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European Union Bailouts and Credibility

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EUROPEAN UNION BAILOUTS AND CREDIBILITY: THE CONSTITUTIONAL DIMENSION

Antonio Estella[1]

Abstract

Since the Great Recession started, there have been eight bailouts to EU Member States, which approximate cost to the EU has been of around 380 billion euros. The aim of this paper is to analyze the legal-constitutional issues that this major bailing out operation has brought about. The conclusion is that the EU was not only ill-prepared from an economic perspective to make bailouts; it was also ill-prepared from a constitutional perspective as well, above all if one understands law, as this paper does, as a credibility device. Absent further reforms and clarifications, the current EU system of bailout governance may be prone to generate important credibility problems in the future.

1. Introduction

At the time of writing, the overall cost of bailouts to the European Union has been around 380 billion euros[2]. We are speaking here of the largest financial rescue operation in the history of humanity –and the process is not over yet, since Greece has recently received a third bailout, which is still being implemented. Just to give a benchmark, the IMF Latin-American bailouts of the 80s and 90s cost approximately 22.7 billion euros, and the IMF East Asian bailouts of the late 90s cost around 31.4 billion euros[3]. However, the Greek bailout alone has already cost around 231 billion euros[4]. Further, the bailouts have been associated with a kind of conditionality that has prompted

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[2] For a summary, see the following table (in billion euros):

COUNTRY	APPROVED	DISBURSED	
Ireland	40,2	39,4	
Greece	308	231,18	
Spain	100	41,3	
Portugal	52	50,3	
Latvia	3,1	2,9	
Hungary	6,5	5,5	
Romania	7	5	
Cyprus	9	5,8	
TOTAL	**525,8**	**381,38**	
	Does not take into account IMF or other contributors		
	Data from EC, ESM, and EFSF		

[3] For IMF programs in Latin America I have taken into account the years 1984 to 1994. For East Asian IMF Programs I have taken into account the following countries: Thailand, Indonesia and South Korea. The years are from 1997 to 1999, except for Indonesia (1997 to 2003). The volumes that are mentioned in the text are nominal volumes. I have taken into account the SDR exchange rate with the euro as of March 4, 2014 (1 euro = 0.89 SDR). All figures correspond to disbursed amounts.

[4] This is the disbursed amount. The approved amount is of around 308 billion euros.

deep reforms in all the European states that have received them. Due to their dimension, scope and intensity, EU bailout management will take up most of the European institutions' and Member States' energies in the years to come.

Although EU bail-outs are receiving a lot of attention from an economic perspective, the legal analysis on this issue is getting a rather disparate and fragmented profile, when not a contradictory one. The aim of this paper is to offer a more comprehensive, analytical and systematic understanding of the legal aspects directly linked with this major bailing-out operation[5].

There are a number of issues that are important legally speaking in the field of EU bail-outs. For reasons of space, this paper will not tackle them all but shall only focus on those aspects which have a constitutional (i.e., Treaty) relevance. To start with, EU bailouts pose constitutional law problems in relation to the interpretation to be given to article 125 FTEU, in its relationship with article 122, 123, and 143 FTEU. Secondly, they also generate problems as regards the interpretation to be given to article 136 FTEU. A third important element is how to understand, constitutionally speaking, the ESM Treaty[6], both in terms of its content and also in terms of its relationship with the EU legal order. All these aspects will be analyzed in this paper.

The study of the constitutional dimension of the EU bailout governance system that is established by the Treaties, and by other legal texts adjoined to them, such as the ESM Treaty, will be preceded by an exposition of the specific theoretical approach that will be used to make this paper's analysis –what I refer to as "law as credibility". In particular, it will be argued that the concept of "law as credibility" offers an adequate framework where to place the analysis of the constitutional dimension of EU bailouts. This article's main contention will therefore be that the current EU system of bailout governance may create an important credibility problem in the absence of further reform or clarification.

2. Law as credibility: an outline

Law performs the function of giving credibility to the commitments public actors make. This notion has been developed mainly in the field of political economy (see above all Elster, 1985; 2003), but it has received much less attention from a "purely legal" perspective[7]. However, there is nothing in the notion of law as credibility as developed by political economists that cannot be used in legal terms; rather, the contrary is true. For reasons of space, the following remarks only offer a very general outline of this theory, which I have started to develop in different places (see Estella, 2008 and 2015). It is however important to clarify from the onset that the propriety or function of credibility is established for the legal system as a whole, and not only for the EU rules on bailouts or for the EU norms of economic and monetary governance[8]. The second important remark that needs to be made from the beginning is that with the concept of law as credibility, I am not just trying to import concepts and notions from political economy and apply them into the legal sphere. What I am attempting to do is, rather, to start reconstructing a legal theory which is based on the very notion of credibility.

[5] For reasons of space, I omit a comprehensive analysis of this literature. However, when relevant, it will be shown in footnotes to the text of this article.

[6] This issue is also of a constitutional relevance since the ESM Treaty is a core piece of the new EU bailout system and also because it is connected to the FTEU through article 136.3º, as shall be seen below.

[7] See, however, Dresser (2003); Markovits (2003); Ferejohn and Sager (2003); Forbath (2003); Issacharoff (2003); Ratner (2003) and Holmes (1995). However, there is not, to my knowledge, any systematic attempt to configure the concept of law as credibility from a legal theory perspective.

[8] This is one of the main differences between my analysis and that of Schneider (2013). It is the whole legal system (in this case, the EU legal system) that is supposed to deliver credibility.

For the concept of law as credibility, the starting point is the acknowledgment of the fact that public institutions make commitments all the time. In fact one could even argue that this is the most important job they do: to commit to do (or not to do) things. To make commitments, they may use different technologies. For example, they may "recommend" that markets take a specific course of action. Recommendations are not laws. They have some legal significance but they are not legally binding. Another option is to make a law. I shall give an example: the Stability and Growth Pact (SGP) is compounded of both legal acts and non-legal acts. The Functioning Treaty of the EU contains some of the aspects of the SGP[9]. The "code of conduct" of the SGP would instead fall into the second category[10].

It is rather obvious that, if presented in this way, the main question that arises is why political actors (or institutions, if one prefers this terminology) would opt for legal acts sometimes and for non-legal acts at other times. A straight answer to this question is: because they want to give commitments different degrees of credibility. When they want to give a higher degree of credibility, they use laws; when they want to give a lesser degree of credibility (and therefore more flexibility), they use non-legally binding technologies. Therefore the conclusion is that law equals credibility. Not only that: my contention is that law is the most sophisticated commitment technology that exists.

What makes law to be credible? The starting point of an answer to this question has to do with what I call "rigidity". Laws are difficult to change. If an institution wants to change a given law, it will have to go through a specific procedure. If the institution simply disregards a given law, then the judicial system will act. Under certain conditions (independence of courts, abstract and general nature of the law, and so on), laws are difficult to ignore. Markets and citizens know that. Therefore, when an institution makes a law it is sending a clear signal to markets and/or citizens that it will do what it committed to do.

Rigidity also explains differences between norms. Not all norms hold the same position in the so-called "normative pyramid". The Constitution is at the top of the normative pyramid and is hierarchically superior to ordinary laws only because it is more rigid than they are. Legal hierarchy is therefore much more than a mere pragmatic solution for norm clashes. Rather, it reflects matters of credibility. If a ruler wants to give a high degree of credibility to a given commitment, she will use a law to encapsulate such a commitment. However, if she wants to give it the highest degree of credibility, she will use the constitution. Due to their rigidity, constitutions are the most credible way to tie a political actor's hands to the mast of a desired course of action[11]. This point is crucial for our discussion; since we are analyzing EU bailouts from a constitutional perspective, it is important to make clear what our specific understanding of constitutional texts is.

The relationship between law, credibility and rigidity is however much more complex than the previous scheme would suggest. There are some instances in which 100% rigidity may be as negative for the purposes of giving credibility to a given commitment as 100% flexibility. A case in point is precisely EU bailouts. As we will see in the next section of this paper, Article 125 of the Functioning Treaty rules out bailouts. To make a bailout is (was) not only illegal but also unconstitutional from an EU law perspective. However, up to now, there have been eight bailouts. How is this possible? Because if the rule had been applied as rigidly as some authors, institutions and even Member States advocated, then this interpretation would have put the whole Eurozone on the brink of collapse[12].

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[9] See, for example, Protocol 12 to the FTEU.

[10] See the "Specifications on the implementation of the Stability and Growth Pact and Guidelines on the format and content of Stability and Convergence Programmes" of 3 September 2012, available here: http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/coc/code_of_conduct_en.pdf

[11] I assume here, for the sake of convenience, that the UE Treaties amount to a Constitution

[12] See for example Tomkin (2013). *A contrario*, see Borger (2013).

With this I mean that the main function that law performs is more complex than that of giving credibility through rigidity. Keleman and Teo (2012:13) raise this point in a context directly linked to the EU bailout regime (fiscal rules)[13]. For them "strictness" is not what makes a given norm fully credible; it is rather its clarity. However, my contention is that it is neither strictness (what I call rigidity) nor clarity that serves the purposes of credibility. To be sure, rigidity and clarity are important dimensions of credibility. However, what really captures the whole problematic of norm credibility is to approach this issue from the perspective of the capacity that a norm has of establishing an equilibrium point between rigidity and flexibility. The basic idea is, first of all, that there is a trade-off between rigidity and flexibility which is implied in the notion of law as credibility; and secondly, that this equilibrium point I am referring to, has to comply with a number of conditions. The most important of these conditions is that the ruler has to be able to pass what I call a "counterfactual" analysis. Rulers should ask themselves how and the extent to which their preferences would change, were the situation radically different from the one they are foreseeing with more probability when they are making a given norm. Again, EU bailouts offer a good illustration of this point. The counterfactual of article 125 FTEU would be the following: what if bailouts were necessary? This could be necessary, for example, if the ruled would be better off (from a Pareto-efficiency perspective[14]) by doing bailouts (and therefore violating article 125 FTEU) than by sticking to the strict application of this article (and therefore letting collapse the whole euro-area). In turn, the main role courts should perform, from the perspective of law as credibility, would be to check if the legislator did a sound counterfactual analysis. Courts might substitute the legislator only in the case in which the latter one had not correctly performed this role (Estella, 2015).

This compressed summary of the concept of law as credibility that I will use in the rest of this article would not be complete if something more specific about markets and credibility was not said. Two points are important at the very least from this perspective. Firstly, markets are not very dissimilar to citizens from the point of view of law as credibility. Markets, as citizens do, make their own calculus as to the credibility of a given rule. Therefore credibility for them is rather an expectation of the extent to which a norm will be implemented and sanctioned at the end of the day. Secondly, there are however differences between markets and citizens. Markets are more specialized than citizens (here we are speaking of financial markets in particular). They have more information. They have more opportunities and resources to analyze this information. And, finally, they are more sensitive to legal misfits in terms of credibility. We could say that the role of law is to reduce the need that markets have to make up stories about future expectations in contexts of high uncertainty (Beckert, 2013)[15]. Therefore their wildish nature is cured or at least mitigated when they have a clear roadmap as to the expected credibility of a given norm; but it is increased

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[13] This is a common mistake in the political economy literature that deals with law and credibility: to equate rigidity with credibility. See, in particular, Moessinger, Feld, Kalb and Osterloh (2013).

[14] Pareto optimality is a measure of efficiency. In a game of a determined number of players, an outcome is a Pareto optimum if there is no other outcome that would make all of the players at least as well off as in the previous outcome, and one better off than in the previous outcome. Therefore, collectively, there are no incentives to look for another outcome. If a situation is a Pareto-equilibrium, then it can only be modified by hurting at least one player. It follows that a Pareto-improvement denotes a situation in which at least one player can be made better off with the new outcome (while the rest of the players remain the same). It is important to differentiate a Pareto-equilibrium from a Nash-equilibrium. A Nash equilibrium is an outcome in which all the players in a game have no incentive to modify their strategy, if taking into account the strategies of the rest of the players in the game. Therefore, an outcome can be (and normally is) a Nash equilibrium without being a Pareto-optimum. Many times, Nash-equilibriums are sup-optimum equilibriums from a Pareto efficiency perspective. This means that although there is room for improvement collectively, there is no room for doing it individually, if taking into account the available strategies of the rest of the players. For a very good and general summary of both points see Binmore (2007) at pages 15 and 64. Binmore (2007). Game Theory. A very Short Introduction. OUP.

[15] Beckert (2013) overlooks this crucial point: law can be seen as a cure that attenuates to a certain extent discourse.

when they are not clear about it. The basic hypothesis on which the rest of this analysis is based is precisely that financial markets will react oddly to the EU bailout state-of-the-art system due to its lack of consistency from a credibility perspective.

3. The EU bailout regime prior to the crisis

3.1 Interpreting the *ex ante* EU bailout regime

a) A clear prohibition: article 125 FTEU

Once the main traits of the law as credibility concept have been established, I may now turn to the analysis of the EU bailout regime that existed before the crisis unfolded. Its main pillar was article 125 FTEU. The language that Article 125 FTEU uses is crystal clear: the "Union shall not be liable for or assume the commitments of (…) of any Member State" which means, more straightly, that bailouts are ruled out in the EU context. In principle the article applies to all Member States, but if read together with Article 143 of the FTEU (see below), then the combined effect of both articles is that Article 125 FTEU is restricted to the Eurozone members. A second important aspect is what we have to understand when we talk about bailouts. The concept of bailout is unclear legally speaking. The first thing that can be said in this regard is that the opposite of a bail-out is a bail-in. Bail-ins basically imply that creditors and shareholders accept a diminution in the value of their assets (whatever these maybe) for rescuing purposes. By opposition, a bailout implies that a third party, who is alien to the assets that need to be rescued, will assume the cost of the bailout. In financial bailouts, this third party I am referring to is very clearly defined: they are the taxpayers. The word bailout is an elegant way of saying that taxpayers will assume the cost of rescue operations.

The wording of Article 125 is also clear as regards the financial commitments that the Union, or its Member States, will not be liable to assume: these are the financial commitments that the central government, its regions, its municipalities or even other authorities or undertakings governed by public law might have assumed. This is rather paradoxical: liabilities that private parties might have committed to are outside the scope of Article 125 FTEU. Therefore, private undertakings could be bailed out by the Union or its Member States, but not the Member States themselves. To be sure, EU state aid rules are of application in this domain. Thus, a private undertaking (for instance, a bank) bailout could be possible if this rescue operation did not amount to a state aid (Papadopoulos, 2012; Ojo, 2011). However, even if applying the state-aid regime, it is clear that Article 125 creates a certain imbalance, having on the one hand Member States that cannot be bailed out in any case, and on the other hand private actors that could be bailed out if the program were not considered a state aid[16].

[16] The European Commission is assessing all rescue measures of banks and financial entities that are being taken in the crisis in order to check their compatibility with the EU state aid regime. For a good summary of the EU Commission stance and policy on bank bailouts from the perspective of EU state aid regulation, see Joaquin Almunia "The impact of the crisis State aid regime for banks", Speech delivered before the European Economic and Social Committee in Brussels, 4 October 2011 (available here: http://europa.eu/rapid/press-release_SPEECH-11-632_en.pdf). If we take Spain as an example, a Commission decision on a bank rescue package *prior* to the Spanish bailout would be EU Commission decision on "Rescue measures in favor of BFA/Bankia – Spain" (Brussels, 27.06.2012 C(2012) 4384 final, JOCE C/220/2012), available here: http://ec.europa.eu/competition/state_aid/cases/245134/245134_1341455_209_1.pdf; a Commission decision taken *after* the Spanish bailout was operated would be the EU Commission on "Restructuring of Banco Grupo Cajatres,

The *telos* of Article 125 FTEU is another important consideration –if not the most important one- for interpretative purposes. Article 125 aims at avoiding the moral hazard problems that Member States' financial behavior may create. Moral hazard is another, non-legal, interesting concept[17]. And the most interesting thing about this concept is that its definition depends on the economic tradition that the interpreter adheres to. In neo-classical economics, moral hazard implies that an economic actor (the debtor) transfers the negative externalities (consequences) derived from her risky economic behavior to another party (the creditor). This is considered unjust, and therefore should be avoided. However, in the neo-Keynesian tradition, the concept is understood in the sense that other (exogenous) factors (like prices, in particular) may have an influence in the occurrence of the debtor´s risky behavior and therefore in the production of moral hazard problems (Arnott and Stiglitz, 1990:3). This being the case, then the predicament that no economic actor can transfer the consequences of her risky financial behavior to another party should probably be qualified.
Applied to the EU context, the previous idea would yield to the following outcome: in the field of sovereign debt, moral hazard issues are at least in part determined by variables that are exogenous to the debtor (such as prices, i.e., money interest rates which in the Eurozone are set by the ECB and the financial markets). This should have been taken into account when drafting article 125 FTEU. Furthermore, article 125 FTEU should also have taken into account that in a deep crisis, the possibility of contagion (moral hazard) derived from the risky activities undertaken by one part of a whole currency Union were real. However, the point is not so much to plead in favor of one or the other vision of moral hazard problems. The point is, rather, to indicate that article 125 FTEU adopted a very specific approach to moral hazard. This in turn had consequences from a credibility perspective, as shall be shown later on. In sum, article 125 FTEU was too callous. It didn't differentiate between different state´s economic behavior (riskier in some cases but maybe not in others) and, what maybe is more important, it had completely discarded the occurrence of a catastrophic crisis scenario as the one that unfolded after 2008.

b) The supplement of article 125 TFEU: Article 123 FTEU

A second provision that is important to connect with this discussion is Article 123 of the FTEU. This article is the cornerstone that duly complements Article 125 FTEU. Without Article 123, Article 125 would be devoid of its very essence. In summary, Article 123 FTEU establishes two

S.A" (Brussels, 20.12.2012 C(2012) 9830 final, JOCE C/138/2013), available here: http://ec.europa.eu/competition/state_aid/cases/247032/247032_1423221_82_2.pdf.

[17] Moral hazard is a concept which has an economic dimension, but that also can be approached from other perspectives, like for example from a normative viewpoint. In economic terms, moral hazard is defined in the sovereign debt markets as the temptation of debtor countries to engage in profligacy, that is, in excessive debt and deficit risk-taking (knowing that at a certain point that risk will be passed upon the creditor-countries). The whole idea of excluding bailouts is understood precisely in this context: a bailout would operate as a sort of "excess" insurance, which would be precisely ruled-out in the EU framework to put a further limit on this kind of behaviour on the side of debtors. However, the concept is more complex than it may seem at first sight. Both the debtors and the creditors may impinge on excessive risk-taking behaviours (the debtors by taking too much credit, the creditors by lending too much). From this perspective (and setting aside the possibility of other insurance mechanisms, like collateral or CDSs) a bailout works also as a sort of insurance not only for the debtor but also for the creditor: if the creditor knew that there would be bailouts, she wouldn´t care about moral hazard. Therefore it can be argued that the EU ruled out bailouts as a way to discipline creditors, as well, and not only debtors. A different question is whether this provision (ruling out bailouts) was credible or not –as this paper argues, it was not. Finally, from a normative perspective, the moral hazard concept poses issues of distributive justice: here the question would be under what conditions it would be fair to disseminate the negative externalities (consequences) of having taken too much credit by a debtor. As Stiglitz and Arnott (1990) suggest, as this is determined in part at least by prices, which are not set by the debtors, it is not totally clear that these should be only borne by the debtors. For more insights in different perspectives of moral hazard see, besides the paper by Stiglitz and Arnott cited above, Pauly (1968) and Arrow (1968) and Redelet and Sachs (1998). I thank one of this paper´s referees for making me clarifying this point.

rules: first, that the ECB cannot bailout Member States, and therefore it cannot act as a lender of last resort for this purpose; and secondly, that the ECB can only buy sovereign debt in secondary markets and not directly from the Member States.

De Grauwe (2011:11) accepts the second rule but questions the first. According to this author, Article 123, besides prohibiting the ECB from buying sovereign debt in primary markets, would only forbid the ECB to give credit to the Member States; in fact, article 123's exact wording speaks of "overdraft facilities or *any other type of credit facility (...)".* De Grauwe's therefore differentiates between credit operations and liquidity operations. The former would be aimed at financing Member States in difficulties; however, the latter would be aimed at solving the liquidity shortages that Member States could be experiencing at a given moment. If this second interpretation were retained, then the ECB could act as a lender of last resort for the purpose of solving liquidity problems.

Although the dividing line between credit and liquidity operations proposed by De Grauwe is rather fine, the truth is that the ECB's behavior during the crisis has been an important element in weathering the financial hardship of the last five years. For example, according to Cour-Thimann and Winkler (2012:785), the volume of money that the ECB pumped into the Euro-system was equivalent to almost 1,6 trillion euro in July 2012[18]. Furthermore, in the midst of what can be considered up to now the worst moment of the financial crisis (July-September 2012), the ECB's President, Mario Draghi, announced the OMT program. Different from other liquidity programs, the OMT basically consisted of an unlimited ECB commitment (both in terms of time and in terms of quantity) to purchase Member States' sovereign bonds in secondary markets. However, the program was not implemented. It seems rather obvious to assume that the OMT program was not implemented due to the Bundesbank´s decision to encourage the bringing of an action to repeal the OMT program before the German Constitutional Court.

In effect, in its order of 14 January, 2014, the German Constitutional Court decided to suspend the national proceedings and refer a preliminary ruling to the ECJEU on the issue in question[19]. In itself, this decision of the German Constitutional Court was of historic importance, since this is

[18] For an extensive description of the non-standard monetary measures that the ECB implemented since the beginning of the crisis see, again, Cour-Thimann and Winkler (2012). Their analysis covers the ECB non-standard operations from January 2007 to January 2013. Therefore, this analysis does not include the last round of non-standard measures operations implemented by the ECB since June 2014. According to Vítor Constâncio, Vice-President of the ECB (https://www.ecb.europa.eu/press/key/date/2015/html/sp150825.en.html) "in June 2014, as part of a set of credit easing measures, the Governing Council announced the introduction of targeted longer-term refinancing operations (TLTROs), offering medium-term credit at fixed rates to banks that are willing to extend credit to the private sector. In September and October 2014 the Governing Council initiated a program of outright purchases of private sector assets, in particular of covered bonds and asset-backed securities. In January 2015 the Governing Council expanded the purchase program to include public sector assets. The Governing Council explicitly committed to purchasing a total amount of EUR 60 billion every month from March 2015 until at least until September 2016. Furthermore, the Governing Council has kept the program open-ended by committing to keep it in place until we see a sustained adjustment in the path of inflation that is consistent with our medium-term inflation objective. The program aims to maintain market neutrality by purchasing assets across the whole maturity spectrum between two and 30 years. The purchases are allocated across countries according to the ECB's capital key and any losses emanating from the programs would be shared between the national central banks and the ECB in an 80%/20% ratio. In any case, it is important to stress that, although the ECB did not materialize its threat of implementing the OMT program, it continued, however, buying sovereign bonds through other, non-standard, instruments, during the crisis" (my emphasis). Therefore, since June 2014 until August 2015, the ECB has injected in the euro-system around 212 billion in TLTROS (Merler, 2014) (http://bruegel.org/2014/12/tltro-spoils-christmas-holidays-at-the-ecb/) plus 414,264 billion thorugh the Expanded Asset purchase program (ECB, 2015 (https://www.ecb.europa.eu/mopo/implement/omt/html/index.en.html) which together make a total of 626,264 billion euro.

[19] See Order of 14 January 2014 - 2 BvR 2728/13. The English translation can be found here: https://www.bundesverfassungsgericht.de/SharedDocs/Entscheidungen/EN/2014/01/rs20140114_2bvr272813en.html

the first time that it has made a referral to the ECJEU. The GCC has basically asked the ECJEU to pronounce on the validity, *vis-à-vis* European Union Law, of the OTM program. However, the GCC not only did that: it also marked its red lines. According to the GCC, the OMT program would be in principle contrary to the European Union's Treaties. The reasons for this conclusion would be three-fold: first, because the OMT program could be considered to be an independent act of economic policy by the ECB –and therefore not merely adopted "in support" of the general economic policies of the Union; secondly, because the OMT program could have a considerable fiscal redistributive effect between the Union and its Member States; and thirdly, and maybe most importantly, because the OMT program would be a way to monetize the Member States' sovereign debt –a power that the ECB would not have under the Treaty rules.
However, the GCC has also left the door open to a possible interpretation that would make the OMT compatible with EU law and therefore with the German constitutional order (Kumm, 2014). This would be the case if it were made clear that OMT would not imply a monetization of Member States' debt, that sovereign debt would not be purchased to unlimited amounts, and that OMT interferences with market price formation would be avoided. A final point would be that the OMT should be subject to strict conditionality (however this is less relevant since the OMT program itself says so).
In its preliminary ruling, the ECJEU addressed the three red lines previously noted by the German Constitutional Court[20]. In particular, the ECJEU stated, firstly, that the OMT program would not imply the monetization of Member States´ debt if "sufficient guarantees" were set up. More specifically, the ECJEU insisted on the importance of not nullifying the prohibition established upon the ECB not to buy sovereign debt in primary markets. The ECJEU set a list of such guarantees; however, at the end, it had to admit that the ECB´s purchase in secondary markets may have "an influence" on primary markets, but that such an effect "is, moreover, essential if those purchases are to be used effectively in the framework of monetary policy"[21]. Secondly, for the ECJEU, the OMT program established sufficient guarantees as not to interfere with the regular process of price formation in the sovereign debt market, but, again, as happened with the issue of monetary financing, the Court had to recognize that "the conduct of monetary policy will always entail an impact on interest rates and bank refinancing conditions, which necessarily has consequences for the financing conditions of the public deficit of the Member States"[22]. Finally, as regards the decisive issue of the unlimited nature of the OMT program, the ECJEU stated that the OMT program "ultimately concerns only a limited part of the government bonds issued by the States of the euro area, so that the commitments which the ECB is liable to enter into when such a program is implemented are, in fact, circumscribed and limited". Those limitations are, first, the fact that the OMT program commits to purchase sovereign bonds with a maturity of up to three years and, second, that it will only buy sovereign bonds of countries under an ESM bailout program[23].
Irrespective of the merits of the ECJEU´s arguments, the crucial point is to evaluate the *Gauweiler* ruling from a law as credibility perspective. As we have seen in section 2 of this paper, from the perspective of law as credibility, in its interpretative role, courts have to favor those interpretations which provide for the maximum of credibility to a given norm or a set of norms (in particular, article 123 FTEU). The ECJEU very clearly establishes that this article prohibits both the monetization of sovereign debt and the purchase of sovereign debt in primary markets. However,

[20] See ECJ Judgement of 16 June 2015, C-62/14, *Peter Gauweiler, Bruno Bandulet and Others, Roman Huber and Others, Johann Heinrich von Stein and Others, Fraktion DIE LINKE im Deutschen Bundestag versus Deutscher Bundestag.*
[21] Paragraph 108.
[22] Paragraph 110.
[23] Paragraph 87.

at the same time, it understands that the OMT program would comply with these (and other) Treaty requirements, if certain conditions were respected. In particular, it sets a crucial condition in this context, which is that OMT cannot be unlimited. Further, it understands that the OMT program is, in fact, of a limited nature, since the ECB could only purchase, though the OMT program, sovereign bonds with a seniority of up to 3 years and only of Member States that are under a bailout program. Let us analyze both limitations in the following.

As regards the first one, the ECB´s Press Release of 6 September 2012, on the Technical features of Outright Monetary Transactions, establishes that "[OMT] transactions will be focused on the shorter part of the yield curve, and in particular on sovereign bonds with a maturity of between one and three years". With such a language paucity it is impossible to know if the ECB is self-imposing a limit or just announcing what the main focus of its OMT program will be (without excluding other options, like buying bonds with a larger maturity). An interpretative clue of the real intentions of the ECB is given by the next sentence of the Technical Features, which very clearly states that "No ex ante quantitative limits are set on the size of Outright Monetary Transactions". Thus even if assuming the 3 year maturity limit, Member States in difficulties would just have to issue bonds of such maturity knowing that the ECB would purchase them all. However, a more plausible interpretation would be to say that the ECB would concentrate the core of the OMT program on sovereign bonds of such maturity (since this can have a wider impact on price formation in the short term) without excluding other possible actions and, finally, without establishing any kind of quantitative limit. In any case, both possible interpretations indicate that this particular limit that the ECJEU is apparently setting is in reality more formal than real.

As regards the second limit, it is true that the Technical Features say that "a necessary condition for Outright Monetary Transactions is strict and effective conditionality attached to an appropriate European Financial Stability Facility/European Stability Mechanism (EFSF/ESM) program. Such program can take the form of a full EFSF/ESM macroeconomic adjustment program or a precautionary program (Enhanced Conditions Credit Line), provided that they include the possibility of EFSF/ESM primary market purchases. The involvement of the IMF shall also be sought for the design of the country-specific conditionality and the monitoring of such a program". It is therefore clear that the beneficiaries of the OMT program will be the Member States under a bailout program. However, whether this is an additional limit to the OMT program is not undisputable. Thus it is clear that the OMT program was set up to help Member States in distress. The question is not whether these countries would be the beneficiaries, but rather, the extent to which (limited or unlimited) they would benefit from the program. The fact of being under a bailout program, with all that it implies (conditionality) is not indicative, in any meaningful sense, of any sort of quantitative limit established upon those Member States that would be helped by the OMT program.

In summary, the ECJ should have struck down that part of the OMT program in which the ECB speaks about its unlimited character, and impose upon the ECB the obligation to redraft that part of the so-called "Technical Features". The Court could have, for example, established that an unlimited program amounts to a monetary financing of the Member States under stress, and at the same time instructed the ECB to establish limits. For example, such limits could have been that the OMT program would buy sovereign bonds of Member States under a bailout program as long as the beneficiary Member State did not reach an inflation rate of around 2%, as the ECB has itself established[24]. In this way, the OMT program would be unlimited in the sense that the ECB could

[24] The ECB´s Governing Council established, in its meeting of 13 October 1998, that "Price stability shall be defined as a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the euro area of below 2%.". See Press Release here: https://www.ecb.europa.eu/press/pr/date/1998/html/pr981013_1.en.html. However, some commentators argued that this declaration established an upper limit, but not a lower inflation limit, which could be interpreted in the sense that the ECB would fight inflation, but not deflationary trends. The ECB acknowledged such

make purchases of sovereign bonds in an unlimited volume[25] but would be at the same time limited since it would stop buying bonds once the 2% inflation level was reached; this, at the same time, would be much more in line with the ECB´s own mandate (the control of inflation[26]). Therefore, the Court could have suggested in its ruling that the ECB should make it clear in the "Technical Features" that this would be the limit. It would be for the ECB, in respect of its exclusive powers on monetary policy, to expressly write down such limits. But the indirect Court´s suggestion would stop further legal challenges against the modified OMT program.

In this way the Court would have struck a better balance from a credibility perspective as regards article 123 TFEU. It would have, on the one hand, saved the principle according to which the ECB cannot monetize Member States debt (which is what the OMT program does under its current, unlimited, form). On the other hand, it would have made the ECB establish limits, of such an ample nature, as to not make the program lose its effectiveness.

c) The exceptions: Articles 122 and 143 FTEU

Starting with Article 122 TFEU, there are two possible interpretations of this provision: the first is more credible than the second one but, as shall be seen later on, it does have to be discarded at present. The first interpretation would be to say that the rule is article 125 (no bailouts) and the exception is article 122 (temporal financial assistance for Member States in difficulties only in very extraordinary circumstances) (Louis, 2010; Louis and Lastra, 2013). However, a second interpretation is possible. The interpretation I am referring to is the one that says that in reality, article 122 FTEU is the rule and article 125 is the exception. In systematic terms, the fact that article 122 is placed in the FTEU before article 125 could be seen as an indication of the former's precedence. Therefore, as a matter of principle, and for solidarity reasons (as Borger (2012) argues), Member States experiencing difficulties could be helped by the Union, in particular (122.2º) by granting "financial assistance" to the Member State concerned. However, an exception to this general principle of solidarity would be article 125. Thus the Union could financially assist Member States *except to help them pay their public debts*. This would be the most coherent interpretation between the two norms, and therefore, the most credible one. It would mean that in the EU context a no-bailout and a bailout regime would not be cohabitating. The no bailout clause would still hold. Outside the domain of public debt management, Member States could receive financial assistance.

A second provision that is important to bear in in this context is Article 143 FTEU. This article establishes the possibility that Member States facing BOP (balance of payments) difficulties can receive financial assistance from the EU. Interestingly, this article refers only to the States that are not members of the Eurozone. Therefore, the European economic constitution establishes here a second exception to article 125. Paradoxically, if you are not a Member of the Eurozone, you can get some financial assistance to overcome your BOP problems. In fact there exists a financial vehicle for this purpose: it is the so-called MTFA (Medium-Term Financial Assistance). This financial vehicle was created in 1988 by regulation 1969/88[27] and reformed in 2002 by regulation

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criticisms and in its meeting of 8 May 2003, it specified that the aim would be to "maintain inflation rates close to 2% over the medium term" (see Press Release here: https://www.ecb.europa.eu/press/pr/date/2003/html/pr030508_2.en.html). Therefore the bottom line is the following: the ECB´s objective is to keep the Eurozone inflation rate below, but around, a rate of 2%.

[25] However, the volume of purchases would never be unlimited, in the sense that the sovereign debt issued by a Member State is always a fixed (and therefore limited) quantity. I owe this point to Paul de Grauwe.

[26] See article 127.1º FTEU: "The primary objective of the European System of Central Banks (hereinafter referred to as 'the ESCB') shall be to maintain price stability (…)".

[27] Council Regulation (EEC) 1969/88 of 24 June 1988, OJEC L 178 of 08/07/1988

332/2002[28]. This mechanism was in fact used during the crisis, in particular to assist Latvia, Hungary and Romania. Had Greece, for example, not been a member of the Eurozone in 2010, it would have received the help of the MTFA. However, being a member of the Eurozone, other financial instruments had to be urgently put in place for the purpose of rescuing this country. Be it as it may, the interesting thing is to understand why a BOP assistance mechanism was foreseen for non-Eurozone members but not for Eurozone members. According to Pisani-Ferry, Sapir and Wolff (2013), the main reason for this different treatment is that when the euro was created, it was believed that the mere existence of the common currency would rule out the possibility of having BOP problems. In their opinion,

What was not well understood in Brussels, Frankfurt or Washington was that euro-area countries could face BOP problems like emerging countries. A BOP crisis happens when private markets stop financing viable borrowers because of the country they belong to. Because it is within the confines of its jurisdiction, the state, as the ultimate insurer of private agents – notably banks – tends to concentrate risk incurred by households, companies and banks. Banks with assets that are not diversified internationally also concentrate risks resulting from the potential insolvency of private agents as well as of the sovereign. As they rely on the state as their backstop, they transfer the risk to it. Finally, because in the euro area the state issues debt in a currency over which it has no control (De Grauwe, 2011), it is vulnerable to liquidity crises. This perspective in turn weakens private agents that hold large quantities of government paper. This web of interdependence between the state, banks and non-financial agents may lead markets to price country risk and, in the extreme, to shun all agents located in a particular country, irrespective of their individual financial health. Pisani-Ferry, Sapir and Wolff (2013:19).

In the EU context, this shortage of private credit, that the authors previously mentioned refer to, was compensated for to a certain extent through the conventional and above all non-conventional operations of the ECB. However, due to the ECB statute, such operations were insufficient to stop the payment crisis that some eurozone members were experiencing. In particular, Cour-Thimann and Winkler (2012) argue that the ECB non-standard operations had an impact –but a limited one- to stabilize the euro-area. Accordingly, the periphery member states of the eurozone experienced increasing difficulties to finance themselves through the channel of international financial markets, and some of them finally had to ask the EU and the IMF for financial assistance. In any case, the truth of the matter is that some Eurozone members in fact experienced very serious BOP problems.

3.2 Why this system was not an equilibrium from the perspective of the idea of law as credibility

In sum, the system that the EU Treaties established before the crisis unfolded, was a system that was presided by a clear commitment of the Union and its Member States to financially assist other Member States in difficulties, except in the area of sovereign debt. In that area, there was a clear and strict prohibition to bailout Member States. The ECB could not use its powers and resources to monetize Member States debt either. The only exception to the exception (the only exception to the bailout prohibition) was set up in favor of non-eurozone Member States that experienced BOP problems. Non-eurozone Member States experiencing BOP problems could be bailed out –and in fact there was even a fund established for this purpose.

It is important to note that the interpretation that I have offered so far has been done from the perspective of the conceptual framework that I set up in point 2 of this paper –law as credibility. In terms of credibility, this is the interpretation that best holds. First of all, because it is a coherent

[28] Council Regulation (EC) No 332/2002 of 18 February 2002 (OJEC L 53/1 of 23.2.2002). This regulation was amended by Council Regulation (EC) No 431/2009 of 18 May 2009 (OJEC L 128/1 of 27.5.2009). This modification raised the total amount of the loans that could be granted to Member States to 50 billion euro.

interpretation, and one of the main conditions that the law as credibility concept has to fulfil is that a norm –or as the case may be, a regulatory framework- has to be coherent. For logical reasons, it is impossible that a non-coherent interpretation be credible[29]. The second point that has to be made at this regard is that my interpretation has been guided by the idea that the important thing in the EU bailout framework was to understand where the equilibrium point between rigidity and flexibility was. In my opinion, the interpretation which is retained in this paper (interpreting this framework in such a way that the principle was financial assistance and the exception was bailouts prohibition) is more credible that its alternative (interpreting that the principle was an overall prohibition to financially assist member States and the exception was to accept in very specific cases and circumstances some kind of financial assistance). The main reason for this is that the first interpretation incorporates better (although not perfectly, as shall be argued in a while) what I have called in a previous section the “counterfactual test”. So the counterfactual would be here the following: taking into account the previous rules, how would the Union react if there was a need to operate bailouts?

If there was a need to operate bailouts, then a legal framework that started from the principle that financial assistance could be operated, would be closer to equilibrium –closer to the possibility to actually operate some kind of financial assistance- than its alternative (to negate as a matter of principle any kind of financial assistance, above all in the field of bailouts). In principle, Member States would be better off from a Pareto-efficiency perspective in the first case (with solidarity) than in the second (without solidarity).

Closer to equilibrium, of course, but not close enough, since the prohibition for EU bailouts was crystal clear. Therefore even if we gave a reading to the EU bailout framework that would give more room to flexibility and less so to rigidity, as I have done before, and we accepted that some relief assistance measures could be granted in favor of member States in financial difficulties, the truth of the matter is that there is no way to escape from the determinacy that articles 125 and 123 generate. Sovereign bail outs (bail outs to solve public debt problems that Member States might be experiencing) were ruled out in the original Treaty system. So if the counterfactual came to occur, and even if we gave a more flexible reading to the overall system established by the Treaty, then the answer could only be one: that Member States would be on their own to solve their fiscal sustainability problems. A bailout could not be operated if the case arose.

More in particular, as regards specifically article 125 FTEU, I have shown before that this article relied on a very specific vision of moral hazard problems. According to this vision –that we may call an “orthodox” vision- the Member State that created the moral hazard problem would be the only responsible for its resolution. This is the main reason why bailouts could not be granted. As I have shown, if article 125 had adhered to a different –more realistic- vision of moral harzard problems, then the solution given by article 125 would have probably been a different one. For example, the article could have been less bold and could have recognized that some exceptions could be granted in the case in which “exogenous factors” (like prices) had accrued moral hazard. This was not however the path that was taken when article 125 was adopted. The result is a clear and precise statement that prohibits bailouts in the EU context.

Therefore the conclusion that we may reach is the following: before the crisis, the EU legal bailout framework was clear and coherent, but this does not mean that it was an equilibrium. Even a flexible reading of this framework from a credibility perspective amounts to the conclusion that bailouts were not possible in the EU framework. Maybe some –but limited- financial assistance could be given; but certainly not overall and broad bailouts as the ones that have been granted since 2010.

[29] See Elster’s analysis (2000) on the connection between logical coherence (and therefore rational argumentation) and credibility.

Member States' defaults –with maybe minor assistance measures- was therefore the foreseen EU response in the case that the counterfactual materialized. But then the second question is: how credible was this scenario for financial markets? Did they believe that a cascade of defaults would be prompted in the case that an economic catastrophe were to occur? What were their expectations on the EU foreseen scenario?

There is some evidence that may allow to think in retrospective terms that markets believed that the system was not an equilibrium and that if a big crisis hit the Eurozone, at the end of the day, the EU would prefer to violate both articles 123 and 125 than to permit a euro break-up. The increase in the senior government bonds interest rates of some Member States prone to be bailed out once the crisis unfolded may be understood as a symptom not that markets were anticipating defaults but rather that markets were anticipating bailouts. When bailouts occurred, and therefore their expectation was confirmed, then markets started a relaxing tendency.

To give flesh to the bones of this argument, graph 1 plots the evolution of the 10 year government bonds interest rates for four bailed out countries (Greece, Portugal, Spain and Ireland). This Graph also indicates the exact dates in which formal bailouts were formally requested by each of these Member States. It also indicates the time span in which actual aid disbursements were made. The results are mixed: only in the case of Spain a certain relaxing trend of the government bonds interest rates can be observed after this Member State government formally requested a bailout. However, it is important to mention that the Spanish formal request for aid was almost coincidental with Draghi's "whatever it takes" (WIT henceforth) statement. It is possible to say that in the case of Spain, both the formal request and the Draghi's WIT declaration apparently had the effect of reducing the interest rates. In the rest of the cases, the formal request of a bailout did not stop the incremental trend that had spiralled some months before. However, in some cases, a relaxing trend can be observed even before the Draghi's WIT declaration. These are the cases of Portugal, which started a relaxing tendency in January 2012, and Ireland, which bonds interest rates started decreasing in August 2011. Therefore for these two countries it could be possible that what really had an effect was not so much the formal request for a bailout, but the actual disbursements. Finally, in the case of Greece, it might have been the case that what had an effect was Draghi's WIT declaration, but not only, since this declaration was already preceded by an important number of disbursements. It could therefore be argued that in the case of Greece, the combination of the actual disbursements of aid together with the Draghi's declaration was what caused a sustained effect to reduce the bond's interest rates.

Each case was therefore different. However, what is common to all cases is that the confirmation of the bailout market expectations (be it formal, be it actual, be it by the EU, be it by the ECB) was what stopped the incremental trajectory that interest rates had taken and even served to reverse the previous trend. This seems to indicate that the markets had discounted that bailouts would take place. If this were the case, then it seems plausible to argue that market expectations that the EU bailout prohibition would be implemented were rather low. In other words, this gives ground to argue that markets thought that the EU bailout system was not an equilibrium[30].

Graph 1: Evolution of the 10 year government bonds interest rates for four bailed out countries (Greece, Portugal, Spain and Ireland)

[INSERT GRAPH 1 HERE]

[30] I have not taken into account the ECB's non-standard operations in the midst of the crisis in order not to prejudge their nature. For the ECB, these were not a bailout but part of its monetary policy (a way to reinforce its standard operations). I very much doubt that this was the case, but for the sake of simplifying my analysis I take this for granted. However, in the case of OMT, I think it is indisputable that this program would be a bailout due to its unlimited character both in terms of time and volumes. This is why I have taken them into account as an ECB's bailout (or rather, promise of a bailout) in Graph 1.

4. The EU bailout regime after the crisis

4.1 Interpreting the *ex post* EU bailout regime

a) Article 136 or article 122?

Let me now turn to the analysis of the EU bailout regime once the crisis unfolded. The most important provision in this new phase is article 136 FTEU. Article 136 did not make any foresight whatsoever for establishing a Stability Mechanism (a bailout Fund) in the European Union. Furthermore, it is questionable whether this was the right place, legally speaking, to introduce such a mechanism. In fact, article 136 uses the rhetoric of contention rather than the language of expansion. The purpose of Article 136 is to give powers to the Eurozone members to "strengthen the coordination and surveillance of their budgetary discipline" and to "set out economic policy guidelines for them" and ensure that they are "kept under surveillance". In other words, this is not the vernacular of assistance. Instead, as has been analyzed, Article 122 FTEU makes an appeal to the "spirit of solidarity" that must preside over the relationships among Member States in the economic area; and its paragraph 2 very clearly states that a Member State may receive financial assistance from the EU when it is "in difficulties or is seriously threatened with severe difficulties" caused, among other things, by "exceptional occurrences beyond its control". All this made of article 122 TFEU a much more appropriate legal environment where to make the reform enacted by Decision 2011/199 (which reformed article 136 to make possible a permanent bailout fund). In fact, in May 2010, the EU decided to set up the EFSM under article 122 FTEU[31], with a volume of 60 billion euros.

Thus the only reason that may explain why the EU and its Member States decided to reform Article 136 instead of reforming Article 122 for the purpose of establishing a Stability Fund is their intention that this Fund is limited to the Eurozone members. In fact, Article 122 applies to the whole EU whereas Article 136 only to the Eurozone members. However, as shall be shown later on in this paper (section c), if we take into consideration how the European Stability Mechanism is structured, not even this interpretation completely holds[32]. We are therefore facing a reform that was established in the wrong legal place.

[31] See Council Regulation (EU) No 407/2010 of 11 May 2010 establishing a European financial stabilisation mechanism (OJ L 118/1, 12.5.2010). It was amended by Council Regulation (EU) 2015/1360 of 4 August 2015 amending Regulation (EU) No 407/2010 establishing a European financial stabilisation mechanism (OJ L 210/1, 7.8.2015). See also the COMMUNICATION FROM THE COMMISSION TO THE COUNCIL AND THE ECONOMIC AND FINANCIAL COMMITTEE on the European Financial Stabilisation Mechanism (Brussels, 30.11.2010).
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[32] The ESM Treaty says at different points (paragraph 6 of preamble, article 3, article 12.1) that its actions will be taken "if indispensable to safeguard the financial stability of the Eurozone". Further, paragraph 9 of the preamble, as well as article 5.4 and 6.3, provides for non-Eurozone members participation in the ESM rescue operations of eurozone members. This opens up the door, in my opinion, for operating non-eurozone Members bailouts through the ESM. The arguments in favor of this interpretation are two-fold: in first place, if a non-eurozone (or an ensemble of non-eurozone) members are hit by a crisis that could impact on the financial stability of the euro-zone itself, then it could be justified to use the ESM. The second reason has to do with redistributive justice: if non-eurozone members can participate in the rescue operations of Eurozone members, then Eurozone members should be able to participate in the rescue operations of non-eurozone members through the ESM.

Decision 2011/199/EU[33] introduces a third paragraph in Article 136. It reads as follows:

The Member States whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the euro area as a whole. The granting of any required financial assistance under the mechanism will be made subject to strict conditionality[34].

b) Article 136.3º FTEU in the context of the no-bailout rule

The real matter that we are confronted with in this area is therefore how this article is to be understood in the context of other Treaty provisions, and in particular in its connection with Article 125 FTEU, previously analyzed. In reality, Article 136.3º closes a circle which started to open in May 2010, when the EU decided to set up the EFSM under article 122 FTEU. The establishment of this Fund using as a legal basis article 122 FTEU gives ground to argue, as has been done in a previous section, that the principle was financial limited assistance and the exception was not to bail-out. In any event, there are though important differences between the Funds that article 122 and 136 were setting up, the main one being that of volume. In effect, as shall be seen later on, the fire power of the ESM is much superior to that of the EFSM. In this way, a provision that was at most of secondary importance in the Eurozone governance, such as was Article 136 FTEU, acquired a central role after its reform and the subsequent establishment of the ESM. In other terms, after the setting up of the ESM fund, the most important exception to the prohibition contained in article 125, inside the Eurozone, would be article 136.3º TFUE[35]. The other exception, comprising non-Eurozone members, would be that of article 143 TFEU.

The overall framework of EU governance would therefore remain as follows after the reform of article 136.3º. The principle would be financial limited assistance to Member States under article 122, for solidarity reasons. The exception would be the no-bailout rule (applied to all Member States). A crucial exception to the exception would be article 136.3º: Eurozone Member States could be bailed out, provided conditionality was accepted. An additional exception (this one existed before the crisis) would be article 143: non-eurozone Member States experiencing BOP crisis could also be bailed out. In sum, if on the one hand non-eurozone Member States could be bailed out, and after the reform of article 136, Eurozone Member States could be bailed out as well, the result is that article 125 becomes devoid of its very substance; a dead letter, as it were. However (and this is the interesting thing for the remaining argument of this paper) Member States decided to keep article 125 FTEU and not to abrogate it[36].

[33] European Council Decision of 25 March 2011, amending Article 136 of the Treaty on the Functioning of the European Union with regard to a stability mechanism for Member States whose currency is the euro (2011/199/EU). OJEU L 91/1 of 6.4.2011.

[34] According to the information provided by the European Parliament, this third paragraph entered in force on May 1, 2013, after the EU Council's Secretary-General received notification from the Czech authorities of the completion of the ratification procedure in this Member State. However, as we shall see below, the ESM started operating before this article was in force. See "Table on the ratification process of amendment of art. 136 TFEU, ESM Treaty and Fiscal Compact" by the Directorate General for the Presidency, Directorate for Relations with National Parliaments Legislative Dialogue Unit (Brussels, 27/09/2013), at http://www.europarl.europa.eu/webnp/cms/pid/1833

[35] See my remarks on conditionality in section c), *infra*.

[36] The ECJEU has ruled, in *Pringle* (Judgment of the Court of 27 November 2012, Case C-370/12, *Thomas Pringle v Government of Ireland, Ireland, The Attorney General*) that there is no incompatibility whatsoever between both articles 125 and 136 FTEU (and therefore between the ESM and article 125), insofar as two conditions are met: first, that the financial assistance is subject to strict conditionality; and secondly, that it is oriented to a sound budgetary policy.

c) The ESM Treaty

Origins

To trace back the origins of the ESM Treaty, it has to be recalled that Member States decided in the midst of the first bailout operation to Greece, in May 2010, to set up two different but interrelated financial assistance mechanisms: the EFSM, previously mentioned, and the EFSF (European Financial Stability Facility). More specifically, the ECOFIN Council of May 9, 2010[37], decided to set up the two mechanisms. The first, the European Stabilization Mechanism, would have a volume of 60 billion euros. In parallel to this mechanism, the "euro area Member States" committed to establish the second mechanism, the EFSF[38], with "an effective capacity to provide Financial Assistance of 440 billion euros". Therefore a first difference between both mechanisms was of volume. The second one was a legal difference: whereas the first financial mechanism was an EU legal instrument, the second one was of a private law nature. Public law versus private law, therefore. The first difference –the difference in volumes- is understandable if one takes into account that the EFSM would be financed by the Union, and the EFSF only by the Eurozone Member States.

The second difference (public versus private law) is however more difficult to understand; after all, Member States could have adopted a public international (non-EU) law Treaty for the second financial vehicle –as they finally did with the ESM. Louis (2010:985) argues that the reasons that may explain this second difference are two-fold. First of all, some Member States preferred a "system of guarantees committing them outside the EU legal order" rather than a financial mechanism imposed from the EU onto them. And secondly, it would also be explained by the need of some Member States –especially Germany- to avoid the whole mechanism being challenged in their constitutional legal orders. None of these arguments seem however plausible. The first argument is not plausible since it would explain only the EFSF but not the EFSM: in fact, this second mechanism was adopted through a Council regulation. The second argument is also implausible since both mechanisms were in the end challenged before the German Constitutional Court. The German Constitutional Court gave its assent to both financial instruments in its judgment of 7 February 2011[39], since it understood that their approval had preserved the Bundesrat's budgetary sovereignty. Louis' argument may be rather interpreted in the sense that what was offered to the German Constitutional Court was a kind of trade-off between the (smaller) volume of the EU law mechanism and the (larger) private law mechanism. This may have played a role in the earliest moments of the EU rescue operation, but the argument should not be pushed further since the German Constitutional Court also gave its assent to the ESM[40], which augmented the lending capacity of the EFSF and is clearly a public law instrument. Given the developments that took place in this area later on, the different legal nature of the EFSM and the EFSF can only be understood as yet other proof of the Member States' and EU institutions' lack of preparation in the face of the massive proportions that the crisis was adopting.

[37] See Press Release here: http://europa.eu/rapid/press-release_PRES-10-108_en.htm?locale=en

[38] See the EFSF Framework Agreement of 7 June 2010 here: http://www.efsf.europa.eu/about/legal-documents/index.htm

[39] Judgment of 7 September 2011 - 2 BvR 987/10. See the official English translation here: https://www.bundesverfassungsgericht.de/SharedDocs/Entscheidungen/EN/2011/09/rs20110907_2bvr098710en.html

[40] Judgment of 19 June 2012 - 2 BvE 4/11. See the english translation: http://www.bundesverfassungsgericht.de/SharedDocs/Entscheidungen/EN/2012/06/es20120619_2bve000411en.html. See also Order of 18 March 2014 - 2 BvR 1390/12. See the english translation: http://www.bundesverfassungsgericht.de/SharedDocs/Entscheidungen/EN/2014/03/rs20140318_2bvr139012en.html

The ESM draws on the experience accumulated through the operation of both the EFSM and the EFSF and integrates with the latter in a single bailing-out mechanism[41]. The first thing that has to be said as regards the ESM Treaty is that it entered into force after Decision 2011/199/EU (which reformed Article 136 FTEU) was adopted but before this article entered in force. In fact, the first and inaugural meeting of the Board of Governors of the European Stability Mechanism was held in Luxembourg in October 2012 and its first operation (issuance of bonds for the recapitalization of the Spanish banking system) took place in December 2012. Therefore, from October 2012 until May 2013 (the date at which Article 136 of the FTEU finally entered in force), the ESM navigated in a constitutional vacuum, at least from an EU legal perspective. It was a public international law Treaty that had no connection whatsoever with the EU legal order. Legally speaking, this may have more consequences than it may seem at first sight: for example, if the ESM went bankrupt, the European Union as such could not be held liable as regards the outstanding ESM's debt during the time-span previously mentioned[42]. It is important to recall that both the Spanish and Cypriot bailing-out operations were decided before Article 136 FTEU entered in force[43].

The structure of the ESM Treaty

As regards the structure of the ESM Treaty itself, four things are relevant from an economic constitutional perspective: its outstanding amount; how the ESM decision process is organized; the conditionality; and the jurisdiction of the ECJ. I will briefly analyze all these items in turn.

First, as regards the ESM fire power, it is important to differentiate between its capital stock, its paid-in capital, its lending capacity, and how the participation of each Eurozone member in the Fund is organized. The total capital stock of the ESM is around 700 billion euros (701.935 million). Of this, the paid-in capital is of around 80 billion (80.221 million). Therefore the rest (ie 680 billion) is "callable" capital. The ESM Member States are committed to make extra-disbursements if need be. This can happen, for example, if the ratio of capital (paid-in capital) to lending would surpass the limit of 15% as set in article 41.2 of the ESM Treaty. For example, in this particular moment, the ESM has lent to Spain 41.3 billion euros and to Cyprus 5.8 billion euros. It totals 46.6 billion euros, so therefore it is underneath the 15% ratio. However, in reality the line of credit that the Eurogroup granted to Spain was of 100 billion euros, and that of Cyprus was of almost 9 billion. It totals 109 billion euros. If we took this figure, then the 15% would have been overshot. However, there have not been new calls on Member States to increment the ESM paid in capital. The ESM Treaty therefore refers to lending *actually* made and not formally approved (but not *actually* disbursed). This could be problematic in the case of a sudden crisis in which a Member State (for example, Spain) rapidly needed the whole of the approved credit, since it could take time for the

[41] It does not, however, integrate the EFSM. This Fund is still operating for the bailout operations of Portugal and Ireland (interestingly enough, the Fund was not activated for the Greek bailout). In Communication COM(2010) 713 final of 30.11.2010, the Commission assessed the necessity to retain the Fund and recommended that it should be maintained until the exceptional circumstances that prompted the creation of this mechanism had not faded away. To the best of my knowledge, the Fund is still operating and Council Regulation (EU) 407/2010 is still in force.

[42] Here I establish a parallelism between the EFSM and the ESM. The former is guaranteed by the EU budget, as the Commission states in Communication COM(2010) 713 final of 30.11.2010. However, the Commission has not pronounced itself on this point as regards the ESM Fund. I see however no reason why the ESM would not have to receive the same treatment, if taking into account that article 136.3º makes reference to it. The point is, rather, that in the time spam mentioned in the text, the ESM would not be guaranteed by the EU budget; however, it would be afterwards.

[43] Spain requested a bailout for its banking system in June 25, 2012. The bailout was granted by the Eurogroup in July 20, 2012. The first disbursement took place in December 2012 and the second one in February 2013. Cyprus requested a sovereign bailout in June 25, 2012. The bailout was granted in April 24, 2013. The first disbursement took place in May 13, 2013, and the subsequent ones in June and September of the same year. Therefore all the disbursements did take place AFTER Article 136 had entered in force (although the decisions to grant the bailout happened BEFOREHAND).

other Member States to make their committed extra-disbursements with the result that the 15% ratio could be overshot either temporarily or definitively (if a particular Member State could not honor at all its commitments, for example). This is clearly the most critical aspect that the ESM governance structure has: once again, how to make credible Member States' commitments to extra-disbursements[44].

Member States' disbursements to fill paid-in capital are organized in five annual installments of 20% of the total amount owed by each Member State. Therefore five years after the entering in force of the ESM, the Fund will reach its full capacity, 80 billion euros, as has been said before. According to the ESM own official information, this volume was almost been reached by April 2014[45]. The Fund started operating in October 2012, so less than five years have elapsed to reach that threshold. In turn, the authorized capital stock of the ESM is not to be confused with its maximum lending capacity, which is of 500 billion euros, both during the initial five year period and afterwards. However, article 10 of the ESM Treaty indicates that the Board of Governors can modify the maximum lending capacity of the ESM. If it does this, then the authorized capital stock as set by article 8 (700 billion euros) will have to be modified accordingly (and the paid-in capital as well, if actual disbursements were made). Shares of members of the ESM are organized according to a "contribution key" that is inserted in Annex I of the Treaty. Accordingly, the Member State with the larger percentage of shares is Germany (27.1%). This is a key issue, since the votes that each ESM member has are correlated to the percentage of shares that it enjoys in the Fund[46].

The second aspect of constitutional relevance is therefore the ESM decision-making process. All relevant decisions are taken unanimously by the Board of Governors (which is composed of one representative per ESM member) or by the Board of Directors (one representative of the Governor per member of the ESM). For example, the decision to grant financial assistance is accorded by the Board of Governors by unanimity (Art. 5.6º f). Not only the first tranche of financial assistance is to be decided by unanimity, but also the disbursement of subsequent ones (Art. 16.5º). In this domain, Article 4.4º opens up a way out from the gridlock that unanimity may bring about by establishing qualified majority for the adoption of both decisions when failure to grant financial assistance would "threaten the economic and financial sustainability of the euro area". However, qualified majority is defined by the same article as 85% of the votes cast. This means that without Germany or France or Italy, a qualified majority vote cannot be attained. In other words, these three countries hold a "veto-player" position in the ESM governance.

Conditionality is the third issue at stake regarding the ESM Treaty. This word –conditionality- is mentioned sixteen times throughout the text of the ESM Treaty. The idea is therefore clear: bailouts are only possible if subject to a strict conditionality program. Both the respective judgments of the ECJEU and the German Constitutional Court on the ESM Treaty (mentioned above) stress the importance of this point: the ESM is compatible with both the no-bailout clause and the German Constitution because bailout programs and conditionality have become co-terminus in the European Union's toolbox for financial assistance to Member States. This implies a significant development of the EU Treaties: for example, Article 122.2º of the FTEU only states that financial assistance to Member States may be granted "under certain conditions". A similar reference can be found in Article 143.2º (BOP financial assistance). But in both cases the word "condition" may

[44] It must however be clear that the ESM does not use its capital-in paid to rescue Member States. It uses it to be able to borrow in the markets (and therefore lend to Member States). This is why the ESM can be referred to as a financial vehicle. However it is clear that the ESM's capacity to borrow in the markets is directly connected with its capital stock, and in particular, with its paid-in capital. This is why the ESM establishes a (conservative) ratio of 15% between paid in capital and lending.

[45] See the ESM Factsheets, available here: http://www.esm.europa.eu/pdf/2014-07-15%20ESM%20Factsheet.pdf

[46] Article 4.7º states that the number of votes of each ESM member equals its number of shares as set out in Annex II of the ESM Treaty.

be understood not in the more restrictive sense of "adjustment" but rather in the more neutral one of "the terms" (both for the EU and for the beneficiary Member State) around which such financial assistance will be organized. However, with the ESM Treaty (which follows the line marked by the Fiscal Compact in this regard) the word "condition" has muted into the word "conditionality". This is also the case as regards the recently introduced Article 136.3º of the FTEU, which even speaks of "strict" conditionality. This shift clearly appeals to the sacrifices that Member States have to make in exchange for aid.

These sacrifices may range from a macro-economic adjustment program to the continuous respect of pre-established eligibility conditions, as Article 12.1º of the ESM Treaty states. If one takes a look at the 8 bailouts that have taken place up to now, but in particular, to the 5 Eurozone bailouts[47], conditionality has rather taken the form of a macro-economic adjustment program. MoUs (Memorandums of Understanding) are the "legal" instrument through which a specific conditionality will be established for particular Member States[48]. One of the main points here is that the beneficiary Member State recovers the path of fiscal sustainability, as defined by the so-called Fiscal Compact[49]. This means, in particular, that the Member State that has received a bailout will have, in the time frame marked by its specific MoU, to evolve towards a fiscal position in which its structural deficit is not larger than 0.5% of its GDP. In turn, the specific MoU will have to be in line with both the Excessive deficit Procedure and the Macro-imbalance Procedure which the beneficiary Member State may be subject to.

It is interesting to note in this regard that the historic experience of the IMF's bailouts that has been accumulated through the years tells us that neither the main objectives of such bailouts (ultimately, economic growth) were achieved, nor the conditionality linked to those rescue programs had a high degree of implementation. According to some authors (Przeworski and Vreeland, 2000; Dreher, 2006; Dreher, 2009) in general bailouts impaired growth and the conditions were largely ignored. It is important to say in this context that this experience concerns countries in development or at most emerging states, and not developed countries –as the EU Member States are. In other words, the IMF's record with past bailouts does not have to be replicated in the EU context. However, it is also true that this story projects a gloomy shadow on the prospects of EU bailouts. In particular, it allows us to be rather skeptical as to the importance that both the ESM Treaty and the Fiscal Compact give to conditionality. In other words, conditionality is not what is going to make EU bailouts more successful –and therefore, more credible. What will make European bailouts an effective tool for the EU overall economic governance will be, at the end of the day, that Member States that have received bailouts recover their path of economic growth in a way that is more even and fiscally sustainable. This is however something that remains to be seen (see Pisani Ferry et al., 2013; Sapir et al, 2014).

In any case, a final point is that any disputes that may arise among the ESM members themselves and between the ESM members and the ESM will be resolved by the ECJEU in final instance. Its rulings will be mandatory for all these actors. On the one hand, this part of the ESM Treaty (and in particular Article 37.3º) shows better than any other provision the interconnections that exist between the ESM Treaty and the EU legal order. On the other hand, however, the ECJEU will be interpreting here not EU law but a public international Treaty that has granted authority to the

[47] Latvia was bailed out before it became an eurozone Member State. Therefore I exclude this country.

[48] The extent to which MoUs are legally binding is debatable. My position is that they are: the financial arrangements that Member States sign with the various Financial Mechanisms are legally binding without any doubt; and these refer to the MoUs as part of a whole legal package. On MoUs see in general Aust (2014) and Klabbers (1996).

[49] Being its technical name "Treaty on Stability, Coordination and Governance in the Economic and Monetary Union". It was signed on 2 March 2012 by the leaders of all then euro area members and 8 other EU member states, and it entered into force on 1 January 2013. The text is available here: http://www.european-council.europa.eu/media/639235/st00tscg26_en12.pdf. See for an analysis of this legal text Craig (2012).

ECJEU to resolve the disputes that may arise in the domain of the ESM Treaty; however, at the very least, it will use EU law as a "parameter of interpretation" to solve legal disputes that may be linked, even indirectly, to the EU legal order. With this important caveat in mind, the ECJEU will be, therefore, a public international law jurisdiction like any other. This has a clear constitutional dimension: for example, its decisions will not have primacy –as EU law does- but they will occupy the position in the normative hierarchy that the respective constitutions of the ESM members give to decisions that Courts adopt in the framework of similar public international law Treaties. Interestingly enough, the ESM Treaty does not grant authority to the ECJEU to rule on the disputes that may arise between the ESM and its creditors. Here the relevant jurisdiction will be the jurisdiction that the specific issuance of ESM securities will establish –normally, English law.

4.2 The *ex post* EU bailout system and credibility

As has been mentioned before, the EU bailout mechanism that has emerged in the midst of the crisis relies on a palatable contradiction. On the one hand, article 125 is still there and establishes in a clear way that sovereign bailouts are prohibited in the EU context; on the other hand, articles 122, 143, and now 136.3, allow for bailouts and financial assistance, both for non-eurozone Member States and for Eurozone Member States. A completely new element emerges in this new scheme: this is conditionality. The outcome is that bailouts will be accepted if conditionality is also accepted. In turn, the ECJEU has granted its fiat to this new regime.

Conditionality is therefore the factor that attempts to create a new equilibrium between rigidity and flexibility in the *ex post* EU bailout regime. The system is rigid in the sense that bailouts would be still ruled out in the EU context; however, it is flexible enough as to accept an exception to the previous rule if conditionality were to be accepted by sovereigns. Apparently, this seems a better fix than the ex-ante crisis situation, since it gives more margin to flexibility than under the previous system.

However, from the perspective of law as credibility, we have to ask ourselves, once again, about the counterfactual: what if bailouts were needed without conditionality? In other words, what if Member States were better off with rescue packages that did not imply the pain involved with conditionality? As was shown in a previous section, making this counterfactual is not only a pure thought experiment. As indicated by analyses of previous IMF bailouts, bailouts plus conditionality programs adopted in emerging countries did not, at least in the majority of the cases, yield very successful outcomes. This shows that conditionality is not what will make the whole ex post EU bailout regime to eliminate the contradictory character that it currently exhibits. In other words, it will not make the system to return to equilibrium, since contradictory legal arrangements cannot claim credibility, as has been argued in section 3.2 of this paper. The only thing that would make it to be in equilibrium would be that Member States returned again to a sustainable growth path.

The problem that this contradictory and off-equilibrium system raises is, above all, how markets will react to this system, how this new regime will affect their economic behavior. To answer to this question, it is difficult to find any decisive evidence since we are still in the middle of the crisis and some bailouts operations have not yet come to an end (see however my comments below on Greece). One alternative to try to understand how financial markets will react to the new EU bailout framework is to build a rational hypothesis on their future behavior. I do this with the help of game theory[50]. In general terms, the idea would be that markets would probably be uncoordinated as a consequence of the ex post EU bailout framework. Parts of them could

[50] For an application of game theory into the legal field see, in general, Baird, Gertner and Picker, 1998; and Jerzy and Wojciech, 2011.

understand that a bailout will always take place if a new crisis arose and parts of them may think that the 2010 onwards bailouts have been a very exceptional episode that would not occur again.
Therefore, in the game, the markets have two options in the middle of a crisis, either to lend or not to lend. In turn, the EU may bail out or not. And a Member State may accept or reject the bailout. The reason for this is that they would prefer the costs of conditionality would be greater than the costs associated to not having the bailout moneys (even if this determined a euro-exit). The problem that this game poses is that markets do not know in what part of the game they are, since they lack full information. Therefore even if there is a bailout proposal from the EU, the Member State in question can finally reject it. That would be the worst-case scenario for the markets, since they would prefer a bailout (and therefore recover the moneys lent) than a rejection of the bailout (and therefore a default). In these circumstances, in which it is not clear whether the EU would bailout or not, and whether the Member State in question would accept or reject the bailout, the markets will be uncoordinated (some segments of it will lend thinking that there will be a bailout that a Member State will not reject) and some others will not (or less so) (thinking that there will not be a bailout). Markets lack of coordination would in turn lead to uncertainty and volatility.
A preliminary and indirect evidence of the point made before is given by the events that unfolded in Greece in the time-span that goes from the victory of Syriza and until the request of a third bailout by the new Syriza government took place (see graph 2). I first relate the facts and then I will comment on them. The facts are the following: 1) Syriza defended a platform in which a third bailout would be rejected, unless conditionality changed and a deep haircut was accepted by the EU institutions. Markets anticipated Syriza´s victory, and already in December 2014, the Greek risk premium started an increasing tendency; 2) Syriza won the national election by an ample majority on January 25, 2015. The Greek risk premium continued its increasing tendency; 3) The EU offered Greece a third bailout. Syriza announced that a referendum on the third bailout package would take place in July. Syriza defended the "no" vote and opinion polls seemed to indicate that the "no" would win. Greece risk premium incremented its increasing tendency; 4) Three days after the referendum (the outcome of which was a "no" vote), Syriza´s government requested a third bailout, on July 8, 2015. The Greek risk premium plumped after the government made the announcement.

Graph 2: Greece risk premium 2015.

Source: http://countryeconomy.com/risk-premium/greece (last accesed on 17 Sep. 15)

This evidence seems to suggest the following points. First of all, it confirms our predicament according to which markets prefer (and discount) bailouts. In the middle of a deep crisis, like the Greek one, they prefer a bailout than a default and/or a euro-exit. Secondly, the transformation of the EU bailout regime, which has been operated during the crisis, and which has been analyzed in this paper, is worthless. The fact that article 136 has been amended, the fact that an ESM mechanism has been introduced, etc., apparently have had no impact in calming the markets. With the new scheme, as happened with the old scheme, markets are only calmed down when a bailout is actually approved. The spectacular drop in the Greek risk premium after the third bailout was announced on July 8 2015 (from more than 2000 basis points to around 600 in a couple of weeks) seems to be an indication of this. Thirdly, the counterfactual is a case in point here: are we better off with this new scheme than with the pre-crisis (no) bailout scheme? The answer is difficult to be given for the reason that since the crisis unfolded, a bailout system was put in place in the EU; however, if we take into account the evolution of the Greek risk premium since the crisis started, it would seem that a similar pattern emerges: the risk premium increases until a bailout is given. Then it decreases after the bailout. However, if markets understand that a new bailout is going to be needed, then the increasing tendency starts over again. In sum, the new system does not seem to have a preventive function.

Now I turn into the discussion of what system would have rendered more credible the EU commitment not to bail out (and in general the whole EU bailout institutional edifice).

Henning and Kessler (2012), speaking of the US tradition in this area, explain that in the American legal context there is no equivalent to Article 125 FTEU. Neither the Federal Constitution, nor the States' respective constitutions, formally prohibit bailouts. However, since more or less 1840, there have been almost no bailouts in this country. In fact 9 US states have defaulted since then (Kelemen and Teo, 2014:355). Therefore the no-bailout rule is more a constitutional convention than anything else. The same authors also argue that there are no general bailing-out funds in the

US. Rather, the no-bailout tradition has been compensated through strong Federal fiscal powers and a strong Federal budget, which come to the rescue of States in financial difficulties either directly or indirectly through mechanisms such as grant-in-aids (see also Loubert, 2012:450).
The lessons that can be extracted from the American experience are therefore the following: 1) it is not necessary to have a no-bailout legal rule, rather it is enough that the no-bailout rule be a political commitment that can, with time, be translated into a constitutional convention and 2) strong fiscal powers in the centre coupled with a strong federal budget are better ways than a Permanent Rescue Mechanism to help states that are undergoing financial stress. The American experience seems to provide an equilibrium point between flexibility and rigidity, whose arrangement in this area is more credible than the EU one.
Therefore, the only option that the EU would have to make credible its commitment not to bail out would be a much higher degree of fiscal coordination at the EU level, in which the EU budgetary powers and resources would be strong enough as to make internal transfers from the center to the states if a new economic calamity arose again. In the absence of such mechanism, the EU commitment not to bailout will not be credible. The existence of article 125 FTEU, together with a bailout regime based on conditionality, would only serve to generate doubts in the markets as to what policy the EU will finally follow in a new crisis. Markets lack of coordination would in turn generate financial volatility and economic distress.

5. Conclusions: wrapping up the credibility problems of the EU current bailout structure

In the field of bailouts, the EU legal-constitutional setting has been profoundly transformed since the crisis started in 2008 and in particular since the first important bailout, the Greek bailout of May 2010, took place. For some authors, this is important proof of the "flexibility" with which the Union solves its acutest problems (Moravcscik, 2012). Under pressing and changing circumstances, the EU would not waver even for a second and would adopt the necessary measures to face the situation –no matter what the legal constrictions are. This may be true; however, the point that this paper makes is that such flexibility has not been deployed without minor costs. Indeed, the costs in terms of credibility have been very large.
To sum up, the Union entered the crisis with a more or less clear legal and constitutional setting in which, first of all, financial assistance was possible; secondly, bailouts were ruled out; and thirdly, there was an extension of the no-bailout rule to the ECB.
Instead, right now we have an institutional framework whereby, first, the no-bailout rule still stands; secondly, there is a financial assistance mechanism connected to Article 122 FTEU, which in principle is temporary but still remains; thirdly, there is another financial assistance mechanism that is permanent and based on conditionality, although this mechanism is set outside the EU legal order (though indirectly connected to it); and fourthly, the ECB has interpreted in a very extensive way (to say the least) the limits set out by Article 123 FTEU, and therefore it has injected massive liquidity in the euro-system during this crisis. A final point is that the ECJEU (and the GCC) have up to now granted its fiat to this profound transformation of the EU bailout governance system. The overall outcome is a jumbled and colorful constitutional picture; a Dalí instead of a Mondrian.
The problem posed by this new complex web of contradictory legal commitments that emerged with the crisis is, as has been argued in this article, better approached through the concept of law as credibility. Before the crisis started, the EU bailout governance system was not an equilibrium: it had simply discarded the possibility of a fatal crisis. However, after the crisis, the resulting system is also far from being an equilibrium. In a sense, the situation is now worse that it was before the crisis. At least the previous system was clear. Now it is both unclear and contradictory, and therefore far from being an equilibrium. Markets will probably be divided on this issue. Parts

of them will understand that the EU bailout regime will prevail; other parts will understand that the no bailout clause will still prevail. As a result of this lack of coordination, financial unpredictable behavior will be the rule. This will be translated into markets volatility and therefore in economic distress.

The bottom line is that this new setting generates more uncertainties than before. Under the current system, it will be difficult for markets to construe a rational representation of their expectations as regards the applicable law. Since other options are however available, the Union should undertake a profound revision of its actual bailout governance rules to make the whole system more credible.

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