the compatibility of debt-financed expenditure and the principle of budgetary balance is under discussion.[48] The Next Generation EU programme, which represents a temporary European fiscal space, overcomes this dilemma by placing the proceeds from the common borrowing outside the standard budget.[49] It does so in a very skilful way, by having recourse to the category of externally assigned revenue, provided in Article 21 of the Financial Regulation.[50] It is conceived as an exception, deviating from standard practices because of the exceptional nature of the Covid crisis. The possibility for the EU to have recourse to joint debt for financing its common projects as a "new normal" requires either a re-interpretation of Treaty provisions (such as the one related to the externally assigned revenue enshrined in Article 310 TFEU) or a more flexible interpretation of the principle of budgetary balance. To this end, the principle of equilibrium may be interpreted as revenue and expenditure shown in the European budget must be balanced over a multiannual period, instead of annually. For the time being, it is too early to assess the compatibility

[47] Begg, "Breaking the shackles of austerity? Using the EU budget to achieve macroeconomic stabilization", Friedrich Ebert Stiftung, November 2012 <https://library.fes.de/pdf-files/id/09450.pdf>. See Parliamentary Questions E-001662/2015, "Subject: The principle of a balanced budget and European public debt" available at <https://www.europarl.europa.eu/doceo/document/E-8-2015-005201_EN.html> and answer E-005201/2015 available at <https://www.europarl.europa.eu/doceo/document/E-8-2015-005201-ASW_EN.html>.

[48] See BVerfG, Judgment of the Second Senate of 6 December 2022 - BvR 547/21 - 2 BvR 798/21 (Act Ratifying the EU Own Resources Decision – Next Generation EU).

[49] Papadopoulos, "The EU Recovery Instrument as a European success story", in Papadopoulos (ed.) *European Economic Governance after the Eurozone and Covid-19 Crises* (CUP 2022), 105.

[50] See Regulation 2020/2094 Art. 3(1).

of a European fiscal capacity managed by EDA and the principle of budgetary balance governing the European budget. It is however important to bear in mind which are the limitations that the actual interpretation of Treaty provisions imposes and reflect upon possible solutions.

4. Legal basis

Section 3.1 has explained how the existence of a Union competence, i.e. economic policy coordination competence under Article 5 TFEU, does not technically impede the establishment of EDA. However, it has also explained the importance of the legal basis requirement in order to set-up EDA within the EU legal framework. The next subsections will examine the legal options available in the Treaties as well as their limits, so as to turn to possible avenues outside the EU legal order.

4.1 Article 136 (1) TFEU

A special legal regime for the euro area is provided by Article 136 (1) TFEU, according to which the Council can adopt "specific measures" for the Eurozone countries in accordance with the macroeconomic surveillance and excessive deficit procedures set out in Articles 121 and 126 TFEU. This Treaty provision envisages closer cooperation among Member States whose currency is the euro allowing the adoption of measures applicable only to them. Such measures shall aim to strengthen the coordination of the economic policy guidelines addressed to euro countries and enhance the surveillance of their budgetary discipline. This legal basis has been used in the midst of the euro area crisis for the adoption of some of the regulations forming the "Six-Pack" and "Two-Pack".[51]These were all legislative measures that reinforced existing mechanisms in the area of economic governance although they have been criticized for extending Union competences since, for instance, they have entrusted the Commission with the power to sanction Member States or introduced the reverse qualified majority voting.[52]

[51] For the Six-Pack, see Regulation (EU) 1173/2011 on the effective enforcement of budgetary surveillance in the euro area [2011] OJ L306/1; Regulation (EU) 1174/2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro area [2011] OJ L306/8; Regulation (EU) 1175/2011 amending Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies [2011] OJ L306/12 [repealed by the new Regulation 2024/1263 introducing new fiscal rules for the preventative arm of the SGP (see lecture 2)]; Regulation (EU) 1176/2011 on the prevention and correction of macroeconomic imbalances [2011] OJ L306/25; Council Regulation (EU) 1177/2011 on speeding up and clarifying the implementation of the excessive deficit procedure [2011] OJ L306/33; Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States [2011] OJ L306/41. For the Two-Pack, see Regulation (EU) 473/2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area [2013] OJ L140/11 and Regulation (EU) 472/2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability [2013] OJL140/1.

[52]See Article 6 Regulation (EU) 1173/2011 on the effective enforcement of budgetary surveillance in the euro area [2011] OJ L306/1; Normally, sanctions should be adopted by the Council upon a proposal by the Commission. However, the

In light of these considerations, it would be controversial to use Article 136 (1) to set-up EDA. It can be argued that EDA would reinforce Member States' compliance with EU fiscal rules as their allocation to a given risk class would depend on the fulfilment of the economic policy guidelines and budgetary requirements set out under EU law. EDA would then meet the objectives of Article 136 (1) TFEU. On the other hand, though, it could be objected that EDA would entail the attribution of new powers to the Union beyond the scope of Article 136 (1) TFEU. Specifically, EDA would involve the issuance of debt, which, although possible under the current Treaty framework, has always been justified by temporary needs and by a different legal basis (i.e. Article 122 TFEU, on which see section 4.6). Furthermore, the express reference to the "relevant procedure from among those referred to in Articles 121 and 126" seems to limit the scope of application of Article 136 TFEU to measures that specifically pertain to the macroeconomic surveillance procedure and excessive deficit procedure. Although functional to the latter, EDA would entail a new and different mechanism of economic governance.

A possible solution could be the combined use of Article 136 (1) and Article 352 TFEU, which, as the next section will explain, allows the adoption of measures that prove necessary to the achievement of Union objectives where the Treaties have not conferred the necessary powers. The combination of these two Articles can possibly shield the establishment of EDA from potential claims of illegality, although this is just one of the possible interpretations.

Finally, another limit to consider is that, although Article 136 TFEU is often referred to as a means for "enhanced cooperation" for the euro area,[53] it does not technically allow euro countries to opt out from the cooperation desired nor allows non-area countries to join. In conclusion, recourse to this legal basis requires the participation of all countries within the euro area; participation of non-euro countries, instead, could be perhaps ensured by the combination of Article 136 with Article 20 TEU (on which see section 4.3). However, the obscure scope of Article 136 TFEU does not make the latter option legally viable.

introduction of reverse qualified majority voting means that, instead of requiring a qualified majority voting (QMV) to impose a sanction proposed by the Commission, a QMV within the Council is needed to prevent its imposition.

[53] See Beukers, "The Eurozone Crisis and the Legitimacy of Differentiated Integration" EUI Working Paper MWP 2013/36 citing Ruffert, "The European debt crisis and European Union law" (2011) CMLRev, 1777-1805, 1801. Enhanced cooperation is a special procedure provided in Ar. 20 TEU and Att. 326 ff TFEU which allows a group of at least nine Member States to advance integration in a specific area of EU law and in compliance with EU Treaties and Union law (see section 4.3). Under no circumstances, may it undermine the internal market or economic, social and territorial cohesion; moreover, it must not distort competition, discriminate, or create barriers to trade between Member States.

4.2 Article 352 TFEU

Known as "flexibility clause", Article 352 TFEU empowers the Council to adopt the appropriate measures to achieve the objectives of the Treaties when an action by the Union proves necessary and the Treaties have not expressly provided the necessary powers. This procedure requires the unanimity within the Council, upon a proposal from the Commission, and the consent of the European Parliament. The unanimity requirement, although onerous, makes this procedure less cumbersome than Treaty revision since it does not envisage a Convention or national ratification.[54] Yet, in some Member States, most notably Germany, national constitutional requirements could still mandate ratification when the flexibility clause is used.[55] In any case, this clause cannot be used as a tool to circumvent the ordinary revision procedure of Article 48 TEU. According to settled case law[56] and Declaration No 42 of the Lisbon Treaty on Article 352 TFEU, the flexibility clause cannot expand the scope of Union powers beyond the general framework designed by the Treaties or serve as a mechanism to substantially amend the Treaties without resorting to the revision procedure expressly provided for this purpose. In practice, Article 352 TFEU has a gap-filling function, which is subject to both political and legal constraints.[57]

In fact, the use of Article 352 TFEU for the establishment of EDA depends on the fulfilment of some conditions: 1) no specific legal basis for the set-up of EDA exists in the Treaties; 2) the action of EDA is within the framework of Union policies; 3) the establishment of EDA is necessary to the attainment of a Treaty objective; 4) the envisaged action does not extend the EU's powers beyond those conferred by the Treaties. EDA seems to meet all these requirements. First, except for Article 136 (1) TFEU, which however cannot be considered an *ad hoc* legal basis or a "flexibility clause for the euro area",[58] there does not seem to be any specific legal basis in the Treaties. Second, although not comparable to financial assistance within the meaning of EU law, the activity of EDA can be broadly conceived of as financial support stemming from optimal debt-management, i.e. an activity thus falling within the area of coordination of economic policies. Third, EDA would be necessary for the attainment of financial stability and would also be crucial for the maintenance of price stability in that, as explained above, it will allow the ECB to focus on its primary mandate. Lastly, the

[54] This procedurally less onerous nature of the clause is highlighted by Beukers, cit. note 54. In case of Treaty revision, a Convention composed of the representatives of national parliaments, the European Parliament and the Commission has to be convened according to Article 48 (3) TEU.
[55] Ibid. where the author recalls the BVerfG, Judgment of the Second Senate of 30 June 2009 - 2 BvE 2/08 -, paras. 1-421, (Lisbon Treaty Judgement) para 328.
[56] Opinion 2/94, ECHR [1996] ECR I-1759, para 30.
[57] For an account of the evolution of the flexibility clause and the demarcation line between circumvention and gap-filling see Konstadinides, "Drawing the line between Circumvention and Gap-Filling: An Exploration of the Conceptual Limits of the Treaty's Flexibility Clause" (2012) YEL 1-36.
[58] Beukers, cit. note 54, 3.

coordination nature of EDA's debt management does not seem to increase Union powers: as clarified, the issuance of debt on behalf of Member States does not elide the responsibility they have towards their creditors. Borrowing experiences within the EU framework, such as the EFSM have not posed a problem of competence creep. Recourse to debt, in other words, has never been discussed in terms of competences, and thus, of power to act, at least before the adoption of NGEU.

A possible limit to the use of Article 352 TFEU could be Declaration No 41, according to which the flexibility clause should be used to pursue the objectives referred to in Article 3 (2) and (3) TEU, such as the area of freedom, security and justice, the internal market, economic, social and territorial cohesion, and foreign policy. Although not legally binding, this Declaration might be read as implicitly excluding the objective of Article 3 (4) TEU consisting of the creation of an Economic and Monetary Union (EMU) from the scope of application of Article 352 TFEU.[59] However, since such a declaration does not expressly rule out the use of Article 352 TFEU in relation to EMU, some proposals in this field have been based on this provision, for instance past Commission proposals regarding the ESM's repatriation within the EU legal framework.[60]

Specifically, in an early proposal, Article 352 TFEU was identified as a suitable legal basis for the ESM's establishment within the Treaty framework, coupled with an amendment to the own resources decision (ORD).[61] In a later and more specific proposal putting forward the transformation of the ESM into a European Monetary Fund (EMF) under the aegis of Article 352 TFEU, the Commission did not recall such an ORD amendment, most likely because the proposed EMF would be backed up by the ESM capital to be attached to the EMF through a simplified multilateral act.[62]

Given the similarities between the ESM and EDA, reliance on Article 352 TFEU as a legal basis for the establishment of EDA within the EU legal framework seems to be the best option both legally and politically. An EDA based on this Treaty provision, though, would exclude non-euro area countries from its membership, since its purpose would be the financial stability of the euro area. Nonetheless, the use of Article 352 requires unanimity in the Council. A literal reading of this

[59] Declaration on Article 352 of the Treaty on the Functioning of the European Union refers to the objectives set out in Article 3 (2) and (3) and of Article 3 (5) TFEU. It expressly excludes the objectives of Art. 3 (1) TEU, not also those related to EMU.
[60] See Commission, "Blueprint for a deep and genuine economic and monetary union: launching a European debate" COM (2012) 777 final, 34, which already identified the possibility of integrating ESM into the EU framework under the flexibility clause, although it warned that this step "would not necessarily be less cumbersome" than a Treaty change. See also Commission, "Proposal for a Council Regulation on the establishment of a European Monetary Fund" COM (2017) 827 final.
[61] See Commission, "Blueprint for a deep and genuine economic monetary union: launching a European debate" cit. note 61.
[62] Commission, "Proposal for a Council Regulation on the establishment of a European Monetary Fund" COM (2017) 827 final, cit. note 61, 11.

requirement suggests that also non-euro area countries should agree on the establishment of EDA; on the other hand, a combined use of Article 352 TFEU with Article 136 (2) TFEU, which excludes non-euro area countries from voting procedures regarding measures specific to the euro area, can rule out the involvement of non-euro area countries in the adoption of the measure establishing EDA. In any case, the application of such a measure would not regard them, unless Article 20 TEU on enhanced cooperation (on which see the next section 4.3) were also to be mobilised. As for the legal form that EDA will take, EDA would be established through a Regulation, which is a directly and entirely applicable act suitable for the creation of a new body of EU law.

4.3 Enhanced Cooperation (Article 20 TEU)

Article 20 TEU provides a mechanism of flexibility and differentiated integration known as "enhanced cooperation", according to which a group of at least nine Member States can cooperate further in areas of Union's non-exclusive competences[63] by making use of the EU institutional framework and the relevant Treaty provisions. In other words, when the objectives of the Union cannot be achieved within a reasonable time due the unwillingness of some Member States to participate in further steps of integration, a group of them can proceed at a different speed.

The mechanism described does not represent a viable option for the establishment of EDA: enhanced cooperation cannot expand the existing powers of the Union as it is limited to the legal basis provided in the Treaties. One might think that since EDA falls within the scope of economic policy, a non-exclusive competence of the Union, enhanced cooperation would be possible. To use the words of the CJEU in *Pringle*, "enhanced cooperation might be established only where the Union itself is competent in the area concerned by that cooperation".[64] Yet, as immediately later clarified by the Court, this condition does not suffice: a specific legal basis is necessary.[65] Therefore, similarly to the ESM, which could not be established within the EU legal framework through enhanced cooperation due to the lack of a "specific competence",[66] EDA cannot be based on an *ad hoc* legal basis provided by the Treaties.

In conclusion, since in the current Treaty framework there is no clear competence basis for the Union to create EDA, Article 20 TEU does not seem fit for the purpose except if combined with Article 136 (1) on the euro area special regime. In this case, it would allow Member States outside the euro area

[63] Article 329 (1) TFEU specifies that enhanced cooperation can be established in any area covered by EU law except for those of exclusive competences and common foreign and security policy.
[64] *Pringle* para 167
[65] *Pringle* para 168; See also Tuori and Tuori, *The Eurozone Crisis: A Constitutional Analysis* (CUP 2014).
[66] *Pringle* para 168.

to join EDA, provided that Article 136 (1) is deemed to be an appropriate legal basis. In other words, Article 20 TEU can have a residual utility in conjunction with other Treaty Articles, either Article 136 TFEU or Article 352 TFEU (on which see above). Yet, both combinations are highly speculative as there are no precedents to lend authority to their legal soundness.[67]

4.4 Simplified Treaty revision

The simplified revision procedure, pursuant to Article 48 (6) TEU, allows the revision of all or part of the provisions of Part Three of the TFEU relating to the internal policies and action of the Union. Contrary to the ordinary revision procedure, this simplified revision procedure does not require a Convention to be convened but still the unanimity within the European Council as well as the approval of all Member States according to their national constitutional requirements. Provided that EDA falls within the area of economic policy as clarified above, and that such a policy field is situated within Part Three of the TFEU, no obstacle seems to preclude recourse to the simplified Treaty revision for the establishment of EDA.[68] Moreover, the use of the simplified revision procedure cannot increase the competences of the Union: in this respect, EDA does not seem to increase the conferred powers of the Union as its activity can be assimilated to coordination of national economic policies, specifically coordinated management of national debts. Although technically the debts to be coordinated would not be "national" as Member States would *de facto* stop issuing debt, the legal fiction through which debt issued by EDA would be indirectly attributed to Member States can justify the integration of EDA within the current Treaty framework. Moreover, issuance of debt per se cannot easily be labelled as an increase in the Union competences. Past borrowing experiences within the EU legal framework, for instance the already cited EFSM based on Article 122 (2) TFEU and the ongoing NGEU programme, did not require a Treaty revision.

Finally, recourse to Article 48 (6) has been used in the past to add a third paragraph to Article 136 TFEU to expressly acknowledge the power of Member States to establish a mechanism such as the ESM under international law. This example did not rule out the possibility to set up EDA within the EU legal order. In *Pringle*, the CJEU left the door open for the use of the flexibility clause under Article 352 TFEU in relation to a stability mechanism for the euro area. This finding supports the fact that the flexibility clause alone could support the creation of EDA and that the simplified revision

[67] See Beukers cit. note 54. Moreover, one should also consider the limits set out by Article 20 TEU, among which the internal market integrity, cohesion, and non-discrimination.
[68] Admittedly, the cited Paper on Stability Bonds clarified that "if a euro common debt management office were constructed under an intergovernmental framework," the simplified procedure would suffice; on the contrary if "placed directly under EU law", it would require the ordinary procedure since it would extend EU competences. However, the Paper framed these findings in the context of issuance of bonds with joint and several guarantees, which are not compatible with the existing Treaties. The Paper's conclusion, then, does not apply to EDA.

procedure does not necessarily have to be the compulsory legal path to follow as the use of Article 352 TFEU would not amount to a circumvention of the Treaties.

4.5 Intergovernmental agreement (reforming the ESM Statute)

Another path to establish EDA, this time outside the EU legal order, would be to reform the ESM Statute. This would take the form of an intergovernmental agreement. Although legally feasible, this option does not seem politically viable since an attempt to reform the ESM has already been blocked.[69] At the moment, the ESM carries a stigma that prevents any potential repurposing of the instrument.

4.6 Article 122 (2) TFEU

When dealing with the institutional framework of EDA, in their contribution Amato and others refer to Article 122 (2) TFEU. This provision, almost unnoticed until the Covid crisis, is growing in importance within the EU constitutional architecture. Together with the first paragraph of Article 122 TFEU is the current legal basis for the Regulation establishing the Recovery Instrument,[70] which is one of the pillars of the Next Generation EU,[71]as well as the SURE programme. Article 122 TFEU is an emergency law provision,[72] placed in the Economic Policy chapter of the Treaty on the Functioning of the EU. It applies in the case of a crisis where a Member State is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control. In such circumstances, the Council may grant to the State concerned the Union's financial assistance, under certain conditions.[73]

Being an emergency law provision, it provides a special legislative procedure in which the European Parliament does not play a role.[74] It allows the Council to provide Union financial support to a State affected by a natural disaster, however, this support is limited to the emergency suffered and is consequently only temporary. Moreover, to counterbalance the provision of financial solidarity by the EU in bad times, Article 122 (2) TFEU sets that the support is given under certain conditions. This

[69] Beside the 2017 Commission's proposal to repatriate the ESM within the EU legal framework, a separate agreement between Member States to reform the ESM while keeping it outside the EU legal framework was reached in January 2021. However, the process of ratification in Member States has been unsuccessful – notably due to Italy's rejection.
[70] Council Regulation (EU) 2020/2094 of 14 December 2020 establishing a European Recovery Instrument to support the recovery in the aftermath of the Covid-19 crisis.
[71] Commission, "Q&A: Next Generation EU - Legal Construction", 9 June 2020.
[72] Croonenborghs, "The European Instrument for Temporary Support to mitigate unemployment risks in an emergency (SURE) – an innovative EU financial assistance under the Treaty", in Utrilla and Shabbir (eds) *EU Law in times of pandemic. The EU Legal response to Covid-19*, (EU Law Press 2020).
[73] Flynn, "Article 122 TFEU" in Kellerbaur, Klamert and Tomkin (eds) *The EU Treaties and the charter of fundamental rights: a commentary*, 1282.
[74] Louis, "Guest editorial: the no-bailout clause and rescue packages", (2010) 47 CMLRev 983.

means that financial assistance is usually accompanied by an agreement in which the beneficiary Member State commits itself to a set of reform initiatives, usually meant to improve the State crisis preparedness and accompany it during the recovery path.

Because of the unique characteristics of this provision, which to summarize are the existence of a situation beyond state control, the special legislative procedure that excludes the European Parliament, the temporality nature of the measure envisaged and the conditionality requirement, Article 122 (2) TFEU does not represent an appropriate legal basis for EDA that, instead, will operate on a permanent basis.

5. Proposal for a sound governance

EDA aims at managing more efficiently the Eurozone's debt. This goal is achieved by filtering market sentiment. Indeed, financial markets' expectations do not always reflect debt fundamentals dynamics but rather tend to under-estimate or over-estimate them.[75] In other words, markets proved to be not that efficient in linking the cost of public debt to the fundamental credit risk of the States.[76]
EDA will filter the market sentiment and realign the interest rate applied to a Member State to its fundamental credit risk. To do this, it is key to assign each Member State to a specific class of risk, linking the latter to States' fundamentals only. Afterward, the EDA will determine the debt pricing applicable to the Member State concerned that will be revised every year and proceed with the debt management.
The assignment of a Member State to a specific class of risk is a very crucial decision. The latter will be periodically revised. Therefore, the decisional procedure should be carefully drafted to prevent it from being either ineffective or pray to ideological capture.[77]

Amato and Saraceno propose to delegate this role to the institution responsible for enforcing the agreed fiscal rules, namely the Commission. We tend to disagree with this task allocation as fiscal policy management entails a political process, while we believe the assignment of a State to a specific class of risk must be more of a technical-financial exercise. Assigning Member States to a class of risk involves the evaluation of States' creditworthiness. This means that when the situation so requires a State may be downgraded or upgraded accordingly. This choice has relevant consequences. Being the Commission the executive power of the EU, its choices are usually

[75] Amato and Saraceno, cit. note 11, 13
[76] Ibid.
[77] Ibid, 20.

politically sensitive and subject to public opinion's reaction. The decision to downgrade a Member State's class of risk may be perceived by the public as a political act, rather than a technical decision.

To avoid conflict of interest, we believe the role of assigning Eurozone's States to a specific class of risk should be conferred upon an independent body, either of EDA or of another body. To this purpose, we identified the European Fiscal Board (EFB) as a potential candidate for this key function.[78] The EFB is an independent advisory body of the European Commission. It is composed of independent experts in the field of Union fiscal framework. Its establishment followed the Five Presidents' Report on "Completing Europe's Economic and Monetary Union".[79] The EFB's goal is to contribute to strengthening the economic governance framework in place and therefore, it would be particularly suitable for EDA's aim, whose functioning will positively contribute to the economic governance of the Eurozone. Among the current tasks carried out by the EFB, it is responsible for evaluating the implementation of the Union fiscal framework and the appropriateness of the actual fiscal stance at euro area and national level.[80] The EFB assesses the prospective fiscal stance appropriate for the euro area as a whole relying on an economic judgement.[81] It also cooperates with the National Independent Fiscal Council.[82] Because of its independence and expertise, the EFB could prove to be an adequate body for the task envisaged.

Within the Amato and others proposal, the idea of transforming the European Stability Mechanism (ESM) into an EDA emerges. This proposal builds on the acknowledgment that the ESM in its current form plays a limited role in the Eurozone governance. Being this scenario, the body involved in the assignment of a specific class of risk could be the ESM Board of Directors. The ESM Board of Directors consists of representatives from each of the ESM Members. Their voting system takes into account the number of shares allocated to it in the authorized capital stock of the ESM. For the link each member of the ESM Board of Directors has with the State he/she represents and the voting procedure applicable we tend to believe the ESM Board of Directors will not be the appropriate body for the assignment of a Member State to a specific class of risk. Indeed, it is likely that its decision may be led by political belief rather than technical considerations only.

[78] Commission Decision (EU) 2015/1937 of 21 October 2015 establishing an independent advisory European Fiscal Board, OJ L 282.
[79] European Commission, 'Completing Europe's Economic and Monetary Union' 22 June 2015.
[80] Commission Decision (EU) 2015/1937 of 21 October 2015 establishing an independent advisory European Fiscal Board, OJ L 282, Article 2.
[81] Ibid.
[82] Ibid.

6. EDA and its relationship with the European fiscal rules

This section aims to reflect upon the relationship between the EDA and the European fiscal rules. The latter refers to the legal framework for the coordination of the economic policies of the Member States within the Economic and Monetary Union (EMU). These rules date back to the 1997 Stability and Growth Pact (SGP) consisting of two Council Regulations.[83] Following the debt crisis, this legal framework was strengthened through the amendment of the SGP, the adoption of new secondary Union law acts[84] and two intergovernmental treaties.[85] In February 2020, the Commission launched a public debate to review this fiscal legal framework acknowledging certain weaknesses of the current framework such as high debt levels in some Member States, pro-cyclical fiscal policies,[86] the complexity of the current fiscal framework, the difficulty in enforcing it and lack of Member States' ownership.[87]

Following the pandemic, the debate on new fiscal rules had to be postponed and, in the meantime, the "general escape clause" of the Stability and Growth Pact was activated for the first time since its adoption.[88] Moreover, the EU adopted a one-off fiscal space recurring to the issuance of joint debt, under the programme Next Generation EU. At the same time, the European Central Bank accompanied this massive fiscal effort with the Pandemic Emergency Purchase Programme (PEPP).[89]

[83] Council Regulation (EC) 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (the preventive arm of the Stability and Growth Pact) and Council Regulation (EC) 1467/97 on speeding up and clarifying the implementation of the Excessive Deficit Procedure (the corrective arm of the Stability and Growth Pact).
[84] Regulation 1173/2011 on the effective enforcement of budgetary surveillance in the euro area [2011] OJ L 306/1; Regulation 1174/2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro area [2011] OJ L306/8; Regulation 1175/2011 amending Council Regulation 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies [2011] OJ L306/12; Regulation 1176/2011 on the prevention and correction of macroeconomic imbalances [2011] OJ L306/25; Regulation 1177/2011 amending Regulation 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure [2011] OJ L306/33; Directive 2011/85 on requirements for budgetary frameworks of the Member States [2011] OJ L306/41. Also called six-pack:
Regulation 472/2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability [2013] OJ L140/1; Regulation 473/2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area [2013] OJ L140/11. Also called two-pack;
[85] Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (Fiscal Compact) (2012), Treaty establishing the European Stability Mechanism (2012).
[86] De Jong and Gilbert, "Fiscal Discipline in EMU? Testing the Effectiveness of the Excessive Deficit Procedure" (2020) 61 European Journal of Political Economy 101822 and Larch, Orseau and van der Wielen, "Do EU Fiscal Rules Support or Hinder Counter-cyclical Fiscal Policy?" (2021) 112 Journal of International Money and Finance, 102328.
[87] Amtenbrink and De Haan, "The European Commission's approach to a reform of the EU fiscal framework: a legal and economic appraisal" (2023) 48 EL Rev (4), 425.
[88] Commission, "Communication from the Commission to the Council on the activation of the general escape clause of the Stability and Growth Pact", COM/2020/123 final.
[89] Decision (EU) 2020/440 of the European Central Bank of 24 March 2020 on a temporary pandemic emergency purchase programme (ECB/2020/17) OJ L 91.

Now, new European fiscal rules concerning the preventive and corrective arm of the SGP and the macroeconomic imbalances procedure have entered into force.[90]

Even within this new framework, it is possible to highlight some of the contributions EDA may make to European economic governance where Member States remain accountable for their fiscal policies. EDA could help Member States maintain sound public finances. It would reduce the spread between interest rates that each Member State is currently paying and the rate justified by its fundamentals (thus absorbing the so-called fragmentation risk), as EDA will borrow essentially at the risk-free rate, as experienced with the NGEU and SURE plan. At the same time, the functioning of EDA will not incentivize moral hazard as to each Member State an appropriate pricing will be applied to the perpetual loans granted by EDA, mirroring States' fundamentals. In other words, EDA may also refuse to refinance Member States' debt when excessive and unsustainable, thus strengthening fiscal discipline. Moreover, the provision of a euro-denominated safe asset will reduce volatility, relieving the pressure on savers and institutional investors that dealt with low or negative rates for a long period of time. EDA will normalize the monetary policy carried out by the ECB, as the EDA only will finance the Member States thus unburdening the ECB from the task of fighting fragmentation. Be the political willingness there, the EU may also exploit EDA's functioning for the creation of segregated portfolios thus developing a European central capacity.
The possibility might be particularly relevant given the current international scenario. In the face of the need to finance massive defence investments, many of the most indebted Member States will be forced to deviate from fiscal rules, relying on the activation of the so-called "national escape clauses".[91] This circumstance will inevitably create tensions in the secondary market for national public debts, which is more sensitive with the actual increase in debt than legal derogations. [92] These conditions might generate a deterioration in the public finance balances of Member States, due to the potential worsening of debt service costs and the consequent worsening of their credit standing.

In any case, market tensions would create an imbalance within EU countries, with the risk for the most indebted countries of seeing their ability to access markets radically worsened, thereby causing instability in the entire Euro area.[93] Leaving defence financing to individual Member States would have potentially negative effects for all countries and the Union as a whole.

[90] Council of the EU press release of 29 April 2024, 'Economic governance review: Council adopts reform of fiscal rules', <https://www.consilium.europa.eu/en/press/press-releases/2024/04/29/economic-governance-review-council-adopts-reform-of-fiscal-rules/>
[91] Menelaos Markakis, Op-Ed: "Could increased defence spending be accommodated within the EU's fiscal rules?" EU Law Live, 3 March 2025.
[92] Rosalba Famà, Op-Ed: "Financing a European Defence: what Role for the EU Budget?" EU Law Live, 3 April 2025.
[93] Lucas Guttenberg and Nils Redeker, 'How to defend Europe without risking another euro crisis', Hertie School Jacques Delors Centre Policy Brief, 21 February 2025.

A coordinated action could instead allow the creation new fiscal spaces, reducing the cost of debt service for all Union countries. To this end, the establishment of a European Debt Agency would enable the EU to finance its defence in the markets on behalf of all member countries and channeling the resources obtained through a segregated portfolio for common expenditure or to the Member States, based on the model explained before, thus rendering debt management more efficient.

7. Conclusions

The aim of this working paper was to provide a preliminary assessment of the Amato and others' proposal for the establishment of a European Debt Agency (EDA). Our analysis shows how the EDA envisaged by the abovementioned proponents complies with the EU Treaties.

In particular, the paper found that EDA falls within the domain of economic policy, which is a shared competence, although having (positive) indirect effects on monetary policy; that to be consistent with the division of competences between the Union and the Member States, EDA should not prevent Member States from issuing their own national debts, as instead required by the proponents. Despite the risk of a juniority effect, national bonds remain a prerogative of Member States that cannot be limited by EU law. Rather than a legal requirement, the full substitution of national bonds with EDA's loans should be a convenient move for Member States, thus left to their voluntary choice.

On the other hand, one of the main conclusions of the paper supports the proponents' claim that EDA would not entail mutualisation, as the analysis on Article 125 TFEU has shown. Although "corrected", the market logic remains, perhaps even strengthened, at the heart of EDA's functioning. In terms of possible legal bases for the establishment of EDA, the paper has identified Article 352 TFEU as the most feasible and legally sound option for the establishment of EDA within the EU legal framework. As explained, past proposals from the Commission have relied on this provision to "repatriate" the ESM within the Treaty framework. Another route, outside the EU legal order though, would be indeed to repurpose the existing ESM – an option that, although legally possible seems to be politically unfeasible – or to resort to a new international agreement.

As for the governance of EDA, the paper concludes that the attribution upon the Commission of the power to determine the class of risk to which a Member State belongs would generate constitutional frictions. A more careful design of EDA's governance should then be imagined, also considering the future entry into force of the new fiscal rules.

Since economic governance is an area subject to ongoing transformation, the paper aims to launch a preliminary reflection on the constitutional feasibility of EDA and generate a scholarly interest in the complex yet fascinating legal challenges that such an agency poses.

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