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European Economic and Monetary Union: History, Trends, and Prospects

Rosa M. Lastra and Jean-Victor Louis***

This paper analyses in depth the law of European Economic and Monetary Union, as well as its history, trends and prospects. It is divided into seven sections. Section 1 is the introduction; it deals with the history of monetary union in Europe and outlines some basic concepts. Section 2 considers the conditions for the adoption of the euro. Section 3 deals with economic union/economic policy coordination. Section 4 examines the European System of Central Banks and the European Central Bank. Section 5 deals with the law of the euro. Section 6 deals with the external relations of the euro. Section 7 presents some concluding observations and recommendations, as well as a brief update of recent developments.[1]

I. Introduction

A. Some Basic Concepts

(i) A 'Decisive Turn in the History of European Integration'.[2]

In this way an author has described the signing of the Maastricht Treaty of 7 February 1992, in particular due to the objective assigned to the then[3] Community of building an Economic and Monetary Union (EMU). The same author envisages EMU as the third major phase in the construction of

* Professor of International Financial and Monetary Law, Centre for Commercial Law Studies, Queen Mary University of London.
** Emeritus Professor of the Université libre de Bruxelles.

[1] Sections I, II, and V of this paper were mainly written by Jean-Victor Louis, while sections III, IV, and VI were mainly written by Rosa M Lastra. This division of work notwithstanding, this chapter is a joint contribution by Louis and Lastra.

[2] C Hadjiemmanuil, 'Economic and Monetary Union' Chapter 12, in D Chalmers, C Hadjiemmanuil, G Monti, and A Tomkins (eds), *European Union Law* (Cambridge University Press, 2006), p 506.

[3] The Treaty on the European Union as modified by the Lisbon Treaty has replaced the European Community by the European Union that succeeds to the Community (Art 1).

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المنارة للاستشارات

the Community, after the signing of the Rome Treaty itself and the Single European Act on the completion of the single market.[4] EMU is not indeed a policy like the others that are provided in the EC Treaty. It is another stage of European integration.[5] As coined by the 'Delors Report' to which reference will be made later on, EMU 'would represent the final result of the process of progressive economic integration'.[6] According to the same report, EMU 'would imply complete freedom of movement for persons, goods, services and capitals, as well as irrevocably fixed exchange rates between national currencies and, finally, a single currency. This, in turn, would imply a common monetary policy and require a high degree of compatibility of economic policies and consistency in a number of other policy areas, particularly in the fiscal field.'[7] These two sentences encapsulate the concept of EMU for its founders. Article 119 of Title VIII on Economic and Monetary Policy of the TFEU (slightly revised in comparison with Article 4 of the EC Treaty in the Nice version) includes these different elements and, in addition, the reference to free competition, but without expressly alluding to EMU. In the concept of EMU as used in the Treaties, monetary union is clearly the central and most innovative element.

(ii) Monetary Union in the Literature and in the Treaties

From a legal point of view, monetary union as reflected in the Treaties, refers to the modern concept of monetary union which differs, in degree more than in nature,[8] from the classical one. Francis A Mann had defined the purpose of States participating in monetary unions in the 19th century as being 'to unify their currency systems on a regional level in the sense not of merging independent systems into a single one, but of arranging them on a common basis.'[9] It was the case with monetary unions, like those established in German states within the framework of the *Zollverein*, the *Union monétaire latine* under the convention of 1865, the Austro-Hungarian monetary union of 1867, and the Scandinavian monetary union of 1873. These unions provided for the harmonization of coinage under a common standard and free movement as well as acceptability of the various coins issued by the states which are part of the union.[10]

[4] See C Hadjiemmanuil, above n 2, p 507.
[5] On the different degrees of integration, see RM Lastra, *Legal Foundations of International Monetary Stability* (Oxford University Press, 2006), pp 196–203.
[6] Committee for the study of Economic and Monetary Union, *Report on economic and monetary union in the European Community* (OPEC: Luxembourg, 1989), No 16, p 17.
[7] Ibid.
[8] M Ló Diatta, *Les unions monétaires en droit international* (PUF, 2007), p 53.
[9] FA Mann, 'Money in Public International Law' (1949) 26 BYBIL 263, quoted by M Ló Diatta, op cit, p 46.
[10] M Ló Diatta, op cit, p 50.

المنارة للاستشارات

All modern monetary unions imply the adoption of the same currency issued by a central bank responsible for the common monetary policy.[11] In some monetary regimes, applicable in cases of inequality (either economic or political) of the partners involved, the currency of one of the participating States is adopted either as the single currency[12] or as a common (or complementary) currency.[13]

The so-called 'classical' monetary unions and the 'modern' ones can be classified under a common definition because they both aim at creating by an international arrangement a community of States whose purpose is to constitute a single monetary territory.[14]

For economists,[15] a single currency issued under the authority of a single central bank is not a constitutive element of a monetary union and it is remarkable that in the earlier plans for monetary union, the choice between the adoption of a single currency and irrevocably locked exchange rates between the participating currencies was left for the future. The 'Delors Report' observed

[11] Ibid, p 51. Examples are of the UMOA (West African Monetary Union) whose monetary unit is the CFA Franc ('Franc of the African Monetary Community') and all other monetary unions based on the 'colonial monetary acquis', ibid, p 4. See also, for a definition of monetary union in the EU, RJ Goebel, 'European Economic and Monetary Union. Will the EMU Ever Fly?' (1998) 4 *Columbia Journal of European Law* 249, 249–56 referred to by RM Lastra, *Legal Foundations of International Monetary Stability* (Oxford University Press, 2006), p 200, note 97.

[12] Such asymmetric monetary unions (B Eichengreen, 'Sui Generis EMU', European Commission, *European Economy* (Economic Papers 303, February 2008), p 12 existed in the ephemeral monetary unions of the FRG and GDR before the unification of the two Germany or between the Czech Republic and Slovakia when Czechoslovakia was split in two countries, and with the Anglo-Irish monetary union before the introduction of the European Monetary System in 1999. One could also mention the situation of the Swiss Franc as legal tender in Liechtenstein, the role, before the adoption of the euro, of the FRF in Monaco, or of the Italian lira in the Vatican and the Republic of San Marino, and of the euro in the microstates, having a special relationship with either Italy or France, after the completion of monetary union. Andorra is another special case of a territory that never had a national currency. These situations can also occur *de facto*, as in the case of the adoption of the DM, and thereafter of its successor, the euro, by some territories, becoming States later on, in South Western Balkans. We will come back to these limited experiences of 'euroization', a word used by analogy with earlier examples of 'dollarization' as in the case of Panama and other Latin American States or US-Liberia Monetary Union.

[13] In the framework of the past Belgo-Luxembourg monetary association, monetary signs denominated in BEF were legal tender in Luxembourg but the monetary signs denominated in Luxembourg Francs were not legal tender in Belgium, under the monetary association established by the Protocol of 9 March 1981, prolonging the regime of the earlier Protocol of 29 January 1963 which it abrogated. Ló Diatta also mentioned the situation of the South-African Rand in the Common Monetary Area of Austral Africa, op cit, p 52.

[14] M Ló Diatta, op cit, p 53.

[15] A number of economists were of the view that economic conditions for the realization of a monetary union were not met within the EU, because it did not constitute a so-called 'Optimal Currency Area' (OCA). Member States could not renounce flexible exchange rates in order to resist asymmetrical shocks affecting their economy. In particular it was alleged that the lack of flexibility on the labour market did not allow wages to adjust to changing market conditions to avoid a large, persistent increase in unemployment. See on the OCA based arguments, Otmar Issing, *The Birth of the Euro* (Cambridge University Press, 2008), pp 47–51, especially, pp 48–9. This theory was first exposed and developed by Nobel laureate Robert Mundell in 1961. For references and a description of the evolution of Mundell's thinking, see RM Lastra, op cit, pp 203-5.

المنارة للاستشارات

that '[t]he adoption of *a single currency*, while not strictly necessary for the creation of a monetary union, might be seen—for economic as well as psychological and political reasons—as a natural and desirable development of the monetary union'.[16]

If the legal definition of the European Monetary Union with its single currency, its single monetary and exchange rate policy, and its European Central Bank at the centre of a European System of Central Banks (Eurosystem) appears to be in line with earlier and contemporary types of monetary developments, it presents economic and political specificities which makes it quite singular. It is for this reason that Barry Eichengreen was right in describing EMU as a *sui generis* monetary union, rejecting comparisons and lessons from other situations and experiences, either national, bi-, or multilateral.[17] The enthusiasm demonstrated by many at the eve of the final stage of EMU, in January 1999, was justified because it was the first time in history that States preserving their international legal personality gave up their national currencies in favour of a single one, managed by a central authority in conditions excluding any kind of hegemony. The fact that this achievement was made by a group of countries, which jointly were the first trading power and had the highest GDP in the World, gave the event the prominent importance it immediately had, and the euro was ranked as the second international currency.

EMU has also been characterized by a specific combination of a monetary transfer of competences and weak economic coordination. The asymmetry between the 'M' of EMU and the 'E' is one of the dominant features of EMU.

(iii) The Asymmetry between Economic Union and Monetary Union

In 2003, long before the present crisis, two economists observed that 'the euro area economy is a unique and still untested structure'.[18] They explained further: 'A centralized monetary policy... interacts with 12 [at the time] different and politically independent fiscal authorities and 12 different labour-market systems.' Alexandre Lamfalussy, one of the fathers of EMU, has popularized the difference between the 'M' and the 'E' of EMU.[19] In an interview he remarked: 'the great weakness of EMU is the E. The M part is institutionally well organized. We have a solid framework. We don't have that for economic policy.'[20] On the one hand we have a single monetary and exchange rate policy, a single monetary policy, and an institutional creation to manage it. On the other hand,

[16] Loc cit, p 19.
[17] Op cit.
[18] C Allsopp and M Artis, 'The Assessment: EMU, Four Years on' [2004] *Oxford Review of Economic Policy*, pp 1–29, at 2.
[19] On this asymmetry, see Section III. Economic Union.
[20] *The Guardian*, 16 August 2003.

المنارة للاستشارات

economic union includes a loose[21] coordination of economic policies, a multilateral surveillance essentially based on peer control, a budgetary discipline including a code of conduct, and a procedure on excessive deficits. The authors of the Treaty deliberately wanted such an asymmetry, as we further discuss below.

The 'Delors Report' explains the philosophy inspiring them:

> Even after attaining economic and monetary union, the Community would continue to consist of individual nations with differing economic, social, cultural and political characteristics. The existence and preservation of this *plurality* would require a degree of autonomy in economic decision-making to remain with individual member countries and a balance to be struck between national and Community competences.[22]

Other reasons could be invoked to explain this situation. The principle of subsidiarity, for the first time inserted in the Treaty as a general principle, except for exclusive competences, has surely played a role: it is not by chance that this novelty coincided with the dramatic extension of the field of competences of the Union by the Maastricht Treaty. The lesson of federal systems with multi-level governance as far as economic policy is concerned has also been instrumental in limiting the ambitions for Community competences in this field. But other reasons have played a role. First, one should mention the trust in the market, as a factor of fiscal discipline, although the central bankers who formed a large majority of the members of the Delors Committee were disposed to avoid overburdening monetary policy for the achievement of price stability by imposing a strict fiscal discipline. They knew that the market was often late and too lenient in its reactions against fiscal deviations but they did not intend to provide for complementary procedures to ensure fiscal discipline. Secondly, there was the perceived necessity to leave instruments of economic policy to Member States that would lose the possibility to use exchange rate variations in order to compensate asymmetric shocks. Thirdly, Member States were reluctant to introduce institutional changes that would have been necessary in case of important transfers of competences in economic policy. Fourthly, the idea of conferring more powers on the Commission as a substitute for peer control was not very popular among governments. Fifthly, Member States were keen to avoid procedures specific to Member States having adopted the euro in order to avoid creating too divisive a regime, as, in the end, all States would adopt the euro. Sixthly, in the context of the late eighties, there were different views among economists about the need for economic coordination, the more 'liberal' among them being sceptical about the merits of economic coordination. And this period was marked by the supremacy of liberal ideas, after thirty years of Keynesianism.

[21] Although it is described as 'close' in some provisions of the Treaty. Protocol No 14 on the Eurogroup, annexed to the TFEU, called for the development of 'an ever closer coordination of economic policies in the euro area' (Preamble, first recital).

[22] Op cit, point 17, p 17. The italics are in the original text.

المنارة للاستشارات

The financial crisis has demonstrated the limitations of market efficiency and of self-regulation. A new era of enhanced regulation and surveillance is now being embraced by EU and national authorities both with regard to banking and finance and with regard to budgetary and economic policy coordination—as exemplified by the reforms undertaken in 2010 following the sovereign debt crisis that commenced in Greece and that has endangered the stability of the whole euro area.

EMU also introduced into the European Community legal order two basic features that were unknown or played a minimal role in primary law up to the Maastricht reform: differentiation and conditionality.

(iv) Differentiation and Conditionality

The concepts of differentiation and conditionality are closely linked in the realization of EMU. The Treaty submits the adoption of the single currency, the euro, to the requirement of both legal and economic convergence. Member States have to comply with a number of so-called 'convergence criteria', known as the 'Maastricht criteria'. For the first time in the history of integration, the full participation in a Community policy was submitted to conditionality, the respect of which implies the exercise of judgement in which the monetary authority and the political institutions play a more or less important role. The changeover to the final stage of monetary union before or at the deadline provided by the Treaty (1 January 1999) was only possible and future adoptions of the single currency were only allowed for those States which were considered as complying with the criteria. This regime is at the origin of a temporary differentiation between 'Ins' and 'Outs', each Member State having the obligation to take the necessary measures in order to adopt the euro and the right to accede to monetary union when it is ready. The Treaty has established a so-called regime of derogation for those States that are willing but are not yet able to adopt the single currency.

But the Maastricht Treaty introduced more radical forms of pre-determined differentiation. It allows some Member States the right to refrain from participating in common policies. The UK and Denmark benefited from such a special status. The most important ones concern EMU. As we will see, two Protocols opened the right to these two Member States to decide on their own if and when they will accept to adopt the single currency, under the conditions provided by the Treaty. These derogatory regimes are in accordance with the general attitude of these countries towards European integration. They constitute, however, an important obstacle to the international projection of the euro.

B. Some Historical Data

It is neither possible nor necessary to describe here in detail, let alone to mention all the developments that after forty years led the European Community towards

المنارة للاستشارات

monetary union.[23] It is a long succession of plans, resolutions, creation, mergers and disappearance of committees, and the adoption of other ephemeral provisions on economic and monetary coordination, all short of the qualitative change that only the transfer of monetary responsibilities from Member States to common institutions could realize. Books have been written either on the 'way to Maastricht' or on the history of monetary cooperation before the building of EMU. We will limit the description to some landmark events, starting with the Rome Treaty, then the Werner Plan, then the European Monetary System (EMS), and finally the Delors Report, which has rightly been held as the blueprint of EMU as provided by the Maastricht Treaty.

(i) The Benign Neglect of the Rome Treaty for Monetary Questions

The provisions concerning money in the Treaty establishing a European Economic Community were very limited. An author has evoked the lack of foresight of the Treaty in the field of money by observing that the EEC seemed to be an institution for happy times.[24] The reason was that the international monetary system created by the Bretton Woods Agreements provided for a fixed but adjustable exchange rate regime that guaranteed a certain stability. Monetary union was not on the agenda. Some years after the failure of the European Defence Community in 1954, the founding Member States were not prepared for the transfer of sovereignty it implied. They included in the original EEC Treaty provisions stating that par value changes were to be treated as a question of common interest (Art 107), and providing for the creation of a consultative

[23] There are a number of studies on the history of monetary cooperation and integration and very often also books that focus on the more recent developments have a chapter on preceding experiences. Among a vast literature, one should single out the books of K Dyson, written as sole author or in collaboration. Let us mention K Dyson, *Elusive Union: The Process of Economic and Monetary Union in Europe* (New edition, Longman, 2004); K Dyson and K Featherstone, *The Road to Maastricht. Negotiating Economic and Monetary Union* (Oxford University Press, 1999); D Gros and N Thygesen, *European Monetary Integration. From the European Monetary System to Economic and Monetary Union* (2nd edn, Longman, 1998); K Dyson and L Quaglia, *European Economic Governance and Policies*, 2 vol, (Oxford University Press, 2010); on the EMS, see also J van Ypersele and J-C Koeune, *The EMS: Origins, Operations and Outlook* (St James Press, 1985) (a third edition in French of this book was published by the OPOCE, Luxembourg, 1988); J-J Rey, 'The European Monetary System' (1980) CMLRev 7–30. On the negotiation leading to Maastricht, described by participants, see A Italianer, 'Mastering Maastricht: EMU Issues and How They were Settled' in K Greschmann (ed), *Economic and Monetary Union: Implications for National Policy-makers* (EIPA, 1993); J Cloos, G Reinesch, D Vignes, and J Weyland, *Le traité de Maastricht. Genèse, Analyse, Commentaires* (2nd edn, Bruylant, 1994). See also for references to the legal acts and a general presentation, RM Lastra, *The Legal Foundations of International Monetary Stability* (Oxford University Press, 2006), ch 6: History of monetary integration in Europe. For a concise description of the legal developments until 1990, see J-V Louis, *From the European Monetary System to Monetary Union* (2nd edn, OPEC, 1990).

[24] D Carreau, 'La Communauté économique européenne face aux problèmes monétaires' [1971] RTDE 586 *et seq* and 592.

المنارة للاستشارات

monetary committee, composed by representatives of treasuries and central banks, in charge of promoting the coordination of monetary policy in the measure necessary for the working of the common market (Art 105). They also provided for mutual assistance and a safeguard clause in order to remedy balance of payments problems (Arts 108 and 109).

(ii) The Werner Report as the Most Significant Earlier Attempt to Build an EMU

A plan for the realization by stages of an economic and monetary union was presented in 1970[25] by a committee chaired by the then President of the Luxembourg Government at the request of the Council after the summit of Heads of State and Government held in The Hague in December 1969. The project was presented in the context of the perceived need to deepen European integration before widening the Community by concentrating upon a new objective and to remedy the growing instability of currencies (the French Franc after the events of May 1968 and the Deutschmark, in particular) within the Community. For the final stage, the Werner Report provided a centre of decision for economic policy, concentrated in the Council, with important powers in the field of fiscal policy, and in the monetary field a 'Community system of central banks', prefigured in the first stage by a European Fund for Monetary Cooperation (EFMC). The report was a compromise between two schools of thinking known as the 'economists' and the 'monetarists'. For the 'economists', in favour of what was often called the 'coronation theory', monetary union was to be preceded by the realization of the full convergence of economic situations. It was the standpoint defended by German and Dutch authorities (that had help on this point from the UK and Denmark after their accession in 1973 to the European Community). The 'monetarist view', popular in France, Italy, Belgium, and in the Commission, agreed on the necessity of economic convergence but believed that perfect convergence as a pre-condition was not justified as monetary union could help to complement an already reasonable degree of convergence achieved in particular as a result of the *acquis* of the common market and expressed by the absence of important divergences in economic situations. The influence of this ongoing debate was notable up to Maastricht.[26]

The Werner Report left open the question of the need for a single currency and the necessity of a revision of the Treaty. By a Resolution of 22 March 1971, the Council and the representatives of the governments of the Member States[27] adopted a programme of action providing for the completion of EMU at the end of the decade, starting with the application of narrower margins between

[25] OJEC, No C136, 11 November 1970.
[26] See Dyson and Featherstone, op cit, p 29.
[27] Resolution on the achievement of the Economic and Monetary Union in the Community by stages, OJEC No C28, 27 March 1971, p 1.

المنارة للاستشارات

their currencies than those existing vis-à-vis the US dollar. A first balance of the achievements which would assure parallel progress between the coordination of economic policies and progress in the monetary field, would be undertaken in 1973. But the decision of President Nixon to suspend the convertibility of the US dollar in gold or in units defined in gold (SDR) on 15 August 1971 was the signal of the disruption of the international monetary system and an important factor, although not the only one and perhaps not the most important, in the failure of the realization of the Werner Plan. The fall of the Bretton Woods system could indeed have been seized as an opportunity for more cohesive action by the Member States of the Community. But if they agreed on the maintaining of a (facultative) mechanism for narrowing the margins between their currencies (the monetary snake) and the creation of an EFMC in 1973,[28] they quickly gave up the intention to enable the Fund to progress towards what was called the institutional stage. The EFMC remained an instrument limited to the accountancy of interventions in the market and credit mechanisms in the functioning of the ERM. Monetary cooperation was, as before, the responsibility of both the Monetary Committee and the Committee of central bank governors, sitting in Basle, that, from 1964 to 1994, was at the centre of the collaboration among central banks of the Community, without decision-making powers.

Member States reacted nationally, after the Yom Kippur war of October 1973, to the energy and financial crisis of the seventies. They were more than ever reluctant about the transfer of sovereignty implied by monetary union.

The next step was a very cautious one aimed not at the creation of a monetary union but at the realization of monetary stability.

(iii) The European Monetary System (EMS)

The lack of response to a Florence lecture on relaunching the monetary union made by the then president of the Commission, Roy Jenkins, during the autumn of 1977 further demonstrated that minds were not prepared for such an ambitious step. This partially explains the success of a more modest but substantial enterprise: to make of the Community an area of monetary stability with the perceived objective of infusing fiscal discipline through external constraints. The EMS[29] was based on a Resolution of the European Council of 5 December 1978, two Council regulations, and an agreement of 13 March 1979

[28] Regulation establishing a European Fund for Monetary cooperation of 3 April 1973, OJEC, No L89, 5 April 1973. On the legal aspects of the EFMC and the perspectives at the time of its creation, see C-D Ehlermann, 'Die Errichtung des europäischen Fonds für währungspolitische Zusammenarbeit' [1973] *Europarecht* 193 *et seq*; J-V Louis, Le Fonds européen de coopération monétaire' [1973] CDE 255 *et seq*.

[29] On the EMS, see Lastra, op cit, pp 183–6.

المنارة للاستشارات

among central banks.[30] It included a unit of account based on a basket of Community currencies, the ecu (originally an acronym for European Currency Unit), an exchange rate mechanism (ERM 1), and credit mechanisms. Each currency had a central rate denominated in ecu that served also as the basis for a divergence indicator[31] among the currencies, a denominator of the operations in the framework of both the interventions in the ERM 1 (in order to maintain the margins of fluctuation of 2.25 % among the currencies), and in the credit mechanism, and a means of settlement between the monetary authorities of the Community. Changes in central rates were made under a common agreement in which the monetary committee played an important role. Participation in the ERM 1 was not compulsory. Not all the currencies participated from the beginning and some left it and reintegrated it after having left for a while.

The EMS experienced a number of crises, due to some important episodes of speculation, the most severe after the signing of the Maastricht Treaty, in September 1992, when an overvalued Sterling Pound was forced out of the ERM by speculation (a rather dramatic story which at the time gave ample publicity to Soros Quantum Fund, and which became a high profile case that marked an auspicious beginning for hedge funds in Europe). Another crisis that almost resulted in the death of the System took place in August 1993; after this crisis, an agreement was reached to enlarge the margins to 15 per cent in order to stop the speculation. Nevertheless, the EMS contributed, as a whole during some twenty years of existence, to the development of a culture of stability. It had a stabilizing effect upon national public finances. But it had important weaknesses, such as the reversibility of the subscribed undertakings and the absence of common views on the binding character of its provisions for the participating currencies. The development of intra-marginal interventions, with the adoption of the so-called Basel-Nyborg agreements at the end of the eighties did not stop speculation despite the progress made to add flexibility to the System.

(iv) The Single European Act (SEA) and the Delors Report

The former plans for an EMU had left unanswered the question of the necessity of a revision of the Treaty in order to build it. To this question, the SEA, signed in 1986, gave a straightforward answer in Article 102A on the 'monetary capacity' of the Community. This Article provided, in its second paragraph, the

[30] See Resolution of the European Council of 5 December 1978 on the establishment of the European Monetary System (EMS) and related matters (1978) *Bulletin of the European Communities*. December, No 12, pp 9–13; Regulations Nos 380 and 381/78, 18 December 1978, OJEC, No L379, 30 December 1978 (and their modifications); Agreement of 13 March 1979 between the central banks of the Member States of the European Economic Community laying down the operating procedures for the European Monetary System (and its modifications).

[31] This innovation on the preceding snake was intended in order to get a more balanced regime imposing obligations not only on the weak currencies but also on the strong ones. This novelty was not successful. Furthermore, the ecu did not succeed either in multilateralizing the mechanism that remained for the participating currencies a DM regime.

المنارة للاستشارات

necessity for a formal revision of the treaty in so far as the ulterior development on economic and monetary policy would require institutional modifications. Some interpreted this provision like a brake or, perhaps rather, an obstacle on the road to a possible EMU. For others, the accent set in the first paragraph on a dynamic vision of monetary cooperation and the references to the experiences acquired with the ecu and the EMS, as well as the subtitle given to this provision on 'Monetary capacity (EMU)' and related paragraphs in the Preamble were encouraging.

Two years after the signing of the SEA, and in the middle of the period assigned for the completion of the single market in 1992, the building of an EMU came forcefully back to actuality. French Prime Minister Balladur and the German Presidency of the first semester of 1988, with Kohl as Chancellor and Genscher as Minister for Foreign Affairs, published political statements in favour of monetary union. Germany pushed for the adoption of the Directive on the realization of free movement of capitals, on which political agreement was reached within the Council in June 1988. Meeting at Hanover on 27 and 28 June, the European Council gave to a committee chaired by Jacques Delors, the President of the Commission, and composed of the twelve governors of the NCBs, sitting in their personal capacity, with Frans Andriessen, Vice President of the Commission, Miguel Boyer, a former Spanish minister, Prof Alexandre Lamfalussy, general manager of the BIS, and Prof Niels Thygesen, a Danish expert, the mandate to prepare a report on the realization by stages of an EMU, in similar terms to the mandate given eighteen years before to Pierre Werner. Later on the committee appointed Gunter D Baer and Tommaso Padoa-Schioppa as rapporteurs. The conjunction of the adoption of the Directive on the freedom of movement of capital and the decision to appoint the Delors committee on EMU was not fortuitous. It appeared as a confirmation of the so-called inconsistent quartet developed by Tommaso Padoa-Schioppa in earlier writings: it is impossible to claim the durable achievement of exchange rate stability, free movement of capital, and free movement of goods while maintaining at the same time a loose monetary cooperation.[32] Or to put it more bluntly, the complete realization of the freedom of movement of capital requires a strong monetary cooperation, and in the long run a monetary union. On the other hand, a monetary union is not conceivable without free movement of capital in order to avoid distortions in the transmission of a centralized monetary policy.

The Delors committee unanimously adopted its report on 12 April 1989. The European Council meeting in Madrid on 26 and 27 June 1989 decided that the report represented a good basis for the follow-up of the work.

For the Delors Report, 'Economic union and monetary union form *two integral parts of a single whole* and would therefore have to be implemented in

[32] See T Padoa-Schioppa *et al*, *Efficiency, Stability and Equity* (Oxford University Press, 1987).

المنارة للاستشارات

parallel' (point 21) but 'Perfect parallelism at each and every point of time would be impossible and could even be counter-productive' (point 42). The report adopted a less centralized view than the Werner Report of 1970 on economic policy, which must be based on the market (point 25) though the market *per se* cannot realize the coherence necessary for the success of EMU. Hence the necessity of combining a competition policy that 'would have to operate in such a way that access to markets would not be impeded and market functioning not be distorted by the behaviour of private or public economic agents' (point 28). The role of regional and structural policies was also stressed in order to promote 'an optimum allocation of resources' (point 29). 'Macroeconomic policy is the third area in which action would be necessary for a viable economic and monetary union' (point 30). 'Many developments in macroeconomic conditions would continue to be determined by factors and decisions at national or local level.' But the report observed that 'uncoordinated and divergent national budgetary policies would undermine monetary stability and generate imbalances in the real and financial sectors of the Community' (ibid).

The report insisted on 'the shift from national monetary policy to a single monetary policy', which 'is an inescapable consequence of monetary union and constitutes one of the principal institutional changes' (point 24). It proposed the creation of 'a new monetary institution' (point 32) with the 'full status of an autonomous Community institution' that would be called a European System of Central Banks (ESCB) and operate 'in accordance with the provisions of the treaty'. It is remarkable that for the report, this new 'institution' would not only be responsible for monetary policy but also for managing 'the Community's exchange rate policy *vis-à-vis* third currencies'. The System would be committed to the objective of price stability and subject to the foregoing, it would support the general economic policy set at the Community level by the competent bodies (point 32). These formulas are very close to the objectives that would be assigned to the ESCB by the Maastricht Treaty.

Other elements in the report concerned the content of the successive stages for the realization of EMU and the procedure to be followed. In the first stage, the main element was the full implementation of the freedom of movement of capital and the second stage was conceived as an 'administrative' preparation of the final one. The transitional arrangements were not detailed in the Delors Report. It would be for the IGC to find a compromise solution which included the creation of the European Monetary Institute (EMI).[33] The Delors Committee

[33] The EMI that started its activities in 1994 was a body of transition. Its status was provided in a special Protocol that the Treaty of Nice abrogated. It replaced the Committee of NCBs Governors and ceased to exist with the creation of the ECB on 1 June 1998. Chaired by an independent president who was not actually leading a NCB, its council included all the NCBs Governors of the Community. National authorities remained during this period responsible for their respective national monetary policy. The EMI was only in charge of promoting monetary policy cooperation. It

المنارة للاستشارات

described the process of realization of EMU as a continuum: once the process commenced it would carry on until its completion. Nevertheless it left the possibility for the Member States to conclude two treaties, one that would include the principles and the second one that would implement the first with the inherent risk of putting the whole process in jeopardy. It also was impossible for the Committee to unanimously agree on a deadline for the changeover to the final stage. Those in the Committee who believed in the primacy of convergence objected to the fixing of a date. On these two points—one or several treaties, and the adoption of a deadline—the IGC was surprisingly able, at the last moment, to make a decision.

C. The Last Steps to Maastricht and the Entry into Force of the Treaty

(i) The Preparation of the IGC

The Madrid European Council that approved the Delors Report in June 1989 as a good basis for the negotiation of an IGC also mandated the committee of central bank governors to prepare the statute of the ESCB and the ECB. Under the French Presidency of the second semester of the year, a high level committee under the chairmanship of Mme Elisabeth Guigou, a close collaborator of President Mitterrand, was charged with preparing a report that would make an inventory of questions that the future IGC would have to resolve. This report was presented on 30 October 1989.[34] The European Council, meeting in Strasbourg on 8 and 9 December 1989, four weeks after the spectacular fall of the Berlin Wall, observed that a majority was met for the convocation, before the end of 1990, of an IGC for the revision of the EEC Treaty. In the meantime, the idea of the necessity of an IGC on political union progressed due to the dramatic evolution on the Continent. It was decided at the European Council of Dublin to provide for two parallel conferences: one on EMU and one on political union. Eleven governments adopted in Rome on 27 and 28 October 1990 the mandate of the IGC on EMU (the so-called Rome I mandate). In December 1990, the European Council decided on the mandate for the IGC on political

had limited decision-making power. It exercised the competences exercised in the past by the EFMC (dissolved on the entry into force of the Maastricht Treaty) in the management of the ERM and credit mechanisms but its main responsibility was to prepare the legal, institutional, economic, and logistical framework for the ECB in order to enable the new monetary authority to exercise in full its responsibilities right from the beginning of the final stage of EMU. To this end, it used the instrument of recommendation of decisions that it presented to the ECB for their adoption in the form of binding legal acts. It had also to give opinions on draft national or Community regulations in its field of competence and opinions, in parallel with the Commission, assessing the sustainable convergence of the economy of a Member State with a view to its adoption of the euro.

[34] It could appear as a duplication of the work of the Delors committee but it was needed in order to implicate national decision-makers, the future actors of the IGC, on questions treated up to that point by central bankers and other experts who had no political responsibilities. Gros and Thygesen, op cit, p 406.

المنارة للاستشارات

union. The negotiation on both IGCs was concluded in December 1991 and the Treaty was signed in Maastricht on 7 February 1992. It entered into force on 1 November 1993, after a difficult process of ratification.

(ii) The Ratification of the Maastricht Treaty

The Maastricht Treaty required a revision of the Constitution in some Member States and in a few of them the holding of a referendum.[35] A first negative referendum in Denmark in June 1992, that needed the holding of a second one after the adoption of a decision allowing for special status for that country by the European Council on 11 and 12 December 1992 and an appeal to the Constitutional Court in Germany which was ended by a decision of the Court on 12 October 1993,[36] favourable in its conclusion to the constitutionality of the Treaty, delayed its entry into force that was originally planned for 1 January 1993. The so-called '*Maastricht Beschluß*' has an importance beyond EMU, as it provides for a doctrine based on the democracy requirement for the legitimacy of the participation of Germany in European integration. More specifically, the Court stresses the concept of EMU as creating a Community of stability and, in that perspective, it insists on the respect of the convergence criteria. The accent set on convergence led the Court to conclude that the deadline fixed by the

[35] The Treaty was approved in France by a '*loi référendaire*' that was voted by the French people by a very close majority after a revision of the Constitution, considered to be necessary by the '*Conseil constitutionnel*'. A referendum was organized in Ireland, following a tradition established under case-law ('*Crotty*') deriving from the time of the ratification of the SEA. Two referendums were necessary in Denmark as we mention in the text. Minor constitutional reform took place in Portugal and an interpretative provision was added in the Greek Constitution. Germany adopted a new '*Europa Artikel*', article 23, that confirmed the 'European' vocation of the country while at the same time it provided for specific limits, and amended article 88 of the *Grundgesetz*, on the Bundesbank in order to provide the possibility of conferring competences to the ECB. The reader will find in other parts of this Manual information on the relationship of EU law and national Constitutions. Most of the pertinent decisions of supreme courts are reproduced in A Oppenheimer, *The Relations between European Community Law and National Law*, vol. 1 (Cambridge University Press, 1994). J Rideau, *Droit institutionnel de l'Union et des Communautés européennes*, 6th ed. (LGDJ, 2007), provides for an analysis of the situation of all the Member States.

[36] On this decision, see J Baquero Cruz, 'The Legacy of the Maastricht-Urteil and the Pluralistic Movement' (2008) ELJ 389–422. A first commentary concerning the EMU aspects of this decision was written by R Smits, 'A Single Currency for Europe and the Karlsruhe Court' (1994) 1 *Legal Issues of European Integration* 115–33. It is interesting to observe that the Constitutional Court rejected an appeal against the decision of German authorities concerning the changeover to the euro, that was considered as done in conformity with constitutional requirements, see the decision of 31 March 1998, Cases Nos 2BvR 1877/97 and 50/98, in Andrew Oppenheimer op cit, *The Relations* . . . , vol 2 (2003), pp 258–85. The next decision of the Constitutional Court that was important for EMU was the 'Lisbon Decision' on the compatibility of the law of approval and constitutional laws of implementation of the Lisbon Treaty with the Constitution (2 BvE 2/08, 30 June 2009). While pronouncing in favour of the constitutionality of the Treaty, the Court insisted on the responsibility of the legislative organs of Germany which have to retain sufficient room for the political formation of the economic, cultural, and social circumstances of life for the sake of preserving democracy, see point 249. It judged in particular that 'fundamental fiscal decisions on public revenue and public expenditure' are to be democratically shaped in a constitutional State (point 253). We will refer later to more recent decisions of the Constitutional Court referring to the imperatives of democracy.

المنارة للاستشارات

Treaty for the realization of monetary union could not be held legally binding. The Treaty did not create a process that would lead to the single currency in an automatic and unforeseen way, and without the participation of Germany (and hence of the *Bundestag*). The Treaty offered sufficient guarantees for the maintaining of stability but one could not exclude a situation in which the Community would no longer be a '*Stabilitätgemeinschaft*'. If this were to occur, Germany would be authorized to withdraw from the Community. This decision, which alternates positive appreciations of the Treaty with a kind of nationalist flavour in the name of democracy, had a great impact in discussions about constitutionalism, primacy, and pluralism and found supporters in Denmark and in the new democracies that acceded to the Union after the fall of communism.

D. The EMU as Part of the Community Law Core of the Treaty

It is historically interesting to observe that contrary to the new domains of CFSP and Justice and Home Affairs, introduced in the new TEU in Maastricht, EMU was conceived as a part of the EC Treaty,[37] governed by Community law. EMU was mentioned in Article 2 ECT next to the single market and common actions for the realization of the public goods mentioned in this Article. In contrast with the Treaty establishing a Constitution for Europe, the establishment of an economic and monetary union of which the euro is the currency figures as an objective of the EU, in Article 3, paragraph 3, of the EU Treaty, as modified by the Lisbon Treaty. This provision places the single currency in a prominent position. It was already the case of the Maastricht Treaty that on repeated occasions made reference to EMU or to the single currency, the 'ecu' later on to be denominated the 'euro'.[38]

The other provisions on EMU are in the TFEU and not in the new TEU. The institutions play their traditional role in EMU, although with some specificities, as, for example, the importance of recommendations in lieu of proposals of the Commission in various provisions and the consequent greater role of the Council. As we will see, the authors of the Treaty have submitted the ECB to judicial control by the Court of Justice and the legal acts of the ECB have the same legal bearing as the acts of the Union under the TFEU. EMU was fully integrated into the Community (now Union) legal order. It was not conceived as an "intergovernmental pillar" as Justice and Home Affairs and Common Foreign and Security Policy were up to the entry into force of the Lisbon Treaty.[39]

[37] Some French authorities would have preferred to insert EMU in a special pillar, outside the EC Treaty, see C Balleix-Barnejee, *La France et la Banque centrale européenne* (PUF, 1999), p 156.

[38] See the Preamble of the Maastricht Treaty, Art 2 TEU and Arts 4, 117, 121, 123 TEC.

[39] As a matter of fact, CFSP remains a *sui generis* form of intergovernmental cooperation. Declarations adopted with the signature of the Lisbon Treaty confirm the special nature of CFSP, which, contrary to the former 'Community' aspects of external action, is inserted in the new TEU, breaking the unity of the matter that was one of the innovations of the Treaty establishing a Constitution for Europe.

المنارة للاستشارات

II. The Adoption of the Euro: Conditions and Procedure

A. Generalities

The procedure for the adoption of the euro answers to an implicit but fundamental principle according to which every State able to participate has to have the possibility of doing so. In other terms, the euro area is not a closed club but each of its members has to be submitted to the same rules.[40] The European Council in its Madrid meeting of 15 and 16 December 1995 recalls this 'Treaty requirement' that 'Member States entering the Euro area after 1999 should be able to do so on the same terms and conditions as those applied in 1998 to the initial participating Member States'. This explains the rule providing, as we will see, that a Member State with a derogation can ask the Commission (at any time) to address to the Council a proposal for the adoption of the euro by this Member State under Article 140 TFUE.

The participation in the euro area is a right but also an obligation for each Member State except for the UK and Denmark, to which protocols have conferred a special status. But States have a margin of discretion in order to determine the timetable of their preparation towards the single currency. Nevertheless, as members of the EU they have to orientate their policy towards the adoption of the euro as the aim of their economic policy and prepare a timetable and a changeover plan in this regard.

B. The Changeover to the Monetary Union

On 1 May 1998, the Council abrogated the decision on excessive deficit (as we will see, one of the convergence criteria was related to the prohibition of excessive deficits) of Belgium, Germany, Austria, Spain, France, Italy, Portugal, Sweden, and the UK.[41] The same day, the Council adopted a recommendation, under Article 121, paragraph 2 ECT favourable to the changeover to the single currency and the European Parliament adopted an opinion on this recommendation.[42] On 3 May 1998, the Council, meeting at the level of Heads of State and Government decided, in conformity with the procedure laid down at Article 121, paragraph 4 ECT, that eleven Member States fulfilled the conditions necessary for adopting the single currency.[43] The same day the Heads of State and Government of the Member States adopting the single currency reached a

[40] F Allemand, 'Les nouveaux Etats membres face à l'euro. Des destins séparés ?' [2007] 38 *Revue d'études comparatives est-ouest* March 69–102.

[41] [1998] OJ L139, 11 May 1998, p 21. There was no decision on excessive deficits for Ireland, Luxembourg, and The Netherlands.

[42] [1998] OJ C67, 1 June 1998.

[43] Decision 98/317 of the Council, 3 May 1998, [1998] OJ L139, 11 May 1998, p 30. These Member States were Belgium, Germany, Spain, France, Ireland, Italy, Luxembourg, The Netherlands, Austria, Portugal, and Finland. Among the twelve Member States without a special

المنارة للاستشارات

political agreement on a recommendation for the appointment of the president and the members of the Executive Board of the ECB and, after hearings by the European Parliament, the Heads of State and Government appointed them, on 26 May 1998.[44] The ECB was created on 1 June 1998. The EMI immediately entered into liquidation and on 31 December 1998, the Council adopted a decision irrevocably fixing the conversion rates of the currencies of the participating Member States in the euro, which became the single currency on 1 January 1999. On 1 January 2002, banknotes and coins denominated in euro started to circulate in the twelve Member States that had adopted the single currency at the time (Greece had joined on 1 January 2001). The timetable provided by the scenario laid down by the European Council in Madrid on 15 and 16 December 1995 was completed. Slovenia, in 2007, Cyprus and Malta, in 2008, Slovakia in 2009, and Estonia, in 2011, subsequently adopted the euro. Seventeen EU Member States have now adopted the euro as their single currency.

The procedure applicable before 1 January 1999, the ultimate deadline fixed by Article 121, paragraph 4 of the ECT and Protocol 10 (abrogated by the Lisbon Treaty) for the adoption of the single currency, differed on some points with regard to the procedure applicable since the establishment of monetary union and the Lisbon Treaty has brought some amendments to the EC Treaty in this respect in Article 140 TFEU. But the basic principles remain.

Article 140 TFEU provides that

> 1. At least once every two years, or at the request of a Member State with a derogation, the Commission and the European Central Bank shall report to the Council on the progress made by the Member States with a derogation in fulfilling their obligations regarding the achievement of economic and monetary union.

As specified by their respective Protocols, such reports will only have been made at their request for the Member States (Denmark and UK) with a special status.

C. The Convergence Criteria and the Reports of the ECB and the Commission

They include an assessment of the compatibility of national legislation with Articles 130 and 131 of the TFEU and of the achievement of 'a high degree of sustainable convergence' of the economic situation of the applying Member State. The ECB (succeeding the EMI in this responsibility) and the Commission make these assessments in their respective reports. These reports contemplate the compliance by each Member State with the economic convergence criteria, as laid down by the Treaty and a Protocol annexed to the Treaty. The final

status (the UK and Denmark), only Greece and Sweden were left behind. Greece adopted the euro on 1 January 2001.

[44] Decision 98/345, 26 May 1998, [1998] OJ L154, 26 May 1998, p 33.

المنارة للاستشارات

decision pertains to the Council. Member States which have not yet adopted the euro are called Member States 'with a derogation'. We will examine successively these different elements. But before entering into this analysis, we would like to stress the 'guiding principles' that are applied both by the ECB and its predecessor, the EMI, in the analysis of the compliance with the convergence criteria. Quoting from earlier reports, the EMI 1998 convergence report[45] announced that:

> First, the individual criteria are interpreted and applied in a strict manner. The rationale behind this principle . . . is that the main purpose of the criteria is to ensure that only those Member States which have economic conditions that are conducive to the maintenance of price stability and the viability of the European currency area should participate in it. Second, the convergence criteria constitute a coherent and integrated package and they must all be satisfied; the Treaty lists the criteria on an equal footing and does not suggest a hierarchy. Third, the convergence criteria have to be met on the basis of current data. Fourth, the application of the convergence criteria should be consistent, transparent and simple. Moreover, it is emphasized again that compliance with the convergence criteria is essential, not only at a specific point in time, but also on a sustained basis. In this vein, the country reports elaborate on the sustainability of convergence.

The necessity of complying with criteria explains the position taken by the Community against 'Euroization', ie the spontaneous adoption of the euro by a third country. The ECB Governing Council adopted a 'Policy position on exchange rate issues relating to the acceding countries' on 18 December 2003. This position refers to a report of 8 November 2000, submitted by the ECOFIN Council to the European Council meeting in Nice, of December 2000. For the Governing Council: 'Any unilateral adoption of the single currency by means of "euroisation" outside the Treaty framework would run counter to the economic reasoning underlying Economic and Monetary Union, which foresees the eventual adoption of the euro as the end-point of a structured convergence process within a multilateral framework. Unilateral "euroisation" cannot therefore be a way of circumventing the stages foreseen by the Treaty for the adoption of the euro.'

D. Legal Convergence

The requirement of legal compatibility of national legislation with central bank independence (Article 130 TFEU) and the provisions of the Treaty (Articles 130 and 131 TFEU) and the Statute of the ESCB and the ECB are less known than the economic convergence often alluded to as the 'Maastricht criteria'. But one should not underestimate the importance of legal convergence. The independence of the NCBs is as crucial for the System as the independence

[45] EMI. Convergence Report, March 1998, p 3.

المنارة للاستشارات

of the ECB itself, because their governors have to decide on monetary policy without undue influence exercised on them and the Eurosystem cannot function if central banking law and other legislation do not allow for a smooth integration in the System. The work of EMI contributed to clarifying the extent of the obligations of the State in this regard.[46] It laid down basic principles and developed with examples the criteria that would allow it to report to the Council.

Neither the Treaty nor the Statute impose on the new participants an obligation to harmonize their national legislation. Member States could preserve their specificity if it does not jeopardize either the independence of the NCB or its integration into the System. NCBs could preserve their legal form and their respective organization. Some, such as the Nederlandsche Bank, have the legal form of companies limited by shares but the sole shareholder is the State. Others have also shareholders other than the State, such as Italy, Greece, and Belgium. Most are public institutions owned by the State and have the form of public bodies, as in Germany, France, the UK, and so on. There is no typical scheme for NCBs that are members of the System although through the convergence reports and the opinions delivered on draft national legislation, the ECB has drawn the features of a euro area kind of central bank. If important changes have been made to the organization of the NCBs before or at the time of the adoption of the euro, they were mainly justified by the evolution in the context of payment systems and the progress in technology. Furthermore, NCBs are allowed to preserve responsibilities not pertaining to the System provided they do not create obstacles to the functioning of the System (Article 14.4 of the Statutes).

What is essential apart from the realization of the independence of the NCB is the availability of all the instruments allowing the NCB to implement the monetary policy as adopted by the ECB and the introduction in their statutes of enough flexibility in order to smoothly implement possible modifications of these instruments.

In practice, the reports of the ECB look also at other questions, such as the spelling of the euro that has, in principle, to be identical in every language[47] and other aspects such as the respect of the prohibition of monetary financing provided by Article 123 TFEU. The reports of the Commission distinguish between the fulfilment of the objectives of monetary policy, independence, and legal integration as well as the prohibition of monetary financing.

[46] See, in particular, EMI, *Legal Convergence in the Member States of the European Union as at August 1997*. Frankfurt, October 1997. The documents of the EMI as well as those of the former Committee of Central Bank Governors of the EC are available on the website of the ECB: <http://www.ecb.int> accessed 15 March 2013.

[47] The Cyrillic alphabet and spelling posed the greatest problems in this regard. See also the Opinion of the ECB of 13 November 2012 on the spelling of the single currency (CON/2012/87), to be published in the Official Journal. This opinion answers a request from the Latvian Minister of Justice. The Cyrillic alphabet is used in the new series of euro banknotes, starting in 2013.

المنارة للاستشارات

The obligation for Member States to consult the ECB on draft legislation in the fields of its competence (under Article 127, paragraph 4 TFEU; Article 105, paragraph 4 ECT; Article 4 of the Statutes) plays a great role in the convergence of legislative provisions. It allows for the ECB to specify its doctrine in questions which are sometimes delicate.[48]

A sensitive issue was the timing of the adaptation of the NCBs' legislation because the Treaty gave ambiguous indications in this respect (cf. Articles 109 and 116, paragraph 5 ECT). The EMI decided that participating Member States should have achieved the independence of their NCB at the time of the constitution of the monetary authority (in June 1998) but that the legislation allowing for the integration into the System should be in force at the time of the functioning of this authority (ie 1 January 1999). In its reports concerning Sweden and the Member States admitted in the EU in 2004 and 2007, the ECB decided that NCB independence should be realized at the moment of this accession and full legal integration when the integration to the System becomes effective, ie when the Member State concerned adopts the single currency.

The concept of independence has many facets.[49] This matter will be treated below in the part relating to the ECB because Article 131 TFEU (ex Art 108 ECT) concerns the whole System, both the NCBs and the ECB.

E. Economic Convergence

(i) Generalities

Criteria of economic convergence aim at measuring the degree of so-called 'nominal convergence'. They concern the level of inflation, the state of public finances, exchange rate stability, and the sustainability of convergence as reflected in long-term interest rates. What is, in this context, the possible role of 'real convergence', ie the catching up of per capita incomes and the adjustment of economic structures in order to make them comparable to those of the euro area countries? These questions were raised in particular by the situation of the Member States that became EU members in 2004 and 2007. There are obvious links between both types of convergence. The Resolution of the European Council of 16 June 1997 on the establishment of an exchange rate mechanism in the third stage of economic and monetary union observed that '[l]asting convergence of economic fundamentals is a prerequisite for sustainable exchange-rate stability' or, more generally, in the words of an Executive Board member of the ECB: 'real convergence has important

[48] See L Bini Smaghi, 'Central Bank Independence in the EU: From Theory to Practice' (2008) EurLJ 446–60.

[49] See RM Lastra, 'The Independence of the European System of Central Banks' (1992) 33(2) *Harvard International Law Journal* 475–519 for a seminal article on the subject.

المنارة للاستشارات

implications for nominal convergence'.[50] An unbalanced growth can degenerate into overheating and jeopardize price stability. Both convergences are complementary but as they are susceptible to create tensions, they must be pursued simultaneously.[51] However, since the convergence criteria—as defined by the Treaty—are nominal ones, it is through the bias of sustainability of the performance that the convergence reports may touch on real convergence of the economies.

What the Treaty requires is a 'high degree of sustainable convergence'. It is not enough to fulfil the criteria at a given moment. The ECB insists in its convergence reports on the importance of the quality and integrity of statistics. It is particularly true for statistics on public finances.[52] Their establishment and their declaration should not to be submitted to political and electoral rotations.[53] The ECB has inserted an annex on statistic methodology on convergence indicators.[54]

Finally, we should once again draw attention to the 'Treaty requirement', stressed by the European Council, at its Madrid session of 15–16 December 1995, 'that Member States entering the Euro area after 1999 should be able to do so on the same terms and conditions as those applied in 1998 to the initial participating Member States'. This principle must in particular be kept in mind while looking at the application of the criteria.

(ii) Price Stability

Price stability is mentioned as an objective of the EU in Article 3, paragraph 3 of the new TEU. It is the main objective assigned to the ECB and the Eurosystem, as provided by the Treaty and the Statutes. It is not surprising in this context to see 'price stability' as the first convergence criterion.

[50] Lorenzo Bini-Smaghi, 'Real Convergence in Central, Eastern and South-Eastern Europe', speech, Frankfurt, 14 November 2007.

[51] Gertrude Tumpel-Guderell, ECB Executive Board member, 'ECB's Monetary Policy Issues in the Run-up to enlargement', speech made at Kronberg on 14 November 2003, before the monetary commission of the European League for Economic Cooperation and reproduced on the website of the ECB.

[52] The present crisis of Greek public finances has once again revealed the importance of reliable statistics.

[53] See for example, ECB. Convergence Report 2004, p 6.

[54] See also European Commission. Recommendation on independence, integrity and responsibility of national and Community statistic bodies, EC/COM/2005/217 def. 25 May 2005. It is well known that the quality of statistics presented by Greece for the adoption of the euro has been contested and that the country has recently met with criticism and a legal procedure activated by the Commission for erroneous or falsified fiscal statistics. See the recent Council Regulation (EU) No 679/2010 of 26 July 2010 amending Regulation (EC) No 479/2009 as regards the quality of statistical data in the context of the excessive deficit procedure, [2010] OJ L198, 30 July 2010, p 1 and Regulation (EU) No 1173/2011 of the European Parliament and of the Council of 16 November 2011 on the effective enforcement of budgetary surveillance in the euro area, [2011] OJ L306, 23 November 2011, p 1, chapter V, Sanctions concerning the manipulation of statistics, Art 8. This Regulation is part of the so-called 'six-pack', see below.

المنارة للاستشارات

Article 140, paragraph 1, 1st indent TFEU defines this criterion:

> the achievement of a high degree of price stability; this will be apparent from a rate of inflation which is close to that of, at most, the three best performing Member States in terms of price stability.

This provision—as for each of the criteria—has to be analysed in the light of Protocol No 13 on convergence criteria. Under Article 1 of this Protocol:

> The criterion on price stability referred to in the first indent of Article 140(1) of the Treaty on the Functioning of the European Union shall mean that a Member State has a price performance that is sustainable and an average rate of inflation, observed over a period of one year before the examination, that does not exceed by more than 1 ½ percentage points that of, at most, the three best performing Member States in terms of price stability. Inflation shall be measured by means of the consumer price index on a comparable basis taking into account differences in national definitions.

Price stability appears in this definition as a relative criterion. Its realization has to be judged in relation to the inflation rate of three Member States. What does 'best performance' mean in this context, if we know that deflation is as bad as inflation? This question is of some importance, considering the economic crisis that started in 2008. The Commission, in its Convergence Report 2006, confirms that countries in deflation should not be taken into consideration for the calculation because the Treaty refers to inflation.

Another question was raised: is the calculation based on the median rate of the three best performing countries or is it enough for the Member State concerned that it should not exceed by 1.5 per cent in relation to one of these three countries? The practice has opted for the more logical median rate. It is a non-weighted median, no matter whether the three best performing countries are 'big' or 'small' ones.

The best performing Member States are not necessarily members of the euro area. Economists have criticized this fact which they qualified as 'perverse'. It has been written that 'the only inflation rate that matters from an economic point of view' is the average inflation rate of the euro area.[55] The Commission appeared to share this view in its Convergence Report 2000 but nothing seemed to have changed in practice and the ECB has never been favourable to any measure that would appear to be relaxing the convergence criteria. The practice adopted since the beginning is consolidated by the application of the principle of equal treatment that a change, without an unforeseeable revision of the Treaty, would seem to disregard.[56]

Neither the ECB nor the Commission limit themselves in their reports to a mechanical comparison of inflation rates during the period of reference. The

[55] See W Buiter and A Sibert, 'Europe must relax its inflation test for euro entrants', *FT.com*, 4 May 2006.
[56] F Allemand, op cit.

المنارة للاستشارات

ECB, in particular, draws attention to the orientation of monetary policy and the effects of the economic environment on the achievement of price stability. It also conducts an analysis of the perspectives of price evolution in the next few years as well as an examination of structural aspects necessary for maintaining price stability.[57] It is the absence of sustainable price stability that led the ECB and the Commission to conclude that Lithuania did not comply with the criterion, although its inflation rate during the reference period of April 2005 to March 2006 was only 0.01 of a percentage point superior to the reference value. The perspective, confirmed by posterior evolution, was of a progressive rise in inflation in the months to come.

(iii) Stable Public Finances

The criterion on the situation of public finances is defined by reference to the rule imposing on the States the requirement to avoid excessive deficits. Under Article 140, paragraph 1, 2nd indent:

> the sustainability of the government financial position; this will be apparent from having achieved a government budgetary position without a deficit that is excessive as determined in accordance with Article 126(6).

Article 2 of Protocol No 13 on the convergence criteria specifies:

> The criterion on the government budgetary position... shall mean that at the time of the examination the Member State is not the subject of a Council decision under Article 126(6) of the said Treaty that an excessive deficit exists.

This double reference to Article 126(6) on excessive deficits justifies the treatment of the matter in the context of budgetary discipline under the section reserved to economic policy coordination and surveillance. The provision of the Protocol could give the impression that the reports could only observe either that there is no decision of the Council on excessive deficit for the State concerned, and if the situation has not changed, conclude on compliance with the criterion, or that there is a decision and the Commission should propose its abrogation if there is no longer any deficit. In practice, the ECB, which can only observe the existence of a procedure for excessive deficit, will, in the framework of the analysis of the sustainable character of the convergence, look at the main indicators related to budgetary evolution in the eight preceding years, analyse the perspectives and the challenges to cope with, and concentrate on the evolution of the deficit and of the public debt.[58] Its examination will also be prospective in the light of budgetary perspectives for the current year, the medium-term budgetary strategy as it results from the convergence programme, and the projections towards a situation close to balance, as provided by the

[57] See ECB. Convergence Report 2008, May 2008, p 9. See also European commission, Convergence Report 2008, p 40.
[58] See, for example, ECB. Convergence Report 2004, p 10.

المنارة للاستشارات

Stability and Growth Pact. These elements should now be read while considering the reform of the Stability and Growth Pact realized by the so-called 'six-pack' and of the adoption of the Treaty on stability, coordination, and governance in the economic and monetary union.[59]

(iv) Exchange Rate Stability

The exchange rate stability criterion is defined by Article 140, paragraph 1, 3rd indent as:

> the observance of the normal fluctuation margins provided for by the exchange-rate mechanism of the European Monetary System, for at least two years, without devaluing against the euro.

Protocol No13 adds in its Article 3:

> The criterion on participation in the Exchange Rate mechanism of the European Monetary System referred to in the third indent of Article 140(1) of the said Treaty shall mean that a Member State has respected the normal fluctuation margins provided for by the exchange-rate mechanism on the European Monetary System without severe tensions for at least the last two years before the examination. In particular, the Member State shall not have devalued its currency's bilateral central rate against the euro on its own initiative for the same period.

These texts raise some questions of interpretation. The first and more delicate one concerns the concept of 'normal fluctuation margins'. For the authors of the Maastricht Treaty, these margins were the ones used in the ERM 1 under the EMS: 2.25 per cent. The normal margins were the narrow margins. But, since the crisis of the ERM1, in August 1993, margins were 'temporarily' enlarged to 15 per cent and for some Member States as well as for some economists,[60] these margins have become the 'normal' margins under the ERM. For the Council, the Commission, and the EMI and later on the ECB, it was not possible to consider the enlarged margins for the evaluation of the stability of the exchange rates.

The two-year deadline could create a problem for the Member States which were at the point of acceding to the EU or for recently admitted members. These States could not possibly have participated in the ERM during the two years although they were in conformity with the other criteria. It was the case for the Finnish mark and the Italian lira when the respective convergence reports for these countries were prepared. It was decided during the accession conference for Austria, Finland, Norway, and Sweden that all the elements determining exchange rate stability in relation to the currencies participating to the ERM

[59] See ibid, p 11 and below, p 63 *et seq*.

[60] PB Kenen and EE Meade, 'EU accession and the Euro: Close Together or Far Apart?' [2003] *International Economic Policy Briefs*, no PB03-9.

المنارة للاستشارات

would be taken into account for the pertinent period of two years, in a way neither more nor less favourable than for the currencies participating in the ERM.

The ECB has repeatedly insisted on the importance of participation in the ERM. It developed its ideas on the subject in a Policy position of 18 December 2003. In its view, it is impossible to give any assurance on the limitation of the duration of the participation in ERM2. The Treaty provides for a minimum duration of two years and in lieu of concentrating on the duration, Member States should contemplate the best way to achieve convergence.[61]

Another question of interpretation was raised by the reference to the absence of 'severe tensions' on the exchange market and the initiative of devaluation. For some authors, the third criterion allowed for detecting 'manifest errors' in exchange policy of a Member State.[62]

The ECB looks at indicators like the degree of divergence of exchange rates vis-à-vis the central rate of ERM2 in relation to the euro. It uses indicators such as the deviation of short-term interest rates in relation to the euro area as well as its evolution and it takes into consideration the interventions on the exchange markets.[63] The Commission tolerates an appreciation or a depreciation of 4.5 per cent without considering any deviation as an indication of severe tensions.

(v) The Convergence of Long-term Interest Rates

The fourth criterion is very close to the first one. It is defined in Article 140, paragraph a, 4th indent:

> the durability of convergence achieved by the Member State with a derogation and of its participation in the exchange-rate mechanism being reflected in the long-term interest-rate levels.

Article 4 of Protocol No 13 specifies that:

> The criterion on the convergence of interest rates [. . .] shall mean that, observed over a period of one year before the examination, a Member State has had an average nominal long-term interest rate that does not exceed by more than two percentage points that of, at most, the three best performing Member States in terms of price stability.
> Interest rates shall be measured on the basis of long-term government bonds or comparable securities, taking into account differences in national definitions.

Some authors considered as 'fairly loose'[64] this criterion that is supposed to reflect the expectations of the market concerning inflation rate differentials.[65] As a matter of fact, countries admitted to participation in the euro area had interest

[61] See Policy Position, op cit, p 5; See also Mrs.Tempel-Gugerell, quoted speech: '[. . .] a longer stay [than two years] allows some exchange rate flexibility to accommodate differences in, for instance, productivity gains and inflation relative to the euro area.'
[62] J Cloos, G Reinesch, D Vignes, and J Weyland, op cit, p 207.
[63] ECB. Convergence Report 2004, p 12.
[64] D Gros and N Thygesen, op cit., p 387.
[65] J Cloos et al, op cit,, p 206.

المنارة للاستشارات

rates well below the reference value increased by two percentage points. The concept of 'three best performing Member States in terms of price stability' has been applied using a non-weighted arithmetic median of long-term interest rates of the three countries presenting the lowest inflation rates.[66]

The same authors that have criticized the reference to the three countries of the EU regardless of whether or not they had adopted the euro, in the application of the first criterion, have also objected to the choice, after the achievement of monetary union, of three countries, without considering the euro area as a whole, in order to assess the level of long-term interest rates. This interpretation could result in requiring exaggerate performances on the part of the candidates to the single currency.[67] It would be more reasonable to take into account the median of the euro area, but this would require a revision of the Treaty. Concerns have been raised—even before 2008—about the need for greater flexibility in the conditions to be admitted to the monetary union. However, in the current political climate no one would dare to propose a Treaty revision regarding this sensitive question of the convergence criteria.

(vi) Additional Criteria

Article 140, paragraph 1, last subparagraph mentions 'additional criteria':

> The reports of the Commission and the European Central Bank shall also take account of the results of the integration of markets, the situation and development of the balances of payments on current account and an examination of the development of unit labour costs and other price indices.

This text differs from the similar provision of Article 121 ECT in that, for obvious reasons, the reference to 'the development of the ecu' would have been meaningless after the introduction of the euro. The elements related to prices are included in the examination of price stability. For the ECB, the 'development of unit of labour costs' is an important indicator of future stability.[68] The Commission underlines the importance of additional factors in the perspective of a smooth integration in the euro area. As far as balance of payments is concerned, it observes that the accent is put on the situation and development of the external balance. Market integration is evaluated on the basis of trade, foreign direct investments (FDI), and the good working of the single market. The progress achieved in market integration is analysed in relation to the structures and tendencies of the financial sector and respect for the *acquis communautaire* in this field.[69] The employment rate is not mentioned but it does not

[66] See EMI, Convergence Report 1998, p 43. In March 2008, the reference value was 6.5 per cent and the three countries concerned were Malta (4 per cent), The Netherlands (4.3 per cent), and Denmark (4.3 per cent).
[67] See n 60, above.
[68] J-C Trichet, *Le Figaro*, 18 July 2008. These costs include both salaries and productivity.
[69] EC, Convergence Report 2008, p 45.

المنارة للاستشارات

mean that it is not considered. These 'additional criteria' could gain importance with the introduction of the 'new economic governance' and in particular, the Excessive Macro-economic Imbalances Procedure in tandem with the Excessive Deficit Procedure, the European Semester, and the Pact Euro Plus. We will refer to this matter in the section on Economic Coordination below.

F. The Abrogation of a Derogation by the Council

Article 140(2) and (3) TFUE takes over and updates part of the content of former Articles 121, 122, and 123 ECT. It includes an interesting novelty which concerns the role of the euro area Member States in the procedure:

2. After consulting the European Parliament and after discussion in the European Council, the Council shall, on a proposal from the Commission, decide which Member States with a derogation fulfil the necessary conditions on the basis of the criteria set out in paragraph 1, and abrogate the derogations of the Member States concerned.
The Council shall act having received a recommendation of a qualified majority of those among its members representing Member States whose currency is the euro. These members shall act within six months of the Council receiving the Commission's proposal.
The qualified majority of the said members, as referred to in the second subparagraph, shall be defined in accordance with Article 238(3)(a).
3. If it is decided, in accordance with the procedure set out in paragraph 2, to abrogate a derogation, the Council shall, acting with the unanimity of the Member States whose currency is the euro and the Member State concerned, on a proposal from the Commission and after consulting the European Central Bank, irrevocably fix the rate at which the euro shall be substituted for the currency of the Member State concerned, and take the other measures necessary for the introduction of the euro as the single currency in the Member State concerned.[70]

Changes in paragraph 2 in relation to Article 121 ECT include:

- the replacement of the Council at the level of Heads of State or Government by the European Council, a natural move as this entity becomes an institution under the Lisbon Treaty;
- the absence of any reference in paragraph 2 to the reports provided in paragraph 1. The Council shall decide on a proposal from the Commission and on the basis of the criteria set out in paragraph 1. Does it mean that the Council may have a different view on the respect of the criteria? In any case, it has to decide on a proposal by the Commission, a proposal that either the Council or a Member State can ask to the Commission to make, under Article 135 TFEU. Such a demand does not impose on the Commission the requirement to present a proposal. If a proposal has been made, the Council can amend it, but it needs to be unanimous, which, in such a delicate matter,

[70] Italics are ours.

المنارة للاستشارات

would be extraordinary. Practically, it has only the possibility to accept the proposal or to refrain from doing so, if there is no qualified majority to adopt it;

– The third element has an important symbolic and practical value. All members of the Council will have to vote by qualified majority on the abrogation of a derogation but the Council will have to decide on the proposition of the Commission, after having received a recommendation of a qualified majority[71] of euro area members, adopted within six months of the reception of the proposal of the Commission. This represents an important sign of the recognition of the euro area identity by the Lisbon Treaty and the formula is practically very close to a veto right. It is difficult to envisage the possibility for the Council, either on political or mathematical terms, to decide contrary to such a recommendation.

Article 140(3) TFEU simplifies and updates former Article 123(4) ECT. It specifies that the Member State concerned shall vote on the irrevocable fixation of the rate of conversion of its currency to the euro, a decision that has to be taken by the unanimous vote of euro area Member States and the State concerned. The word 'measures' used in the last sentence of this Article refers to legislative as well as possible administrative 'measures'.

G. Status of Derogation and Exemption

The Delors Report and the Maastricht Treaty have taken account of the fact that not all the Member States would be able to qualify for monetary union. It is the reason why a status of derogation has been provided and institutional formulas specific to the ESCB and ECB have been adopted to cope with this situation.

The UK was not favourable to the organization of the intergovernmental conference on EMU and required the drafting of a Protocol of exemption. Denmark also received a special Protocol subordinating to a referendum the adoption of the single currency. Respectively Protocol No 15 and Protocol No 16 provide for a special regime for both countries. The Lisbon Treaty has updated these protocols and, for the Danish one, clarified the position of this country.

It is the first time that the Treaty has established a multi-speed regime for the realization of a major Community objective and, furthermore, that it has conferred upon some Member States the possibility of avoiding the achievement of that objective for motives that only depend on their own will.

[71] This majority is defined under Art 238, para 3 TFEU as equal to at least 55 per ent of the members of the Council representing more than 65 per cent of the population of these States.

المنارة للاستشارات

(i) Status of Derogation

Since the start of the final stage of monetary union, the status of derogation is conferred on Member States that have not yet adopted the euro but do not have a special status like the UK and Denmark. The status of derogation applies automatically to these Member States since the changeover to the euro.

It includes a number of exceptions to provisions of the Treaty. These exceptions are listed in Article 139 TFEU but other provisions are also applied to Member States with a derogation in Chapter 5 of Title VIII on Transitory Provisions. Such provisions concern the powers of the General Council (Article 141 TFEU) to which the Statutes on the ESCB and ECB dedicate their Chapter IX, a chapter listing the provisions of the Statutes that confer no right and impose no obligation on Member States with a derogation, the obligations of the States with a derogation in exchange matters (Article 142 TFEU), and safeguard clauses remaining applicable to these States in case of balance of payments problems (Articles 143 and 144 TFEU).[72] To these Articles, one should add Article 134, paragraph 5 TFEU on the competences of the Economic and Financial Committee which keeps for these States the functions of the former Monetary Committee. But the bulk of provisions concerning the specific regime of Member States with a derogation is included in Article 139, paragraph 2 TFEU, the next two paragraphs defining the consequences for the Member States with a derogation of the non-application to them of the Treaty Articles listed in paragraph 2:

2. The following provisions of the Treaties shall not apply to Member States with a derogation:

(a) adoption of the parts of the broad economic policy guidelines which concern the euro area generally (Article 121(2));

(b) coercive means of remedying excessive deficits (Article 126(9) and (11));

(c) the objectives and tasks of the ESCB (Article 127(1) to (3) and (5));

(d) issue of the euro (Article 128);

(e) acts of the European Central Bank (Article 132);

(f) measures governing the use of the euro (Article 133);

(g) monetary agreements and other measures relating to exchange-rate policy (Article 219);

(h) appointment of members of the Executive Board of the European Central Bank (Article 283(2));

[72] Regulation No 1969/88 of the Council on the mechanism of medium-term financial support has been replaced by Regulation No 332/2002 of 18 February 2002, [2002] OJ L53, 23 February 2002, p 1. This mechanism has been used for helping some non-euro area countries badly hit by the financial and economic crisis developing since 2007, like Latvia and Hungary. The amounts available were dramatically increased.

المنارة للاستشارات

(i) decisions establishing common positions on issues of particular relevance for economic and monetary union within the competent international financial institutions and conferences (Article 138(1));

(j) measures to ensure unified representation within the international financial institutions and conferences (Article 138(2)).

In the Articles referred to in points (a) to (j), 'Member States' shall therefore mean Member States whose currency is the euro.
3. Under Chapter IX of the Statute of the ESCB and of the ECB, Member States with a derogation and their national central banks are excluded from rights and obligations within the ESCB.
4. The voting rights of members of the Council representing Member States with a derogation
shall be suspended for the adoption by the Council of the measures referred to in the Articles listed in paragraph 2, and in the following instances:

(a) recommendations made to those Member States whose currency is the euro in the framework of multilateral surveillance, including on stability programmes and warnings (Article 121(4));

(b) measures relating to excessive deficits concerning those Member States whose currency is the euro (Article 126(6), (7), (8), (12) and (13)).

A qualified majority of the other members of the Council shall be defined in accordance with Article 238(3)(a).

There have been controversies in the past on the voting rights of Member States with a derogation or a special status for the adoption of the so-called 'complementary legislation', and especially on the Regulation on sanctions applicable by the ECB.[73] The UK, supported by other 'Out' countries, considered that all Member States could have a voting right on this Regulation because neither Article 122, paragraph 6 ECT, nor the UK Protocol quoted Article 107, paragraph 6 ECT among the decisions which apply only to participating Member States. The Regulation was nevertheless adopted by the unanimity of the euro area Member States that invoked a teleological interpretation against a literal interpretation of the provisions at stake.[74]

Member States with a derogation must prepare for the adoption of the euro, which is an obligation under the Treaty. As we examine below, they have to present and update the so-called 'convergence programmes' submitted to multilateral surveillance, and their participation in ERM2 is also conceived from the perspective of their eventual adoption of the single currency. Central and

[73] Council Regulation (EC) No 2532/98 of 23 November 1998 concerning the powers of the European Central Bank to impose sanctions, [1998] OJ L318/4, 27 November 1998.

[74] The UK and the majority of euro area Member States have made declarations for the minutes stating their respective positions. On the controversy, see J-V Louis, 'A Legal and Institutional Approach for Building a Monetary Union' (1998) 35 CMLR 33–76, at 65, and Ph Vigneron and M Mollica, 'La différenciation dans l'Union économique et monétaire' (2000) *Euredia* 197 *et seq*, p 219 *et seq*.

المنارة للاستشارات

Eastern European countries have different views as to the rhythm to follow in their preparation for the adoption of the euro. For most of them, it is not a priority for the immediate future. Convergence criteria are often judged as either outdated or unequally applied. The present crisis in the euro area does not encourage non-eurozone EU members to take now the necessary steps to adopt the euro, even though they fear isolation from the eurozone.

(ii) Exchange Rate Mechanism 2

Article 142 TFUE (Article 124 ECT) requests that the Member State with a derogation that in principle keeps its autonomy in the field of monetary policy, treat its exchange policy as a matter of common interest. Reference is also been made to 'the experience acquired in cooperation within the framework of the exchange rate mechanism'. But no provision in the Treaty specifies the exchange regime between the 'Out' currencies and the euro. This is the reason why the European Council meeting in Amsterdam adopted on 16 June 1997 a 'Resolution on the principles and fundamental elements of a new exchange mechanism'.[75] This Resolution has been implemented by an agreement of 1 September 1998 between the ECB and NCBs of the Member States outside the euro area laying down the operating procedures for an exchange rate mechanism in stage three of EMU.[76] The president of the ECB and the Governors of the non-participating Member States signed this agreement. It draws upon the lessons of the application of the agreement between NCBs of 13 March 1979, laying down the operating procedures of the European Monetary System that it replaces.

Today, Latvia and Lithuania participate in the ERM2, with a currency board,[77] and Denmark with a narrow margin of 2.25 per cent. Bulgaria has adopted a currency board with the euro but apparently does not envisage adopting the single currency in a near future. Poland refrains to participate in order to avoid an appreciation of the zloty and so as to preserve its competitiveness.

The participation in the ERM2 is described by the Resolution of the European Council as non-compulsory. This facultative feature of the ERM2 is contradictory with the fact that the participation over the two-year period, is, as we have seen, listed by the Treaty as one of the convergence criteria for the adoption of the euro. There are good arguments for considering that, on this matter, the Resolution is not in line with the Treaty.

The Resolution of 1997 assigns two complementary objectives to the ERM2. First, it aims at ensuring monetary stability which is a necessity for

[75] [1997] OJ C236, 2 August 1997, p 5.

[76] [1998] OJ C345, 13 November 1998, p 6. This agreement was replaced by an agreement of 16 March 2006, [2006] OJ C73, 25 March 2006, p 21. This text was amended each time a new Member State adopted the euro.

[77] Latvia, which had adopted a currency board providing for a pegging of its currency to the euro, was admitted with the standard margin of 15 per cent and a unilateral commitment of +/- 1 per cent.

المنارة للاستشارات

the smooth functioning of the single market and the development of investments, growth, and employment. Secondly, the participation in ERM2 should orientate the policies of Member States towards stability, facilitate convergence, and support their efforts towards joining the euro. For the authors of the Resolution, participation in ERM2 would contribute to the equality of treatment of all the candidates as far as respect of convergence criteria is concerned.

There are no pre-established criteria for participation in ERM2 but as the Policy position adopted on 18 December 2003 by the Governing Council specifies, adjustments in macro-economic policies are needed for a harmonious participation in the field of price liberalization and fiscal policy. Participation in ERM2 is but one element of the general framework of economic policy. It has to be compatible with other elements of this framework, in particular, with monetary, budgetary, and structural policies. The central rate adopted for the participation must of course reflect the best evaluation possible of the equilibrium exchange rate at the moment of accession to the mechanism.

ERM2 is based on central rates defined in relation to the euro. There is no parity grid like in the EMS. Standard fluctuation margins are 15 per cent on each side of the central rates. Narrower margins of 2.25 per cent may be adopted by mutual agreement, as is the case for the Danish crown. Common procedures are provided for changing central rates, standard and narrow margins (points 2.3 and 2.4).

Interventions at the standard margin or at the narrow one resulting from a multilateral agreement will, in principle, be automatic and unlimited, with short-term financing available. But price stability has priority and realignments are not to be excluded as well as the use of other instruments such as interest rates.

Some limited obligations, mainly of information, are imposed in application of Article 142 TFEU on Member States which do not participate in ERM2.

(iii) The Status of Denmark

Denmark anticipated the probable result of a referendum on EMU, after the negative referendum on the Maastricht Treaty in June 1992. A decision of the European Council meeting at Edinburgh, on 11 and 12 December 1992, acknowledged that Denmark had notified that it would not participate in the third stage of EMU. It is for Denmark to notify its partners that it no longer intends to refer to all or part of the Edinburgh decision. A negative referendum confirmed on 28 September 2000 the refusal of the euro by a majority of the Danish people. The Lisbon Treaty has clarified the situation of Denmark, as it derives from Protocol 16, point 1: ‘1. In view of the notice given to the Council by the Danish Government on 3 November 1993, Denmark shall have an

المنارة للاستشارات

exemption. The effect of the exemption shall be that all Articles and provisions of the Treaties and the Statute of the ESCB referring to a derogation shall be applicable to Denmark.'[78]

(iv) The Status of the UK

The UK opposed the convocation of an IGC on EMU and always refused to accept that a treaty could impose upon it the participation in a monetary union. This reflected the British vision of the 'non-compulsion' principle. It obtained in Maastricht a Protocol 11, now Protocol 15, to the Treaties. This Protocol takes note of the notifications made, respectively on 16 October 1996 and 30 October 1997, by Britain that it would not participate in EMU and lists a number of exceptions that cease to be applicable if and when the UK decides to participate in EMU. This would need 'a separate decision to do so by its government and parliament'.

The UK is the only country that does not accept the leading principles of monetary union as outlined in Article 119, paragraph 2 TFEU (former Article 4, paragraph 2 ECT). But the UK did not ask for an exemption to Article 3, paragraph 4 TEU which states that '[t]he Union shall establish an EMU of which the currency is the euro'. Without agreeing to the modalities, this attitude appears to pay lip service to this objective. Contrary to the situation of Member States with a derogation, the UK 'shall endeavour to avoid' and not 'shall avoid' (Article 126, paragraph 1 TFEU) an excessive government deficit (point 5 of the Protocol). It has no obligation to consult the ECB on draft legislation under Article 127, paragraph 5 TFEU; it may maintain the credit line 'Ways and Means' in favour of the Government (Protocol, point 10), an important derogation applicable since the entry into force of the Maastricht Treaty to the prohibition of monetary financing under Article 123 TFEU. The other exceptions are the same as those applicable to the Member States with a derogation.

The Protocol also provides the procedure applicable if the UK decides to adopt the euro. It will be submitted to the same conditions as those imposed on other countries. It will have, in particular, to respect the convergence criteria.[79] This could raise problems as far as ERM2 is concerned; the memory of the 1992 crisis when the Pound was forced off the System is still a vivid one. The British Government has defined the so-called 'economic circumstances' that would enable it to consider the adoption of the single currency. The Government

[78] It is to be observed that the French version uses always the word 'dérogation' where the English text uses the word 'exemption'. But both assimilate the status of Denmark to that of a Member State with a derogation. The date referred to by the text coincides with the entry into force of the Maastricht Treaty.

[79] An 'Outline National Changeover Plan' was drafted at the end of the nineties and the Bank of England worked on different scenarios and practical preparation. A synthesis of the work of the Bank of England was published in a number of issues of a rolling series of papers entitled 'Practical issues arising from the euro'. See <http://www.bankofengland.co.uk/publications/Documents/quarterly-bulletin/qb960308.pdf> accessed 7 March 2013.

المنارة للاستشارات

has succeeded so far in rejecting requests for a referendum on the euro, as it succeeded with regard to the Lisbon Treaty. The time does not seem to be right for the adoption of the single currency, and it is opposed by the Conservative Party as well as by a part of the Labour Party and, of course, by the UK Independence Party. Public opinion—supported by the press in the UK—does not appear to be inclined to take such a step either.

(v) The Peculiarity of the Swedish Case

Sweden has no special status. It did not request an exemption like Denmark. Under Union law it is a Member State with a derogation. At the opening of the negotiations of accession of the country to the EU, the Swedish representative made a statement that is perhaps ambiguous but that by no means can be considered as a valid opt-out clause, since only a text with the same value as a treaty could have given legality under EU law to such an opt-out. The statement is as follows: 'A final Swedish position relating to the transition from the second stage to the third stage will be taken in the light of future developments and in accordance with the provisions of the treaty.'[80]

Sweden complied with most of the conditions for adopting the single currency in 1998, except for legal compatibility with the Statute of the ECB and ECB and the lack of an objective for its exchange rate policy.

By neglecting to observe all the convergence criteria, Sweden does not comply with its obligations under the Treaty. The Swedish Government first considered that the decision on the adoption of the single currency should be taken by Parliament. Thereafter it opted for a referendum. On 14 September 2003, the Swedish people rejected the adoption of the euro. Needless to say, to submit the compliance of an obligation imposed upon the State by the Treaty to the approval of either Parliament or the people is not compatible with the Treaty. Obviously, the Commission did not wish to adopt a legal position in this respect. How can you enforce upon a State a change of its currency?

III. Economic Union[81]

A. Introduction and Institutional Structure

(i) Introduction

While the meaning of monetary union is clear, the term economic union is a bit of a misnomer. Economic union is, in fact, economic policy coordination, given

[80] See E Clapham, 'Swedish report', in J-V Louis (ed), *Euro Spectator: implementing the euro 1999*, EUI, Working papers, Law No 2000/9, p 1-24, p 16.

[81] See generally RM Lastra, *Legal Foundations of International Monetary Stability* (Oxford University Press, 2006), ch 8 and J-V Louis, *L'Union Européenne et sa Monnaie* (Editions de

المنارة للاستشارات

that Member States—whether participating or not in monetary union—have been in charge of their fiscal policies, albeit subject to Community/Union rules. The singleness of monetary policy contrasts with the multiplicity of fiscal policies. While the area of jurisdiction of fiscal policy is national, the area of jurisdiction of monetary policy (for those countries which have adopted the euro) is supra-national.

The advent of monetary union took place without a corresponding transfer of fiscal powers to a supra-national authority. A centralized monetary policy coexists with decentralized fiscal policies, despite the imposition of significant procedural and substantive supra-national constraints, such as the permanent obligation for Member States to avoid excessive deficits.

The term 'economic' is a broad concept that in other contexts also encompasses exchange rate and monetary policies, trade policy, and other policies. In the EU context, however, the term 'economic union' refers mostly to the budgetary and fiscal policies of the Member States. A fundamental principle of the 'economic' component of EMU is that public finances in individual Member States are a matter for common concern at the European level.

It should be noted that the EU budget is relatively small (representing about 1 per cent of the EU's GDP, or one-fiftieth of all public spending) and mostly financed by budget contributions of the Member States.[82] The EU budget is a 'curious hybrid', since it is much more than the budget assigned to international organizations such as the IMF, but not comparable to the budget of 'an autonomous political entity which [. . .] has some direct link with a local electorate in relation to fund-raising'.[83] The impasse in November 2012 in the negotiations of the EU budget for the next seven years.[84] As Alexandre Lamfalussy rightly stated (as mentioned above): 'the greatest weakness of EMU is the E. The M Part is institutionally well organised. We have a solid framework. We don't have that for economic policy.'[85]

(ii) Institutional Structure

The rather straightforward institutional structure of monetary policy with the European Central Bank as the main actor contrasts with the multiplicity of actors with regard to the institutional structure of 'economic policy'. National governments remain the principal actors and the institutions dealing with issues

l'Université de Bruxelles Collection: Institut d'Etudes Européennes, 2009), Commentaire J Mégret, 3rd edn, ch III.

[82] See Art 311 TFEU (Art 269 EC Treaty).

[83] I Begg, 'Future Fiscal Arrangements in the European Union' (2004) 41 CMLRev 776 at 781.

[84] The EU Budget totalled 976 billion for the 2007–2013 period. As regards the Multiannual Financial Framework (MFF) for the 2014–2010 period see <http://ec.europa.eu/budget/mff/index_en.cfm> accessed 1 March 2013. Final agreement with the European Parliament is still needed for the new MFF to enter into force in January 2014, and the approximately 75 legislative acts covered by the MFF package have yet to be formally adopted.

[85] See Alexandre Lamfalussy, interview published in *The Guardian*, 16 August 2003.

المنارة للاستشارات

of economic policy coordination at the EU level are the Council of Ministers in the configuration of the Ministers of Economy and Finance (the ECOFIN Council), the Commission, mostly via the Directorate General for Economic and Financial Affairs, the European Parliament (both in plenary session and via the Economic and Monetary Affairs Committee of the European Parliament—ECON), and the European Central Bank. The Economic Policy Committee (EPC), the Economic and Financial Committee (EFC), the Eurogroup Working Group, and the Eurogroup at ministerial level assist in the governance of the E of EMU.

Economic Policy Committee. The EPC was set up in 1974 (under Decision 74/122/EEC) to improve coordination of Member States' economic and budgetary policies. With the advent of monetary union and the greater need for closer coordination of economic policies, the Committee's operation and composition were reviewed in 2000 and then again in 2003.[86] The EPC is made up of representatives of the Member States and contributes to the work of the Economic and Financial Affairs Council (ECOFIN) as regards the coordination of Member State and Union economic policies. Article 121 TFEU, Article 99 ECT (analysed below) provides for the formulation of broad economic policy guidelines (BEPGs), underpinned by a multilateral surveillance procedure. The EPC provides support for the formulation of the guidelines and to contribute to the multilateral surveillance procedure, thus assisting the work of the Economic and Financial Committee. The EPC also cooperates closely with the Employment Committee, which promotes coordination between Member States on employment and labour market policy. With regard to the membership of the EPC, the Member States, the Commission, and the European Central Bank must be represented on it. (Each Member State appoints two members from among senior officials possessing competence in the field.) The Committee delivers opinions at the request of the Council, the Commission, or the Economic and Financial Committee or on its own initiative. Though proceedings of the Committee are confidential, its reports or opinions are made publicly available, unless there are overriding reasons to keep them confidential.

Economic and Financial Committee. According to Article 114(2) ECT (which has become Article 134(2) TFEU) on 1 January 1999, the EFC replaced the Monetary Committee.[87] The EFC prepares the ECOFIN Council's meetings,

[86] See Council Decision 2000/604/EC of 29 September 2000 on the composition and the statutes of the Economic Policy Committee. The statutes of the EPC were revised again in 2003 to take account of the enlargement of the European Union. See generally <http://europa.eu/legislation_summaries/economic_and_monetary_affairs/institutional_and_economic_framework/l25055_en.htm> accessed 15 March 2013.

[87] See Council Decision 98/743/EC of 21 December 1998 on the detailed provisions concerning the composition of the Economic and Financial Committee and Council Decision 1999/8/EC of 31 December 1998 adopting the Statutes of the EFC. The statute of the EFC has been revised in the perspective of the enlargement of the Union by Decision 2003/476 of the Council of 18 June 2003,

المنارة للاستشارات

drafts opinions for the ECOFIN Council and for the Commission and keeps the economic and financial situation of EU Member States under review. The EFC has some autonomy within the Commission's Directorate General for Economic and Financial Affairs (EcFin). Since 2003, the EFC has met with representatives of the NCBs in a 'full EFC', when a review of the economic situation, issues of financial stability or questions concerning the International Monetary Fund (IMF) are on the agenda. This measure is considered necessary in order to ensure that the expertise and analytical insight of the national central banks are available to the Committee. Smaller EFC meetings are held where the NCB representatives are not present, in 'restricted EFC' (NCB representatives may however attend discussions concerning their country's stability and convergence programmes, and discussions on excessive deficit procedures against the country concerned).[88] The EFC also meets in a specific format, the Financial Stability Table, twice a year. The EFC has set up specialized working groups or sub-committees, including: the EFC Committee on IMF related questions (SCIMF), the Eurogroup working group (EWG, where NCBs are not represented), which prepares meetings of the Eurogroup, and others.[89] The Euro Area Summit, in a statement of 26 October 2011, decided to improve the governance of the euro area. It provided for a more permanent Euro sub-group composed of alternates of the members of the EWG and decided that the EFC and the EWG would be chaired by the same permanent president. Though the Economic and Financial Committee remains the main source of advice for the Council and the Commission on financial affairs, the ECOFIN Council established the Financial Services Committee or FSC in a decision of 18 February 2003, to focus on financial regulatory issues. The FSC reports to the EU Economic and Financial Committee (EFC) in order to prepare advice to the Council (ECOFIN).

Eurogroup. The Eurogroup was established as an informal body in the Luxembourg European Council of December 1997, to bring together the Finance Ministers of the countries adopting the euro and the Commissioner for Economic and Financial Affairs, with the President of the ECB coming as an invitee. The Eurogroup is not a decision-making body, nor a configuration of the Council. It is the Council (ECOFIN) that takes the decisions, but in certain matters only the euro area members participate in the vote. The Eurogroup meets normally before the ECOFIN meeting and deals with issues relating to Economic and Monetary Union. The Eurogroup can thus be described as an informal 'economic government' of the euro area, meant to enhance the dialogue and to develop closer coordination of economic policies within the euro

[2003] OJ L158, 27 June 2003, p 58. See generally <http://europa.eu/legislation_summaries/economic_and_monetary_affairs/institutional_and_economic_framework/l25038_en.htm>.

[88] Ibid.

[89] Ibid.

المنارة للاستشارات

area. The Eurogroup finds formal recognition in the Treaty of Lisbon[90] with the adoption of a Protocol on the Euro Group. According to Article 1 of this Protocol, the Eurogroup is an informal meeting of the Ministers of Finance of the Member States whose currency is the euro together with the Commission to discuss 'questions related to the specific responsibilities they share with regard to the single currency'; the European Central Bank will also be invited to take part in the meetings of the Eurogroup. According to Article 2 of the Protocol, the Eurogroup is chaired by a President who is elected for a renewable term of two and a half years. The need for a permanent structure was highlighted during France's six-month EU Presidency by French President Nicolas Sarkozy who spoke of the need for a unified economic government of the euro area, calling for more regular coordination meetings at Heads of State and Government level, such as the extraordinary Eurogroup Summit meeting held in Paris on 12 October 2008 (to which UK Prime Minister Gordon Brown was invited) at the height of the financial crisis.[91] Other such summits have taken place under the chairmanship of the (permanent) President of the European Council. These Euro Summit meetings will be 'institutionalized', with a specific president, by the Treaty on stability, coordination and governance in the EMU, signed on 2 March 2012 and entered into force on 1 January 2013. The President of the European Council was elected president of the Euro Area Summits.

B. The Way to the SGP

As stated earlier, in the run up to EMU it was argued by many that monetary union could only be securely achieved as the culmination of a general process of convergence (the view of German 'Economists', which was also the standpoint in countries such as The Netherlands). A compromise was reached between this view (reflected in the choice of criteria of economic convergence) and the view that early moves toward monetary union would put pressure on members to converge in other economic respects (the view of French 'Monetarists', shared also by the Commission and countries such as Italy and Belgium). However, as Goodhart notes, 'most of the Monetarists also hope[d], that monetary unification would accelerate the transfer of fiscal powers'.[92]

In the negotiations that led to the Maastricht Treaty, Germany was adamant that fiscal sustainability was to be a key foundation for monetary stability and, accordingly, the Community's primary and secondary law enshrined numerical

[90] See <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2007:306:0153:0153:EN:PDF> accessed 15 March 2013.

[91] See <http://www.eu2008.fr/PFUE/lang/en/accueil/PFUE-10_2008/PFUE-12.10.2008/reunion_des_chefs_d_etat_et_de_gouvernement_de_la_zone_euro_21541.html> accessed 15 March 2013.

[92] See CAE Goodhart, *The Central Bank and the Financial System* (MIT Press, 1995), p 181. In chapter 8 of this book (pp 156–202), Goodhart provides an excellent analysis of the political economy of monetary union (including the debate between 'Monetarists' and 'Economists').

المنارة للاستشارات

and quantitative criteria with regard to the prohibition of 'excessive' deficits and the size of the public debt and established procedures to enforce such rules.[93] Germany (not confident that stability was warranted in the Maastricht Treaty) was the main 'architect' of the Stability and Growth Pact, introduced in 1997, to ensure that the prohibition of excessive deficits by the Treaty could be enforced through strict rules and sanctions and to introduce an EU-wide medium-term objective of budgetary balance or light surplus for the Member States. These rules and sanctions, which constitute the framework underpinning fiscal policy in the European Union, and which were hailed by many as a guarantee of restraint and a condition for the success of the euro, have been the subject of intense debate, sometimes because of their rigidity, sometimes because of their inadequacy to deal with crises.

As also stated earlier, the first clear legal basis of economic and monetary union was Article 102A of the EC Treaty as revised by the Single European Act (SEA).[94] The Maastricht Treaty revision of the EEC Treaty introduced important provisions regarding economic policy coordination (with the aim of achieving 'economic union') in Articles 98–104 of the ECT, which have become Articles 120–126 in the TFEU (Treaty of Lisbon)).[95] The primary law provisions impose a permanent obligation upon the Member States to avoid excessive deficits, so as to prevent fiscal irresponsibility (through the excessive deficit procedure) and provide for further macro and micro-economic coordination and multilateral surveillance.

C. Primary Law

The key primary law provisions regarding economic policy are Article 121 TFEU regarding broad guidelines and multilateral surveillance (element of 'positive integration') and Article 126 TFEU regarding excessive deficits and the excessive deficit procedure (element of 'negative integration').

[93] 'The concern of the Bundestag to oppose any relaxation of the stability criteria derives support from the Protocol on the Convergence Criteria. Without German agreement, the convergence criteria cannot be relaxed.' Extract (recital 86) from the Judgment of the German Federal Constitutional Court (Bundesverfassungsgericht) of 12 October 1993 in the case of *Brunner v The European Union Treaty*, published in *Recht der Internationalen Wirtschaft* 1993, Supplement No 5 to Issue No 12. An English translation was published in (1994) 1 CMLRev 57.

[94] Art 102A, as introduced by the SEA read as follows: '(1). In order to ensure the convergence of economic and monetary policies which is necessary for the further development of the Community, Member States shall co-operate in accordance with the objectives of Article 104 [balance of payments]. In so doing, they shall take account of the experience acquired in cooperation with the framework of the European Monetary System (EMS) and in developing the ECU, and shall respect existing powers in this field. (2). Insofar as developments in the field of economic and monetary policy necessitate institutional changes, the provisions of Article 236 [procedure to amend the treaty] shall be applicable. The Monetary Committee and the Committee of Governors of the Central Banks shall be consulted regarding institutional changes in the monetary area.'

[95] For a table of equivalences between ECT and TFEU provisions see <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2008:115:0361:0388:EN:PDF> accessed 15 March 2013.

المنارة للاستشارات

(i) Primary Law Concerning Coordination of Economic Policies ('Positive Integration')

Before the advent of monetary union, Member States were in charge both of monetary policy and fiscal policy. Since the introduction of the euro, a centralized monetary policy coexists with decentralized fiscal policies in the countries which have adopted the common currency. The need for economic policy coordination in the light of this asymmetry is evident. According to Article 121(1) TFEU Member States shall regard their economic policies as a matter of common concern and shall coordinate them with the Council. The main instruments to achieve coordination are the setting out of broad guidelines—Article 121(2) TFEU—and a mechanism for peer review—Article 121(3) TFEU—which is referred to as 'multilateral surveillance'.

The procedure for the adoption of these 'broad economic policy guidelines' (BEPG) is as follows: the Council, acting by a qualified majority on a recommendation from the Commission, formulates a draft for these guidelines and reports its findings to the European Council. In turn, the European Council, acting on the basis of the report from the Council, discusses a conclusion on these broad guidelines of the economic policies of the Member States and of the Community. On the basis of this conclusion, the Council, acting by a qualified majority, adopts a recommendation setting out these broad guidelines and informs the European Parliament of this recommendation.[96]

The BEPG often resembled reports and economic surveys prepared by the IMF or the OECD. For example, the Council Recommendation of 26 June 2003 on the broad guidelines of the economic policies of the Member States and the Community (for the 2003–2005 period) urges the Member States 'to reach or maintain budgetary positions of close to balance or in surplus throughout the economic cycle; countries with deficits exceeding the close to balance or in surplus stability and growth pact requirement must improve their cyclically-adjusted position; countries with excessive deficits need to correct them in line with the stability and growth pact'.[97]

Multilateral surveillance according to Article 121(3) TFEU refers to the assessment of the economic policies of the Member States to ensure convergence and consistency with the broad guidelines defined above. The Member States

[96] Art 121(2) TFEU.

[97] Council Recommendation of 26 June 2003 on the broad guidelines of the economic policies of the Member States and the Community (for the 2003–2005 period) [2003] OJ L195/1. There is also a section with guidelines addressed to individual Member States. For example, Greece was recommended *inter alia* to: (1) ensure that the government debt ratio is kept on a sustained declining trend at a satisfactory pace by maintaining high primary surpluses, (2) ensure effective control of government current primary spending by addressing resolutely the problem of the inelastic elements of expenditures such as the wage bill, (3) use public resources more effectively with the aim of improving labour productivity and enhancing working capacity of the unemployed, and (4) continue reforms of the social security system, and in particular the pension system, in order to avoid budgetary strains in the future due to the problem of the ageing population.

المنارة للاستشارات

provide the relevant information, the basis for the assessment, to the Commission. The Commission then prepares the reports that it then submits to the Council for the purposes of 'multilateral surveillance'.

If the assessment concludes, according to Article 121(4) TFEU, that the economic policies of the Member States are not consistent with the broad guidelines or that they risk jeopardizing the proper functioning of economic and monetary union, the Council may make the necessary recommendations to the Member State concerned, acting by a qualified majority on a recommendation from the Commission. It may also decide to make its recommendations public, acting by a qualified majority on a proposal from the Commission. The President of the Council and the Commission shall report to the European Parliament on the results of multilateral surveillance.

The Lisbon Treaty has added the possibility for the Commission to address a warning to the Member State concerned (Article 121(4) TFEU). It has also provided that the Council will act under this paragraph without taking into account the vote of the member representing the Member State concerned.

Article 121(6) permits to the European Parliament and the Council acting by means of regulations in accordance with the ordinary legislative procedure to adopt the modalities of the procedure of multilateral surveillance provided in paragraphs (3)) and (4).

(ii) Primary Law Concerning Budgetary Discipline and Excessive Deficits

There are strong reasons to restrict the fiscal behavior of governments in the Member States which have adopted the euro, even though the experience of fiscal decentralization in a monetary union is novel. Borrowing and spending decisions by the government in one Member State may have negative influences in the whole eurozone, driving up interest rates (inflation) and crowding out private investment. The Treaty contains a number of prohibitions which are intended to reinforce market mechanisms and to impose an official level of fiscal restraint. These provisions have acted as a 'straightjacket' in trying to solve the sovereign debt crisis in some euro area Member States. However, since they are enshrined in primary law, only a Treaty revision can modify them.

(a) Prohibition of Monetization of Government Debt, also Known as 'Monetary Financing'

In accordance with the provisions of Article 123(1) TFEU, overdraft facilities or any other type of credit facility with the ECB or with the central banks of the Member States in favour of Community institutions or bodies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States are prohibited. The same applies for the purchase directly from these public organizations by the ECB or national central banks of debt instruments. The prohibition does not apply to publicly owned credit institutions which, in the context of the supply of

المنارة للاستشارات

reserves by central banks, are treated in the same way by national central banks and the ECB as private credit institutions.[98]

The prohibition dictated by this Article has gained, with the sovereign debt crisis in the euro area, some 'celebrity' because it is the legal basis which the ECB invokes in refusing to buy sovereign bonds in the primary market. The rule prohibiting government financing is repeated in Article 21 of the ESCB Statute which concerns operations of the ESCB with public entities. While Article 21 allows the ECB and NCBs to perform functions as fiscal agents for governments, it prohibits the financing of governments.

(b) Prohibition of Privileged Access to Financial Institutions

In accordance with Article 124 TFEU, any measure, not based on prudential considerations, establishing privileged access by Community institutions or bodies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States to financial institutions, is prohibited.

(c) Prohibition of 'Bail-outs' of Governments

In accordance with the provisions of Article 125 TFEU, the Community is not liable for and does not assume the commitments and liabilities of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of any Member State (with the exception of mutual financial guarantees for the joint execution of a specific project). Similarly, a Member State is not liable for and does not assume the commitments and liabilities of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of another Member State (with the exception of mutual financial guarantees for the joint execution of a specific project). This particular provision, the no bail-out clause, has had serious repercussions during the recent financial and sovereign debt crises. It has become a central point of the debate on the legality of the financial support interventions in favour of euro area Member States in a dramatic fiscal situation. The no bail-out clause is an important basis for the functioning of the monetary union. It was traditionally interpreted as preventing Member States and the Community from providing financial assistance to other Member States that are facing rising public debt. It appeared indeed as designed to prevent Member States in the eurozone from relying on the possibility of a bail-out from another Member State.[99] A broad interpretation of the provision prevailed as is well expressed by Smits who pointed out: 'financial markets are

[98] Art 123(2) TFEU.

[99] See House of Lords Report, House of Lords, European Union Committee, Sub-Committee A, 'The Future of EU Financial Regulation and Supervision', 17 June 2009, para 103 <http://www.publications.parliament.uk/pa/ld200809/ldselect/ldeucom/106/106i.pdf> accessed 15 March 2013.

المنارة للاستشارات

hereby warned that each Member State is "on its own" and not backed by implicit guarantees from the Community or from fellow Member States'.[100] The philosophy of this provision was that governments whose behaviour is financially irresponsible are therefore not allowed to 'free ride' on the credit-worthiness of other Member States and will pay the risk premiums for their own individual circumstances. The no bail-out clause was meant to be clear and precise. However, the crisis has forced national and European authorities to intervene in favour of Member States in great need. Furthermore, Article 122.2—mentioned below—permits financial help, and acts as a corrective to the rigour of Article 125.

So what could Member States do? The instruments at their disposal in case of need were limited. The medium-term balance of payments finance facility—available only for non-euro area Member States under Article 143 TFEU, Article 119 ECT—allows the Community to borrow on behalf of a Member State and can be used to support Member States in financial difficulty. Member States can also resort to the International Monetary Fund for financial assistance to resolve their balance of payments problems.[101] The crisis has put in question the fact that 'if a member of the euro area were unable to implement sound fiscal policies, it would be let to its own devices'.[102] And given the limitations of the current institutional framework, new instruments and facilities have been developed since May 2010, as we further discuss below. These new mechanisms have not pretended to be in contradiction with Article 125 TFEU. Voluntary financial support should not be considered as the indirect takeover of obligations of another Member State. This support does not give any right to creditors. The Union or the Member States would not 'answer' to obligations by the sovereign debtor. They exercise a kind of largely understood political and political economy responsibility, which is based on the mutual dependence of Member States and enterprises in the bundle of relations in the single market.[103]

Without putting into question the traditional and teleological interpretation as identified above in the writings of René Smits, an author has evoked, in order to legally explain some forms of support which do not appear as having a legal basis in EU law or which at least have a widely contested legal basis, the requirement of EU loyalty ('*Unionstreue*') in the form of an obligation of loyal collaboration and consideration as provided very clearly by Article 4, paragraph

[100] See R Smits, *The European Central Bank. Institutional Aspects* (Kluwer Law International, 1997), p 77.

[101] See <http://www.imf.org/external/pubs/ft/survey/so/2008/CAR110608A.htm> accessed 15 March 2013, with regard to Hungary and <http://www.imf.org/external/pubs/ft/survey/so/2008/CAR121908A.htm> accessed 15 March 2013, for Latvia.

[102] See L Bini-Smaghi, 'Challenges for the Euro Area, and the World Economy' Group of Thirty, Rabat, 28 May 2010.

[103] So D Triantafyllou, 'Garantiestellungen und staatliche Garantien–zur Umformung eines Europäischen Rechtsprinzip' in P-C Müller-Graff, S Schmahl, and V Skouris (Hrsg), *Europäisches Recht zwischen Bewährung und Wandel* (Nomos, 2011), pp 758–72, esp. pp 770–1. Translation ours.

المنارة للاستشارات

3 TEU. But to reconcile this imperative with budget discipline, solidarity has to be accompanied by strict conditionality.[104]

In respect of risk premiums, the effect of the financial crisis of 2007–2009 upon the fiscal position of the Member States has affected the creditworthiness of government bonds in eurozone countries with a weak fiscal position, such as Greece, where financial markets have exerted their discipline (a stern reminder that Member States should always expect serious 'market penalties' if they exhibit fiscal indiscipline).[105] Despite the eurozone's single interest rate, the state of public finances does matter, raising issues of credibility.[106] Indeed, we face a daunting problem in that the possible bankruptcy of a euro area Member State could have negative consequences for the whole euro area; paradoxically, before the recent adoption of the ESM Treaty it was easier for Member States to get help through the IMF and the European Bank for Reconstruction and Development, than through the EU available mechanisms.

For part of the literature the limited scope for exercising financial solidarity was foreseen, as briefly mentioned above, in Article 122 TFEU, according to Article 122(2) TFEU, in situations in which a Member State 'is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control'. In these cases, the Council, acting by a qualified majority on a proposal from the Commission, may grant, under certain conditions, Community financial assistance to the Member State concerned. However, this possible assistance is discretionary, not mandatory. The President of the Council shall inform the European Parliament of the decision taken. Article 122(1) TFEU, which refers, since the Lisbon Treaty, to 'a spirit of solidarity between Member States' establishes that the Council may adopt 'measures appropriate to the economic situation, in particular if severe difficulties arise in the supply of certain products', thus going beyond the mere coordination of States' policies.

For those who favour the traditional strict interpretation of Article 125 TFEU, as a kind of general prohibition of financial assistance to Member

[104] C Calliess, 'Das Europaäische Solidarität sprinzip und die Krise des Euro. Von der Rechtsgemeinschaft zur Solidaritätsgemeinschaft?', Forum Constitutionis Europae 01/11, 18 January 2011, Walter Hallstein-Institut für Europäisches Verfassungsrecht, p 57 available at <http://www.whi-berlin.eu/tl_files/FCE/Rede_Calliess.pdf> accessed 15 March 2013. Translation ours.

[105] See L Schuknecht, J von Hagen, and G Wolswijk, 'European government bond spreads in the current crisis', 21 December 2009, <http://www.voxeu.org/index.php?q=node/4421> accessed 15 March 2013, where the authors reflect upon the fact that spreads on government bonds in the eurozone Member States have risen dramatically since the Lehman default in September 2008. Their analysis shows that financial markets' reactions were not random but rather reflect an intensification of risk concerns, especially regarding the state of public finances. German bonds have acquired a 'safe-haven' status that they did not have before. They also show that in high-deficit and high-debt countries (notably Ireland and Greece), the deterioration in fiscal positions on account of the crisis contributed most to the bond spread increase.

[106] See P Athanassiou, 'Withdrawal and Expulsion from the EU and EMU. Some Reflections', ECB Legal Paper Working Series, No 10, December 2009.

المنارة للاستشارات

States in need, Article 122(2) TFEU appeared as part of a compromise achieved during the Maastricht negotiations. In this reading, it worked as a kind of counterweight to the rigour of the no bail-out rule.[107]

In its judgment on *Thomas Pringle v Government of Ireland, Ireland, The Attorney General*, the Court (full court) gave an important clarification in the debate on the interpretation of Articles 125 and 122(2) TFEU.[108] The Court has decided on a reference for a preliminary ruling made by the Supreme Court (Ireland) in a case brought before the Irish courts by which a member of the Irish Parliament, after having without success pleaded their unconstitutionality, contested the compatibility with the Treaties of both the amendment of Article 136, by adding a third paragraph to this provision, and of the Treaty establishing the ESM. We cannot comment on all the aspects of this important sentence. We will limit ourselves to quoting what the Court decided on the interpretation of both Articles 125 and 122(2). The Court of Justice concluded that Article 125 TFEU 'does not prohibit the granting of financial assistance by one or more Member States to a Member State which remains responsible for its commitments to its creditors provided that the conditions attached to such assistance are such as to prompt that Member State to implement a sound budgetary policy (§138). The Court added: 'As regards the ESM Treaty, it is clear, first, that the instruments for stability support of which the ESM may make use under Articles 14 to 18 of the ESM Treaty demonstrate that the ESM will not act as guarantor of the debts of the recipient Member State. The latter will remain responsible to its creditors for its financial commitments' (§138).[109] We can conclude that financial support has to answer to two fundamental conditions for being compatible with the Treaties: to be submitted to conditions aimed at favouring budgetary discipline and not including a substitution of debtor. Furthermore, assistance by the ESM is subjected to a supplementary condition by the Treaty establishing it: a Member State has to be experiencing or threatened by severe financing problems to receive support by the ESM if this support is indispensable to safeguard the financial stability of the euro area as a whole.

Article 122(2), for its part, provides for financial assistance by the Union (and not by Member States) without indicating that it is an exclusive competence of the EU (§§ 118 and 119). For the Court, this competence of the EU is not affected by a mechanism such as the ESM.

Article 122(2) TFEU was the legal basis for the establishment of a 'European Financial Stabilization Mechanism' (EFSM) which could mobilize up to 60 billion euros in the context of a joint EU/IMF support, subject to strong

[107] See J-V Louis, 'Guest editorial: The no-bailout clause and rescue packages' (2010) 47 CMLRev 971–86, 983 and five quoted authors.
[108] Judgment of 27 November 2012, Case C-370/12.
[109] The operations of the ESM are further examined below.

المنارة للاستشارات

conditionality, ie 'on terms and conditions similar to the IMF'.[110] This mechanism, available to euro area members as well as to non-euro area members, is additional to the existing facility providing medium-term financial assistance for non-euro area Member States.[111] The legal basis and the concept of the EFSM is in strong contrast with the solution adopted on 7 May 2010 for the package of bilateral loans to Greece by the Member States (80 billion euros) and the IMF (30 billion euros) for a period of three years, in the framework of a joint programme, negotiated between the Commission, the Greek Government, and the IMF.

The European Financial Stability Facility (EFSF), of which the ECOFIN Council adopted the principle, in parallel to the ESFM, on 10 May 2010, was established as a temporary facility for three years under the form of a 'special purpose mechanism' as a '*société anonyme*' under Luxembourg law, on 7 June 2010. This Facility has been able to collect funds and provide loans, subject to a strict conditionality, with the guarantee of all the Member States of the euro area, up to 440 billion euros.[112] The IMF contributed in the guarantee up to an amount of 250 billion euros. The whole package (EFSM, EFSF including the IMF part) amounts to 750 billion euros.

The multiplicity of the support mechanisms (bilateral aid to Greece, EFSM, and EFSF) as well as the controversies about their legality and the appeals addressed to the Federal Constitutional Court against the participation of Germany in the rescue operations, prompted the German Government to request a minimal change to the TFEU in order to provide for the creation of a permanent stability mechanism firmly based on the Treaty. The solution was found in the addition of a new paragraph 3 to Article 136 TFEU through the simplified revision of the Treaty by the European Council based on Article 48(6) TEU.[113] The 'simplification' consists in the fact that no convention and intergovernmental conference were needed but such a Treaty still requires the

[110] Council Regulation (EU) No 407/2010 of 11 May 2010 establishing a European Stabilisation Mechanism [2010] OJ L118/1.
[111] See Arts 143 and 144 TFEU and Council Regulation (EC) No 332/2002 of February 2002 establishing a medium-term financial assistance for Member States' balance of payments [2002] OJ L53/1. This facility has recently benefited to Latvia, Hungary, and Romania.
[112] See J-V Louis, 'Guest editorial: The no-bailout clause and rescue packages' (2010) 47 CMLRev 971–86.
[113] Art 48(6) on 'simplified revision procedures' reads as follows:

6. The Government of any Member State, the European Parliament or the Commission may submit to the European Council proposals for revising all or part of the provisions of Part Three of the Treaty on the Functioning of the European Union relating to the internal policies and action of the Union.
The European Council may adopt a decision amending all or part of the provisions of Part Three of the Treaty on the Functioning of the European Union. The European Council shall act by unanimity after consulting the European Parliament and the Commission, and the European Central Bank in the case of institutional changes in the monetary area. That decision shall not enter into force until it is approved by the Member States in accordance with their respective constitutional requirements.
The decision referred to in the second subparagraph shall not increase the competences conferred on the Union in the Treaties.

المنارة للاستشارات

unanimous ratification of the EU Member States. The European Council took its decision on 25 March 2011 after having received the opinions of the Commission, the European Parliament, and the ECB.[114] The text of the new Article 136(3) TFEU 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.

Important features of the future mechanism are to be underscored: it will be an intergovernmental instrument, not a Union one; it may be established for the exclusive benefit of the euro area Member States. It will be activated 'if indispensable to safeguard the stability of the euro area as a whole'. This formula, like the 'strict conditionality' to which the intervention of the mechanism will be submitted, was also at the basis of the creation and the functioning of the improvised rescue packages of 2010. Both elements respond to the preoccupation of reconciling the financial support allocated to Member States with severe fiscal difficulties with the no bail-out clause of Article 125 TFEU, which remains unchanged in the Treaty. The nature of the possible 'financial assistance' is not specified, which gives the Member States great flexibility while designing the stability mechanism.[115]

The Treaty establishing the European Stability Mechanism (ESM) was signed by the Finance Ministers of the euro area on 11 July 2011.[116] But, the Summit of the euro area, meeting on 21 July, decided, in view of the worsening of the sovereign debt crisis and the increasing risk of contagion from Greece to other Member States, to provide both the EFSF and the ESM with other financial instruments than those originally provided. On 9 December 2011, the Summit decided to introduce an emergency procedure in the EMS Treaty and it confirmed its intention to clarify in the EMS Treaty the policy as far as Private Sector Involvement was concerned.

The Summit of the euro area decided at the same meeting of 9 December 2011 that the ESM Treaty should enter into force, when it would be ratified by Member States representing 90 per cent of the capital commitments and to fix the objective of an entry into force on 1 July 2012 in lieu of 1 January 2013, as initially provided. The ESM would coexist for a while with the EFSF, which will be able to confer loans up to mid-2013.

[114] [2011] OJ L91, 6 April 2011, p 1.

[115] The Supreme Court of Ireland has referred on 31 July 2012 to the ECJ the question of the validity of European Council Decision 2011/199/EU and the question of the entitlement of a Member State to enter into an international agreement such as the Treaty establishing the ESM, Case C-370/12, *Thomas Pringle v Government of Ireland, Ireland and the Attorney General*. The sentence was pronounced on 27 November 2012. See above and below, pp xx.

[116] A version of the Treaty as signed in July 2011 can be found at <http://www.european-council.europa.eu/media/582311/05-tesm2.en12.pdf> accessed 15 March 2013.

المنارة للاستشارات

The new Treaty establishing the ESM was signed by euro area Member States on 2 February 2012. Its entry into force was delayed because a number of cases were being brought on the constitutionality of the Treaty before the German Constitutional Court.

The Court decided on 12 September 2012 (2 BvR 1390/12) against the issue of temporary injunctions to prevent the ratification of the ESM Treaty (and the Fiscal Compact, see below) provided that it would be ensured under international law that no higher payment obligations could be imposed on Germany than the amount stated in the Treaty (190 billion euros) without the agreement of the German representative and that the provisions on inviolability of documents and professional secrecy could not stand in the way of the comprehensive information of the Bundestag and of the Bundesrat.[117] An interpretative declaration was signed to that effect by the permanent representatives of the Member States of the euro area, on 14 September 2012. The Treaty entered into force on 27 September 2012.

The ESM is an international organization under international law. Its structure is copied on that of the IMF. It includes a Board of Governors (the Finance Ministers of the euro area Member States with the EMU Commissioner and the ECB President as observers), a Board of Directors (representatives appointed by the national governments, with observers from the Commission and the ECB), and a managing director. Major decisions are taken by the Board of governors by mutual agreement requiring the unanimity of the members participating in the vote, qualified majority (which is the rule if nothing else is provided), or simple majority. There is also an emergency procedure. The mutual agreement rule—normally applied when deciding a financial intervention—will be replaced by a qualified majority of 85 per cent in case the Commission and the ECB conclude that an urgent decision related to financial assistance is needed when a failure to urgently adopt a decision would threaten the economic and financial sustainability of the euro area. That gives a veto right to three bigger Member States, voting individually and, inversely, prevents some small or middle-sized countries from vetoing a decision that an overwhelming majority finds necessary.

The paid up capital will be 80 billion euros. A minimal ratio of 15 per cent between the paid-in capital and the outstanding issues has to be maintained. The authorized capital stock will amount to 700 billion euros. The establishment of capital distinguishes the ESM from the EFSF, which works under the guarantee of the euro area Member States. The contribution key to the capital will be based, as for the EFSF, on the paid-in capital key of the ECB, a key based on both GDP and population.

The ESM Treaty provides in Article 8(5) that: '[t]he liability of each ESM Member State shall be limited, in all circumstances, to its portion of the

[117] Summed up after BVerfG Press release No 67/2012 of 12 September 2012, <http://www.bverfg.de/pressemitteilungen/bvg12-067en.html> accessed 15 March 2013.

المنارة للاستشارات

authorised capital stock at its issue price. No ESM Member shall be liable, by reason of its membership, for obligations of the ESM.' The effective lending capacity aimed at will be 500 billion euros. Until the end of the possibility for the EFSF to enter into new lending operations, the cumulated lending capacity of both mechanisms will be of 700 billion euros, an amount that is the result of a difficult compromise reached among euro area members. In addition, euro area and other EU Member States are declaring their willingness to lend funds to the IMF to allow the Fund to open credit lines to euro area countries and they are asking third countries to do the same, possibly within the G20 framework, with, until now, relative success.

The ESM will provide stability assistance through 'precautionary assistance' (Article 14 ESM Treaty), 're-capitalisation of financial institutions' (Article 15) 'ESM loans' (Article 16) 'primary market support facility' (Article 17), and 'secondary market support facility' (Article 18) on the basis of a macroeconomic adjustment programme with strict conditionality and if agreed by the Board of Governors (in principle, see above) by mutual agreement (Article 12 ESM Treaty).

Two remarks on the new list of instruments: the ESM financial assistance is not necessarily a last resort (cf. the possibility of precautionary intervention) and as the ESM is endowed with the competence to intervene on the secondary markets of debt instruments, it could replace the cancelled ECB Securities Market Programme (SMP) or, in the future, complement the Outright Monetary Transactions (OMT, analysed below) which substitutes for the SMP. Article 18(2) of the ESM Treaty specifies that a decision of the ESM to intervene in the secondary market to address contagion should be exercised 'on the basis of an analysis of the ECB recognizing the existence of exceptional financial market circumstances and risks to financial stability'.

In line with the flexibility noticed in the wording of Article 136(3), the Board of Governors may review the list of financial assistance instruments and decide to make a change to it (Article 19 ESM Treaty).

The pricing policy of the ESM is dramatically changed in the definitive version of the ESM Treaty. The 'punitive' approach is abandoned. 'The ESM shall aim to fully cover its financing and operating costs and shall include an appropriate margin' (Article 20). The pricing policy may be reviewed by the Board of Governors.

An important issue in the debates on the ESM was the so-called 'Private sector involvement' (PSI). For Germany, in particular, it was necessary to avoid that the whole burden of rescue operations, be they based on guarantees or direct loans, would fall on tax payers. France, whose banks were heavily exposed to peripheral State debt, insisted on a case-by-case approach. This principle was set out in Article 12(2) of the original version of the ESM Treaty which provided that 'an adequate and proportionate form of private-sector involvement shall be sought on a case-by-case basis where financial

المنارة للاستشارات

assistance is received by an ESM Member, in line with IMF practice', far from the kind of treatment desired by Germany. The ESM Treaty also provided for the insertion of Collective Action Clauses (CACs) in all new euro area government securities, with maturity over one year. When the Euro Area Summit decided on 21 July 2011 to restructure a substantial part of the Greek debt, it was adamant in specifying that 'Greece require[d] an exceptional and unique solution' and they reaffirmed the 'inflexible determination' of all other countries 'to honour fully their own individual sovereign signature'. On 9 December 2011, it solemnly repeated its intention to 'strictly adhere to the well-established IMF principles and practices'.[118] The Heads of State and Government announced their desire to 'unambiguously' reflect this in the Preamble of the Treaty and confirmed that the decisions taken concerning Greece debt are 'unique and exceptional'. The references to CACs and to the IMF practice were inserted respectively in recital 11 and recital 12 of the Preamble of the new 2 February version of the ESM Treaty. Article 12(3) of the Treaty also provides that 'CAC's shall be included, as of 1 January 2013, in all new euro area government securities, with maturity above one year, in a way which ensures that their legal impact is identical'.

The European Stability Mechanism (ESM) was launched in the margins of a Eurogroup meeting on 8 October, when the ESM Board of Governors held its inaugural meeting.[119]

On 27 November 2012, the European Court of Justice (ECJ) confirmed the compatibility of the ESM with EU law in Case C-370/12 (*Pringle*).[120] The Court finds that the objective of the ESM, to safeguard the stability of the euro area as a whole, is distinct from the objective of maintaining price stability, the primary objective of monetary policy. The Court finds that 'an economic policy measure cannot be treated as equivalent to a monetary policy measure for the

[118] On the IMF practices, see 'The European Stability Mechanism' (2011) *ECB Bulletin*, July, pp 71–84, esp p 79, 'The International Monetary Fund's approach to debt sustainability assessments, private sector involvement and its preferred creditor status', with reference to a 'Staff guidance note on debt sustainability analysis for market access countries', IMF, Washington DC, July 2008.

[119] <http://www.consilium.europa.eu/homepage/highlights/the-european-stability-mechanism-(esm)-inaugurated?lang=en> accessed 15 March 2013.

[120] <www.curia.europa.eu>.The judgment originated from a request by the Irish Supreme Court to interpret EU law (*Thomas Pringle v Government of Ireland, Ireland and the Attorney General* [2012] IESC 47, Supreme Court Record Number: 339/2012, 31 July 2012. See <http://www.supremecourt.ie>). The Irish court was faced, on appeal, by a challenge by an Irish MP of the ratification of the ESM Treaty. Mr. Pringle had gone to court in Ireland arguing that the amendment to the TFEU had not been adopted by the European Council according to the appropriate Treaty revision procedure. He also argued that ratification by Ireland of the ESM Treaty would violate provisions in the Treaties on EMU and confer on the institutions of the Union powers that were incompatible with their Treaty-given functions. The Irish Supreme Court also wanted to know whether the amendment encroached upon the exclusive EU competence for monetary policy and on EU competences on the coordination of economic policies of the Member States. For a summary of this case see R Smits, mimeo, 'ECJ confirms validity of ESM', 28 November 2012. See above, in the text, a reference to the judgment of the Court in Case C-230, of 27 November 2012.

المنارة للاستشارات

sole reason that it may have indirect effects on the stability of the euro'. The ECJ further states that: '[t]he grant of financial assistance to a Member State however clearly does not fall within monetary policy' and concludes that the ESM constitutes a financing mechanism within the area of economic policy. As regards the role of the Union in the area of economic policy the Court sees this as 'restrict[ed] to the adoption of coordinating measures'. The Court considers that the strict conditionality .required under the newly added paragraph 3 of Article 136 TFEU will ensure that the ESM operates in compliance with EU law, notably with measures adopted in the context of economic policy coordination.

The contention by a number of economists that a single monetary area would require financial transfers from one region to another to absorb cyclical problems or to deal with other asymmetrical shocks,[121] has come to the fore since 2010. However, the current Treaty does not include any provision regarding the possibility of fiscal transfers to deal with cyclical problems or to offset regional/ national imbalances.

(d) Prohibition of Excessive Deficits

The prohibition of Article 126(1) TFEU, is a firm rule: 'Member States shall avoid excessive government deficits' (though the UK has a lesser obligation in this regard[122]). It is for the Commission to monitor the budgetary situation in the Member States and for the Council to decide whether an excessive deficit exists and, if necessary, to compel the Member State to reduce the deficit identified.

The provisions of the Treaty ought to be read in conjunction with the evolution of secondary law and in particular the six-pack and two-pack. However, for reasons of clarity we felt it was necessary to present successive analysis of the different elements of fiscal and macro-economic discipline.

1. The Reference Values

Under Article 126(2) TFEU, the Commission examines compliance with budgetary discipline on the basis of the following two criteria:

(a) whether the ratio of the planned or actual government deficit to gross domestic product exceeds a reference value, unless either the ratio has declined substantially and continuously and reached a level that comes close to the

[121] Indeed, this is one of the tenets of fiscal federalism. For a recent reflection, see Simon Tilford, 'Europe cannot afford to let Greece default', *Financial Times*, 15 January 2010: 'The eurozone needs tougher fiscal rules. But it also has to set limits on intra-eurozone current account surpluses and deficits. Fiscal rules will mean little without the latter. The alternative to such rules is fiscal (hence political) union. This would involve the "stronger" economies transferring money to the "weaker" ones on an ongoing basis, much as happens within individual member states.'

[122] Art 5 of the Protocol (No 15) on certain provisions relating to the United Kingdom states that '[t]he United Kingdom shall endeavour to avoid excessive government deficits'.

المنارة للاستشارات

reference value, or, alternatively, the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value.

(b) whether the ratio of government debt to gross domestic product exceeds a reference value, unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace.

The reference values are specified in Protocol No 12 on the excessive deficit procedure annexed to the Treaties.[123] According to Article 1 of the Protocol the reference values referred to in Article 126(2) TFEU, Article 104(2) of the EC Treaty are: (a) 3 per cent for the ratio of the planned or actual government deficit to gross domestic product at market prices and (b) 60 per cent for the ratio of government debt to gross domestic product at market prices.

The Treaty provides some room for interpretation and a degree of discretion with regard to these reference values. The definition of an excessive deficit according to Article 104 EC entails a judgment. A current deficit, for instance, exceeding the reference value of 3 per cent does not constitute a lack of budgetary discipline if 'the ratio has declined substantially and continuously and reached a level that comes close to the reference value' or, alternatively, the excess over the reference value is 'only exceptional and temporary and the ratio remains close to the reference value'. Similarly, the total stock of government debt may be in excess of 60 per cent of the GDP without leading to the finding of budgetary imbalance provided that 'the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace'.

Under the provisions of Article 126(3) TFEU, the Commission prepares a report if a Member State does not fulfil the requirements under one or both of these criteria. But the two criteria are not the only ones to be taken into account. The Commission must also take into account 'whether the government deficit exceeds government investment expenditure' (which reflects the golden rule that only investment can be financed through deficits) and 'all other relevant factors, including the medium-term economic and budgetary position' of the Member State in question.

The Protocol on the Excessive Deficit Procedure further defines the technical terms used in Article 126 TFEU, Article 104 of the ECT.[124] Hence, for the purposes of the excessive deficit procedure, 'government' means 'general government', that is, central government, regional or local government, and social security funds, to the exclusion of commercial operations, as defined in the European System of Integrated Economic Accounts; 'deficit' means net borrowing as defined in the European System of Integrated Economic Accounts; 'investment' means gross fixed capital formation as defined in the European System of Integrated Economic Accounts; and 'debt' means total gross debt at nominal

[123] See Protocol (No 12) on the Excessive Deficit Procedure at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2008:115:0201:0328:EN:PDF> accessed 15 March 2013.
[124] See Protocol on the Excessive Deficit Procedure, Art 2.

المنارة للاستشارات

value outstanding at the end of the year and consolidated between and within the sectors of general government as defined in the first indent.

Under Article 3 of the Protocol, the governments of the Member States are deemed responsible for the deficits of general government as defined above. Further, the Member States must ensure that national procedures in the budgetary area enable them to meet their obligations for the purposes of the excessive deficit procedures and must report their planned and actual deficits and the levels of their debt promptly and regularly to the Commission. But crucially, it is the statistical data provided by the Commission and not the statistical data provided by Member States which are decisive for the purposes of the excessive deficit procedure.[125]

The crucial reference values of 3 per cent and 60 per cent and the remaining provisions of the Protocol can be replaced by appropriate provisions adopted by the Council, acting unanimously on a proposal from the Commission and after consulting the European Parliament and the ECB.[126]

2. The Excessive Deficit Procedure

The excessive deficit procedure is a procedure in stages. Article 126 TFEU specifies the manner in which it is carried out and the respective roles and powers of the Commission, the Council, and the Member States. Since these are provisions of primary law, they can only be altered by a revision of the Treaty.

- The Commission monitors the budgetary position of the Member States and the compliance with the reference values of 3 and 60 per cent of government deficit and total government debt to GDP with a view to identifying gross errors (Article 126(2) TFEU).
- According to Article 126(3) TFEU, if a Member State does not fulfil the requirements under one or both of the criteria, or if the Commission is of the opinion that there is a risk of an excessive deficit in a Member State, the Commission prepares a report. **The Commission has the right of initiative in the excessive deficit procedure.**[127]
- The Commission Report is discussed in the Economic and Financial Committee, which formulates an opinion (Article 126(4) TFEU).
- Should the Commission consider that an excessive deficit in a Member State 'exists' or 'may occur' the Commission addresses an opinion to the Member State concerned and informs the Council (Article 126(5) TFEU).
- The Council decides after an overall assessment whether an excessive deficit 'exists', acting by a qualified majority on a *proposal* (and not more on a

[125] Ibid, Art 4.
[126] See Art 126(14) TFEU.
[127] The powers of the Commission and the Council have been clarified in by the European Court of Justice in its judgment of 13 July 2004, Case C-27/04 *Commission v Council*.

المنارة للاستشارات

recommendation, as before the Lisbon Treaty) from the Commission, and having considered any observations which the Member State concerned may wish to make (Article 126(6) TFEU).

- According to Article 126(7) TFEU, where the existence of an excessive deficit is decided under Article 126(6), the Council adopts without unjustified delay recommendations to the Member State concerned, upon recommendation of the Commission, with a view to bringing the situation to an end within a given period. This first set of recommendations must not be made public.
- The recommendations can only be made public after a separate decision to that effect by the Council, if the Council establishes that there has been no effective action in response to its recommendations within the period laid down (Article 126(8) TFEU).
- If, however, a participating Member State persists in failing to put into practice the recommendations of the Council, the Council may decide to give notice to the Member State to take, within a specified time limit, measures for the deficit reduction which is judged necessary by the Council in order to remedy the situation, and to submit reports on its proposed adjustment efforts (Article 126(9) TFEU). **Responsibility for making the Member States observe budgetary discipline lies essentially with the Council**.
- According to Article 126(11) TFEU, as long as a participating Member State fails to comply with the decision of the Council, the Council may decide to apply or, as the case may be, intensify one or more of the following measures: (1) to require the Member State concerned to publish additional information, to be specified by the Council, before issuing bonds and securities; (2) to invite the European Investment Bank to reconsider its lending policy towards the Member State concerned; (3) to require the Member State concerned to make a non-interest-bearing deposit of an appropriate size with the Community until the excessive deficit has, in the view of the Council, been corrected; and (4) to impose fines of an appropriate size. All these measures must be made public, alerting of course investors in financial markets. The President of the European Council must also inform the European Parliament of the decisions taken.

It must be noted that the normal provisions for securing a State's compliance with the EC Treaty (Articles 259 and 260 TFEU) do not apply in the excessive deficit procedure.[128] Any decision to impose a sanction or not to impose a sanction is, of course, subject to judicial review.

[128] See Art 126(10) TFEU.

المنارة للاستشارات

Once an excessive deficit has been corrected, the Council is obliged to make a public statement that an excessive deficit in the Member State concerned no longer exists, if it—the Council—had previously made public recommendations with regard to its existence (Article 126(12) TFEU). In its judgment of 13 July 2004, the Court clarified the powers of the Council and the Commission relating to the excessive deficit procedure, as further explained below.

D. Secondary Law: The Stability and Growth Pact

Though we briefly mentioned the road to the SGP above, in this section we discuss first the relevant secondary law concerning economic policy coordination that preceded the Stability and Growth Pact (SGP), we then refer to the genesis of the original SGP (the old 'SGP')[129] and the regulations that form the core of the Pact and, finally, we analyse the 'new' or reformed SGP.

Following one of the recommendations of the Delors Report, on 12 March 1990 the Council adopted Council Decision 90/141/EEC on the Attainment of Progressive Convergence of Economic Policies and Performance during Stage One of Economic and Monetary Union.[130] In that decision, the Council officially acknowledged that progress towards economic and monetary union required a high degree of convergence of economic performance between Member States through greater compatibility and closer coordination of economic policies. According to Article 1 of Decision 90/141, the Council was empowered to undertake 'multilateral surveillance' in order to help to achieve sustained non-inflationary growth in the Community, together with a high level of employment and the degree of economic convergence necessary for the success of stage one of economic and monetary union. This decision was later replaced by the provisions on economic policy coordination inserted in the EC Treaty by the Maastricht Treaty and in the secondary law adopted for its implementation. Council Regulation (EC) No 3604/93 of 13 December 1993 elaborates on the application of the prohibition of privileged access referred to in Article 104a of the Treaty[131] and the concept of 'privileged access'. Council Regulation (EC) No 3603/93 of 13 December 1993 specifies definitions for the

[129] See <http://ec.europa.eu/economy_finance/sgp/index_en.htm> accessed 15 March 2013.

[130] [1990] OJ L78, p 23. This Council Decision repealed the Council Decision 74/120/EEC of 18 February 1974 on the attainment of a high degree of convergence of the economic policies of the Member States of the European Economic Community as well as the Council Directive 74/121/EEC of 18 February 1974 on stability, growth and full employment in the Community. Council Decision 90/141/EEC was in force up to the start of the second stage of EMU, on 1 January 2004. The procedure of coordination and mutual surveillance was thereafter provided by the then Art 99 ECT.

[131] [1993] OJ L332, 31 December 1993, p 4. The Regulation was adopted under the enabling provisions of Art 102(2) EC. Art 1 of the Regulation defines privileged access as any law, regulation, or any other binding legal instrument adopted in the exercise of public authority which:

- Obliges financial institutions to acquire or to hold liabilities of Community institutions or bodies, central governments, regional, local or other public authorities, other bodies governed

المنارة للاستشارات

application of the prohibitions referred to in Articles 104 and 104b(1) of the EC Treaty regarding the prohibition to finance government deficits via central bank credit.[132] For example, the term 'overdraft facilities' is defined as any provision of funds to the public sector resulting or likely to result in a debit balance.[133] 'Public sector' means Community institutions or bodies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States.[134] The power of the Council to adopt regulations for the purpose of defining these technical concepts is based on Article 103(2) of the EC Treaty (which has become Article 125(2) TFEU).

The Council laid down detailed rules and definitions for the application of the provisions of the Protocol on the Excessive Deficit Procedure annexed to the EC Treaty in Council Regulation (EC) No 3605/93 of 22 November 1993, as amended.[135]

(i) The Genesis of the SGP

In November 1995, Theo Waigel, then German Minister of Finance, put forward the idea of adopting a Stability Pact as it was originally called by its promoters, a scheme which would ensure stricter budgetary discipline for the Member States acceding to monetary union. Though the Maastricht Treaty had already been criticized by many for defining fiscal policy sustainability in quantitative terms,[136] Germany felt that more clearly defined rules on prevention and deterrence (of excessive deficits) were needed to strengthen the 'economic' component of EMU and to achieve sustained and lasting convergence of the economies of the Member States belonging to the euro area. However, the amendment of the Protocol on the Excessive Deficit Procedure would have required unanimity within the Council, and few countries wanted to renegotiate the agreement reached at Maastricht. Instead, the European Council favoured the adoption of rules by way of a European Council Resolution. Following the agreement reached at the Dublin European Council in December 1996, the Resolution on the Stability and Growth Pact was adopted by the Amsterdam

by public law or public undertakings of Member States (hereinafter referred to as 'public sector'), or

- Confers tax advantages which may benefit only financial institutions or financial advantages which do not comply with the principles of a market economy, in order to encourage the acquiring or the holding by those institutions of such liabilities.

[132] [1993] OJ L332, p 1.
[133] Art 1(a).
[134] Art 3.
[135] [1993] OJ L332, 31 December 1993, p 7. Under Art 4 of Council Regulation 3605/93, from the beginning of 1994, Member States shall report to the Commission their planned and actual government deficits and levels of government debt twice a year, the first time before 1 March of the current year (year n) and the second time before 1 September of year n. Regulation 3605/93 was last amended by Regulation 351/2002 of 25 February 2002, [2002] OJ L55, 26 February 2002, p 23.
[136] See Editorial Comments, 'Whither the Stability and Growth Pact?' (2004) 41 CMLRev 1197.

المنارة للاستشارات

European Council in June 1997.[137] The SGP initially consisted of the Resolution of the European Council of 17 June 1997 (which reflected a political commitment to ensure fiscal discipline) and of two regulations: Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the coordination of economic policies[138] and Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the excessive deficit procedure.[139] The original SGP fully entered into force on 1 January 1999 with the start of the third and final stage of EMU.

(ii) The Life of the Old SGP and the Judgment of the ECJ

Breaches of the SGP were soon to become a regular feature of the life of the 'old' or original SGP. Ireland was the first Member State against whom a recommendation issued under the provisions of multilateral surveillance (rather than the excessive deficit provisions) was issued. Ireland's robust economic activity had become a matter of concern to the Commission, the Council, and the European Central Bank, since it could have inflationary consequences. The Council criticized some of the proposals included in the 2001 budget (such as tax cuts) and issued a recommendation to Ireland under Article 99(4) ECT (now Article 121(4) TFEU) to keep fiscal policy tight.[140]

In 2001, Portugal became the first participating Member State to incur an excessive deficit.[141] The Commission proposed to the ECOFIN Council to initiate an early warning procedure against Portugal. However, since the Portuguese Government committed itself to achieve a balanced budget by 2004, the Council decided not to follow the Commission's proposal.[142] In 2002, the Portuguese Government revised its budgetary deficit to 4.1 per cent of GDP. The Commission prepared a report (as required by Article 104(3)

[137] Council Resolution 97/C236/01 on the Stability and Growth Pact [1997] OJ C236/1. According to the Resolution, Member States undertake to comply with the medium-term budgetary objective of positions close to balance or in surplus.

[138] See Council Regulation 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies [1997] OJ L209/1.

[139] See Council Regulation 1467/97 of 7 July 1997 speeding up and clarifying the implementation of excessive deficit procedure [1997] OJ L209/6. The Regulation provides a clear method for proposing and implementing prompt corrective actions within a year of the reporting of the excessive deficit.

[140] See Council Recommendation of 12 February 2001 with a view to ending the inconsistency with the broad guidelines of the economic policies in Ireland (2001/191/EC). An immediate Council decision to publish the recommendation was adopted on the same day.

[141] 'The general government deficit in Portugal rose [. . .] in 2001 [. . .]. With a view to securing close monitoring and the needed reduction in the deficit to create a safety margin to avoid breaching the 3% of GDP deficit laid down in the Treaty, the Commission proposes to the Ecofin Council to give Portugal an early warning on the basis of Regulation 1466/97 of the Stability and Growth Pact.' See <http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/02/165&format=HTML&aged=1&language=EN&guiLanguage=en>.

[142] See SM Seyad, 'Destabilisation of the European Stability and Growth Pact' (2004) 19 *Journal of International Banking Law and Regulation* 242.

المنارة للاستشارات

ECT), stating that the excessive budget deficit was neither the result of a severe economic downturn nor of an unusual event outside the control of the Portuguese Government. The Commission thus proposed to the Council that it should establish the existence of an excessive deficit in Portugal in accordance with Article 104(5) ECT. In November 2002, the Council, acting by a qualified majority, endorsed the Commission's proposal and adopted a decision stating that an excessive deficit had been incurred (Article 104(6) ECT), and a recommendation addressed to the Portuguese Government with a view to bringing the deficit down in 2003 (Article 104(7) ECT).[143]

Fiscal problems in France and Germany in 2002 prompted the Commission and the Council to take action under the SGP rules. In February 2002, upon examining Germany's proposed stability programme, the Commission proposed to the ECOFIN Council to give Germany an early warning on the basis of Regulation 1466/97 of the Stability and Growth Pact (SGP). The Council, however, did not follow the Commission's recommendation for an early warning. Germany's budget deficit and projected Government debt in 2002 exceeded the reference values of 3 and 60 per cent (reaching 3.7 per cent and 60.9 per cent respectively). In accordance with Article 104(3) EC, the Commission adopted a report on the budgetary situation in Germany. The report stated that the excessive deficit did not result from an unusual event outside the control of Germany or from a severe economic downturn. The Commission recommended to the Council that it should decide that there was an excessive deficit in Germany. On 21 January 2003, the Council adopted a decision on the existence of an excessive deficit in Germany.[144] The Council informed the German Government that it should bring the excessive deficit situation to an end as rapidly as possible. According to the Commission's forecast on the German finances, the deficit for 2003 was over 4 per cent of GDP. In view of this budgetary development, the Commission declared that Germany was not in compliance with the Council recommendation issued in January 2003. The Commission further declared that Germany should put an end to the excessive deficit situation by 2004 as required by the Council.

With regard to France, in its assessment of the 2002 stability programme, the Commission concluded that general government finances had deteriorated markedly in 2002, with a significant divergence from the projections of 2001. In January 2003, the Council adopted a recommendation with a view to giving an early warning to France in order to prevent the occurrence of an excessive

[143] Council Recommendation to Portugal with a view to bringing an end to the situation of an excessive government deficit (Application of Article 104.7 of the EC Treaty), of 5 November 2002 [2002] OJ L322, 27 November 2002, pp 30–1. The Portuguese Government adopted austerity measures and reduced the deficit in 2002 and 2003.

[144] Council Decision 2003/89/EC of 21 January 2003 on the existence of a government deficit in Germany - Application of Article 104(6) of the EC Treaty, [2003] OJ L034 , 11 February 2003, pp 16–17.

المنارة للاستشارات

deficit.[145] In June 2003 on the basis of a Commission Recommendation, the Council decided that an excessive deficit existed in France,[146] and issued a recommendation based on Article 104(7) EC to bring the excessive deficit situation to an end by 2004 at the latest. The Council also established 3 October 2003 as the deadline for the French Government to take appropriate measures.[147]

In October 2003 the Commission proposed that the Council should adopt two recommendations on the basis of Article 104(8) and 104(9) (now Articles 126(8) and (9) TFEU) stating that no effective action had been taken neither by France nor by Germany in relation to the excessive deficit procedure. However, at the ECOFIN meeting held on 25 November 2003, the Council did not adopt the decisions recommended by the Commission under Articles 104(8) and (9) against France or against Germany. It merely adopted, instead, a set of conclusions holding the excessive deficit procedure in abeyance and addressing recommendations to both France and Germany for correcting their excessive deficits in the light of their previous commitments.

On 27 January 2004, the Commission brought an action before the European Court of Justice challenging (1) the Council's failure to adopt the decisions recommended by the Commission under Articles 104(8) and 104(9) EC which, if adopted, would have ordered France and Germany to put an end to their excessive deficits by 2005 and to achieve a reduction of the deficit in 2004; and (2) the conclusions adopted by the Council.[148] On application by the Commission, the President of the Court ordered on 13 February 2004 that the case was to be determined in accordance with an expedited procedure. The Court of Justice did react speedily and on 13 July 2004 its judgment was published.[149] The Court found that failure by the Council to adopt the decisions recommended by the Commission 'does not constitute an act challengeable by an action for annulment' and that, therefore the action [for annulment] brought by the Commission against the Council was inadmissible. The Court also ruled that the conclusions of the Council holding the excessive deficit procedures in abeyance and modifying the recommendations that it had previously adopted were unlawful. The Court clarified that though the Council has discretion in this field, it cannot depart from the rules laid down by the Treaty or those which it set for itself in Regulation 1467/97. Accordingly, the Court stated that once that the

[145] See Council Opinion of 21 January 2003 on the updated Stability Programme of France, 2004–2006 [2003] OJ C026, 4 February 2003, pp 5–6.
[146] Council Decision 2003/487/EC on the existence of an excessive deficit in France—application of Article 104(6) of the EC Treaty [2003] OJ L165, 3 July 2003, pp 29–30
[147] Above n 142, 244.
[148] See Case C-27/04 *Commission of the European Communities v Council of the European Union*, 13 July 2004, in [2004] OJ C228/16, 11 September 2004, concerning the action of the Commission and the conclusions of the Council with regard to the excessive deficits of France and Germany. See also the European Court of Justice Press Release No 57/04 of 13 July 2004 concerning Case C-27/04.
[149] Ibid.

المنارة للاستشارات

Council has adopted recommendations for the correction of the excessive deficit, the Council cannot modify such recommendations without being prompted again by the Commission, which has the right of initiative in the excessive deficit procedure. The Court also found that the recommendations contained in the Council's conclusions were adopted in accordance with the voting rules prescribed for a decision to give notice, which are different from those prescribed for the adoption of the recommendations for correcting the excessive deficit. The Court therefore annulled the Council's conclusions of 25 November 2003.

The ECJ's judgment on 13 July 2004 focused on procedural issues. The nature of the fiscal rules and budget policy has been left to politicians to renegotiate. The judgment of the Court of Justice of 13 July 2004 has shown that judicial involvement cannot sort out the problems of economic policy coordination (the Court, in this case, limited its judgment to the clarification of the powers of the Council and the Commission relating to the excessive deficit procedure but did not rule on the wisdom of the fiscal rules). Judicial activism that occurs in other areas of EC law (particularly competition law and the area of the internal market) may not be expected in the area of economic policy coordination.

(iii) The First Reform of the SGP

In September 2004, the Commission issued a Communication on 'strengthening economic governance and clarifying the implementation of the Stability and Growth Pact'.[150] Following this communication, on 20 March 2005, the ECOFIN Council adopted a report on 'Improving the implementation of the Stability and Growth Pact',[151] which was endorsed by the European Council meeting in Brussels on 22 and 23 March 2005.[152] The Ministers of Finance agreed to 'rewrite the SGP', with more flexible fiscal rules, thus lending some credence to the allegation that political pressures had prevailed over economic considerations. The rewriting of the SGP took place through the adoption on 27 June 2005 of two Regulations (Regulation Council 1055/2005 and Regulation 1056/2005) on the basis of the ECOFRIN Council Report mentioned above, and bearing in mind that the EC Treaty stands, with the main elements of the Excessive Deficit Procedure and the qualitative and quantitative reference valued—3 per cent and 60 per cent—unaltered. Regulation 1055/2005 amended Regulation 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies.[153] Regulation 1056/2005 amended

[150] Communication from the Commission to the Council and the European Parliament on strengthening economic governance and clarifying the implementation of the Stability and Growth Pact, 3 September 2004, COM (2004) 581 final.
[151] See <http://register.consilium.eu.int/pdf/en/05/st07/st07423.en05.pdf> accessed 15 March 2013.
[152] See J-V Louis, 'The Review of the Stability and Growth Pact' (2006) 43 CMLRev 85–106.
[153] Council Regulation (EC) No 1055/2005 amending Regulation (EC) No 1466/97 on the strengthening of the surveillance of the budgetary positions and the surveillance and coordination of economic policies [2005] OJ L174, 7 July 2005, pp 1–4.

المنارة للاستشارات

Regulation 1467/97 on the excessive deficit procedure (Regulation 1467/97).[154] Some of the changes that were agreed by the European Council did not require amendments to Regulation 1466/97 and resulted in a Code of Conduct on the Content and Format of the Stability and Convergence Programmes that was endorsed by the ECOFIN Council on 11 October 2005. This code of conduct incorporates the essential elements of Council Regulation 1466/97 into guidelines to assist the Member States in drawing up their programmes. It also aims at facilitating the examination of the programmes by the Commission, the Economic and Financial Committee, and the Council.[155]

According to some commentators, the problem with the 1997 Stability and Growth Pact is that it was more about stability than growth.[156] Former Chancellor Schröder wrote at the beginning of 2005 that 'the goal of consolidating public budgets may well conflict in the short term with the goal of enhancing the potential for economic growth'.[157] Further, Schröder argued that the complexities of fiscal policy cannot be adequately captured by quantitative limits: 'Whether a fiscal policy is "right" and promotes stability and growth equally cannot be measured solely by compliance with the deficit reference value of 3 per cent of gross domestic product. This indicator is inadequate to deal with the complex realities of fiscal policy.' The term 'pact' is misleading in that the rules (with preventive and corrective elements) are not a separate agreement. They have been adopted in the form of regulations under the provisions of the EC Treaty.[158] The rules apply to all Member States but the strict enforcement of budgetary discipline pursuant to the excessive deficit procedure applies only to the States which have adopted the euro. One of the major novelties of the SGP as designed in 1997 was the commitment to budgetary balance over time (which goes one step further than 'simply' avoiding excessive deficits). This commitment has been weakened in the 'new SGP'. This is one of the most visible differences between the 1997 SGP and the 2005 SGP.

In the new or reformed SGP, the obligation for Member States to adhere to the medium-term objective for their budgetary positions of close to balance or in surplus 'should be differentiated for individual Member States, to take into account of the diversity of economic and budgetary positions and developments' in the light of the economic and budgetary heterogeneity in the Union.[159]

[154] Council Regulation (EC) No 1056/2005 amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure [2005] OJ L174, 7 July 2005, pp 5–9.
[155] See European Commission, Economic and Financial Affairs, 'The Stability and Growth Pact' at <http://www.eu.int/comm/economy_finance/about/activities/sgp/sgp_en.htm>.
[156] See LB Smaghi, 'What Went Wrong with the Stability and Growth Pact' in P Sørensen (ed), *Monetary Union in Europe. Essays in Honour of Niels Thygesen* (DJØF Publishing Copenhagen, 2004), p 169.
[157] G Schröder, 'A Framework for a Stable Europe', *Financial Times*, 17 January 2005.
[158] See Arts 121(5) and 126(14) TFEU.
[159] See recital 5 and Art 2a of Regulation 1055/2005.

المنارة للاستشارات

Furthermore, the new SGP is more 'growth-oriented' than the old one and considers the impact of long-term structural reforms. Structural reforms, such as the introduction of a multi-pillar system for pension fund reform, which can entail a short-term deterioration of public finances during the implementation period, should be taken into account when defining the adjustment path to the medium-term budgetary objective, so as to safeguard the sustainability of public finances in the long run and to avoid imposing excessive burdens on future generations.[160] The term 'national ownership' (an expression which has become 'fashionable' in many contexts: law reform, IMF conditionality, implementation of soft law standards) recurs in the new version of the SGP.[161] The SGP does not alter the main organizational divide between monetary and fiscal policy: 'Member States remain responsible for their national budgetary policies, subject to the provisions of the Treaty; they will take the necessary measures in order to meet their responsibilities in accordance with those provisions.'[162]

(a) **Regulation 1055/2005 amending Regulation 1466/97 on the strengthening of the surveillance of budgetary positions and the coordination of economic policies**

For the purposes of the multilateral surveillance foreseen by Article 99 of the Treaty (now Article 121 TFEU), Member States prepare 'stability' or 'convergence programmes' in conformity with Regulation 1466/97 as amended by Regulation 1055/2005. The Member States of the euro area have to present annual 'stability programmes' to the Commission and to the Council, while the Member State with a derogation have to present annual 'convergence programmes'. The Member States must draw up the programmes in accordance with the Regulation and along the guidelines set in the Code of Conduct on the content and format of the stability and convergence programmes.[163] These programmes must present a medium-term objective for a budgetary position close to balance or in surplus (though this requirement has been 'weakened' following the 2005 amendment), as well as the main assumptions about expected economic developments (growth, employment, inflation and others), a description of the budgetary and other economic policy measures being taken or

[160] See recitals 2 and 8 of Regulation 1055/2005 and Art 5 as amended. See Art 2 as amended, paras 3–5 of Regulation No 1056/2005.

[161] See ECOFIN Council Report of March 2005, above n 153, 4. 'The Council, in reviewing the SGP provisions, detected mainly five areas where improvements could be made: (i) enhance the economic rationale of the budgetary rules to improve their credibility and ownership; (ii) improve 'ownership' by national policy makers; (iii) use more effectively periods when economies are growing above trend for budgetary consolidation in order to avoid pro-cyclical policies; (iv) take better account in Council recommendations of periods when economies are growing below trend; (v) give sufficient attention in the surveillance of budgetary positions to debt and sustainability.'

[162] Resolution on the Stability and Growth Pact, Amsterdam, 17 June 1997 [1997] OJ C236/1.

[163] See EC Commission, Economic and Financial Affairs, The examination of stability and convergence programmes, at <http://europa.eu.int/comm/economy_finance/about/activities/sgp/scp_en.htm>.

المنارة للاستشارات

proposed to achieve the objectives of the programme, and an analysis of how changes in the main economic assumptions would affect the budgetary and debt positions, bearing in mind the reference values of 3 per cent and 60 per cent. Convergence programmes must also present the medium-term policy objectives and the relationship of those objectives to price and exchange rate stability. The programmes are assessed by the Economic and Financial Committee and by the Council, through a process of multilateral surveillance, which has a preventive function, since it aims to identify problems early on (checking that budget deficits do not exceed the 3 per cent reference value).

The Regulation gives specific content to the obligation to forward relevant information to the Commission foreseen in Article 99(3) ECT[164] (now Article 121(3) TFEU) and introduces a yardstick for the evaluation of such programmes. Based upon Article 99(4) ECT (now Article 121(4) TFEU), the Regulation also foresees the establishment of an 'early warning procedure' in the event of an imminent breach of the rules (ie before an excessive deficit as defined in the Treaty has actually occurred).[165]

(b) Regulation 1056/2005 amending Regulation 1467/97 on speeding up and clarifying the excessive deficit procedure

Regulation 1056/2005 introduces some changes that 'relax' the rigidity of some of the rules of Regulation 1467/97, in particular with regard to the concept of exceptional excess, the medium-term budgetary position, and the nature of the assessment. The assessment by the Commission (under Article 104(3) ECT, now Article 126(3) TFEU) moves towards more 'qualitative terms' according to the amended Article 2.3 of the Regulation, which reads as follows:

> The Commission shall give due consideration to any factors which, in the opinion of the Member State concerned, are relevant in order to comprehensively assess in qualitative terms the excess over the reference value [. . .]. In that context, special consideration shall be given to budgetary efforts towards increasing or maintaining at a high level financial contributions to fostering international solidarity and to achieving European policy goals, notably the unification of Europe [a veiled reference to the costs of Germany reunification, which turned Germany from a saint to a sinner in budget management] if it has a detrimental effect on the growth and fiscal burden of a Member State.

Article 5 as amended by Regulation 1055/2005 states that the Council shall also take into account whether a higher adjustment effort is made in 'economic good times', whereas the effort may be more limited in 'economic bad times'. The reference to good and bad economic times allows for a greater degree of

164 Regulation 1466/97, Art 3(2).
165 Regulation 1466/97, Art 6(2).

المنارة للاستشارات

discretionary judgment in the assessment of the budgetary position of a Member State than under Regulation 1667/1997.[166]

Regulation 1467/97—rightly considered as the cornerstone of the original SGP—defined more precisely and strengthened the Treaty rules relating to the excessive deficit procedure, so as 'to deter excessive general government deficits and, if they occur, to further their prompt correction' (Article 1.1 of the Regulation) and established a system of sanctions to penalize countries in case of breach of the rules.[167]

(iv) The SGP in the Aftermath of the Financial Crisis. The 'New' Economic Governance

Breaches of the SGP have been a recurrent feature in the life of the 'Pact', both with regard to the original SGP and with regard to the reformed SGP. National fiscal responses to the financial crisis of 2007–2009 signified an important departure from fiscal discipline, with most eurozone and non-eurozone countries incurring significant fiscal deficits to combat the fiscal costs of recapitalization of the banking system. Member States were allowed—often encouraged—to take fiscal measures to stimulate the economy. In this context, infringements of the SGP became commonplace in 2008. The flexibility of the revised SGP was stretched to the maximum. It has been said—perhaps with exaggeration—that the SGP was suspended during the crisis.[168] Indeed, it appeared to be 'in coma' as Member States struggled to combat the crisis with all means including fiscal activism. But there is still life in the SGP: as the expected recovery of the economies gets under way, the Commission and the Council will ask

[166] Gerhard Schröder, former German Chancellor, writing in the *Financial Times*, 17 January 2005, on the reform of the stability and growth pact ('A Framework for a Stable Europe'), referred to 'cyclical incentives'. He complained about 'the mechanistic application of the pact' which had led the EU to recommend further restrictive measures [in a downturn, albeit not a 'severe economic downturn'], which had delayed recovery [in the country affected].

[167] Sanctions first take the form of a non-interest bearing deposit with the Commission, which comprises a fixed component equal to 0.2 per cent of GDP, a variable component equal to one tenth of the difference between the deficit as a percentage of GDP in the year in which the deficit was deemed to be excessive and the reference value of 3 per cent of GDP. Each following year until the decision on the existence of an excessive deficit is abrogated, the Council may decide to intensify the sanctions by requiring an additional deposit. This will be equal to one tenth of the difference between the deficit as a percentage of GDP in the preceding year and the reference value of 3 per cent of GDP. The annual amount of deposits may not exceed the upper limit of 0.5 per cent of GDP. A deposit is, as a rule, converted into a fine if, in the view of the Council, the excessive deficit has not been corrected after two years.

[168] Compare with point 12 of the conclusions of the European Council, 15–16 October 2008: 'Budget policies must continue to be in line with the reviewed Stability and Growth Pact, which also should be applied in a manner which reflects the current exceptional circumstances, as provided for in its rules.' In this context, one should point out the 'overarching principle' following which 'the general government deficit remains close to the reference value and its excess over the reference value is temporary', Art 2, para 4 of Regulation 1467/97, as amended by Regulation 1056/2005.

المنارة للاستشارات

Member States for clear exit strategies in order to come back to budgetary orthodoxy.[169]

The success of the euro in the long run requires fiscal discipline.[170] One of the tenets of central bank independence is the prohibition on financing government deficits via central bank credit. Fiscal restraint remains a fundamental pillar for the maintenance of monetary stability, the statutory primary objective of the European Central Bank. and one of the objectives of the EU listed in Article 3, paragraph 3 of the TEU (Treaty on European Union, as revised by the Lisbon Treaty).

It is not surveillance ('carrots') that deters countries from misbehaving; it is the effective application of sanctions that is the true deterrent ('sticks'). By analogy with the IMF functions of surveillance and conditional financial assistance, it is not IMF surveillance that makes countries comply with their self-imposed reform programmes, but the 'conditionality' that governs the access to and use of IMF resources (conditionality as a 'stick'). Under this test of 'carrots and sticks', it can be said that if the sanctions or penalties foreseen in the excessive deficit procedure when the budgetary rules are breached, are not applied, the 'deterrent effect' of the SGP disappears, 'inviting' other Member States to be 'fiscal delinquents', too.[171]

In order to restore fiscal discipline and to extend the process of coordination and sanction to macro-economic imbalances (which have been at the heart of the crisis), with emphasis on the necessity of structural reforms and of improving competitiveness, the European Council created, at its meeting of 25 and 26 March 2010, on a proposal of the Heads of State and Government of the euro area, a special task force, chaired by the President of the European Council and composed by representatives (Finance Ministers) of the twenty-seven Member States plus the Commission and the President of the ECB. The European Council, in its meeting of 28 and 29 October 2010, approved the report which was in large part inspired by the proposals made by the Commission on 29 September. Legislation has now entered into force on 13 December 2011.[172] It provides for an improvement of fiscal surveillance by

[169] See eg, Council Conclusions on fiscal exit strategy, 2967th Economic and Financial Affairs, 20 October 2009, <http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ecofin/110612.pdf> accessed 15 March 2013.

[170] 'A co-ordinated economic policy is not a luxury for a monetary union. It may be essential to its long-term survival.' See W Munchau, 'Eurozone faces risks if inflation rates stay out of line', *Financial Times*, 31 May 2004.

[171] The SGP wanted to get more automatism than what the Treaty provided (as we have explained above); Germany believed that once the carrot of the accession to the euro would disappear, the States would forget about the prohibition of excessive deficits.

[172] There are five Regulations and one Directive generally referred to as the 'six -pack', all published in [2001] OJ L306, 23 November 2011. These are Regulation (EU) No 1173/201 of the European Parliament and of the Council of 16 November 2011 on the effective enforcement of budgetary surveillance in the euro area; Regulation (EU) No 1174/2011 of the European Parliament and of the Council of 16 November 2011 on enforcement measures to correct excessive macroeconomic

المنارة للاستشارات

a better ex ante examination of the draft national budgets during what is henceforth called a 'European Semester',[173] a revision of the regulations implementing the Stability and Growth Pact in order to organize better control of the adjustment path of the public debt up to a limit compatible with the maximum provided by the Treaty, an earlier and gradual process of sanctions (interest bearing deposits, non-interest bearing deposits, fines, increased fines)—to which the Commission has proposed to add conditionality with regard to 'imprudent' budgetary conduct of Member States when granting structural funds—an Excessive Imbalances Procedure (EIB) including an alert procedure in the hands of the Commission and based on a scoreboard of relevant criteria—aiming at detecting and fighting macro-economic imbalances such as lack of competitiveness or asset bubbles in the housing sector to cite two relevant examples which have been at the root of the banking crises and sovereign debt crises in Ireland and in Spain—complementing the Excessive Deficit Procedure (EDP), and also sanctions concerning the manipulation of statistics, a phenomenon which played a significant role in triggering the Greek debt crisis. A new voting procedure is provided for the adoption of sanctions: the reversed majority rule. It means that sanctions in the preventive stage will automatically be adopted on a proposal (as a matter of fact, a recommendation) of the Commission, unless it is rejected within ten days by a qualified majority in the Council. A remarkable development in the 'six-pack' is the Directive of 8 November 2011, based on Article 126(14), on requirements for budgetary frameworks of the Member States, which has a very broad field of application. Under Article 2 of the Directive, 'budgetary framework' means the "set of arrangements, procedures, rules and institutions that underline the conduct of budgetary policy of general government". It lists in particular seven items, such as country-specific numerical fiscal rules,[174] medium-term budgetary frameworks, and arrangements for independent monitoring and analysis, to enhance the transparency of the budget process.

imbalances in the euro area; Regulation (EU) No 1175/2011 of the European Parliament and of the Council of 16 November 2011 amending Council Regulation(EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies; Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macro-economic policies; Council Regulation (EU) No 1177/2011 of 8 November 2011 amending Regulation (EC) N°1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure; Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary framework of the Member States.

[173] An idea already accepted by the European Council at its meeting of 17 June 2010 and decided by the ECOFIN Council of 7 September 2010 which adopted the 'Specifications on the implementation of the Stability and Growth Pact and the Guidelines on the format and content of Stability and Convergence Pacts'. This made it possible to start with the first 'European Semester' after 1 January 2011.

[174] Arts 5 to 7 related to numerical fiscal rules of the Directive of 8 November 2011 on requirements for budgetary frameworks of the Member States, shall not apply to the United Kingdom.

المنارة للاستشارات

The new legislation incorporating the reform was adopted on the basis of Articles 121(6) (economic policy coordination and surveillance), 126(14) (excessive deficit procedure), and 136 (special measures applicable to the euro area). Prevention plays an important role in it but new sanctions are also provided at this stage only for euro area members and the UK will escape them under the special regime deriving from Protocol No 15. In order to judge the new mechanisms it will be necessary to look at the way they are applied in practice. Many are sceptical about the effectiveness of a sanction mechanism that was never applied during the first decade of monetary union. It is probably one of the main reasons why Member States are required to insert in their national law the so-called 'golden rule' of budget balance. The ECB has regretted that too much of a role is still given to the Council in the process. As in 2005, at the time of the first reform of the SGP, it pleads for automaticity in the application of sanctions. The Fiscal Compact, discussed below, tries to address this situation. The ECB supported the idea—espoused by Germany and a small number of other Member States—of depriving the persistent violator of budget rules of its right to vote in the Council, an idea that would require a revision of the Treaty on a very sensitive point and, for this reason, seems to have been abandoned

Another ingredient which may play an important role in the 'European Semester' is the Europe 2020 Strategy, the new strategy for jobs and growth to replace the failed 2000 Lisbon Strategy which aimed at building within a decade the most competitive knowledge-based economy in the World. The new strategy was proposed by the Commission and adopted by the European Council at its meetings of 25/26 March and 17 June 2011. It aims at 'smart, sustainable and inclusive growth'. In other terms, it will focus on knowledge and innovation, a more sustainable economy, high employment, and social inclusion. It requires structural reforms which, to quote the European Council, 'are essential for a strong and sustainable recovery and for preserving the sustainability of our social models' (Conclusions, 25/26 March 2011, I, 3). Numerical objectives are fixed for 'headline targets' (Conclusions, 17 June 2011, Annex I). The Reform Programmes presented by the Member States during the 'European Semester' are due to implement the priorities of the Strategy. Its role is to avoid or at least limit the tendency which could transform the semester in a purely budgetary exercise clause.

The key question remains: will the reformed and extended SGP enshrined in the new economic governance be more successfully applied than its predecessor? One cannot neglect the importance of what has been achieved by the task force chaired by Mr Van Rompuy and the EU Legislator (the EP played a great role in improving the texts, providing in particular for an economic dialogue), but Member States have apparently not fully realized that to be in a monetary union means to share sovereignty in economic and fiscal affairs (the 'remorseless' logic of monetary union is fiscal union, in the words of UK Chancellor George

المنارة للاستشارات

Osborne). Nevertheless, already before its adoption, the result of the six-pack seemed not to be bold enough for Germany and France. They rather abruptly proposed to the Member States in February 2011 the adoption of what was primarily called a 'Pact for Competitiveness', which was adopted in March 2011—through the intermediation of President Van Rompuy—by the euro area Member States and six other EU Member States, under the name of the Euro Plus Pact.[175] This Pact, which is not legally binding, includes provisions on competitiveness (labour costs), convergence, tax harmonization, employment, and the introduction of a debt brake in national Constitutions. Member States commit themselves to make annual undertakings in the framework of the European Semester. The Pact is an informal arrangement which can be qualified as pertaining to soft law, but the absence of compliance with the undertakings subscribed in the Pact could be taken into account as an element of appreciation of the 'good conduct' of the Member State concerned as far as budgetary discipline is concerned.

At the meeting of 9 December 2011 of the Euro Area Summit, twenty-six Member States, decided to conclude without Britain—which had refused to agree to a revision of the EU Treaties without a specific clause excepting the UK from the application of new rules on financial markets, supposedly detrimental to the interests of the City of London—a fiscal compact under the form of an international treaty that could enter into force through the ratification of a reduced number (twelve) of euro area Member States. The Treaty entitled 'Treaty on stability, coordination and governance in the EMU' (TSCG) was finalized and accepted by twenty-five Heads of State or Government (all except the UK and the Czech Republic) at their meeting of 30 January 2012. It was signed by the same States on 2 March. It will enter into force with the ratification of twelve Member States of the euro area. Its Preamble underlines that this Treaty and the ESM Treaty are part of a global strategy and that the attribution of financial assistance in the framework of new programmes under the EMS will be conditioned, as from 1 March 2013, on the ratification of the TSCG by the Contracting Party concerned and, from the expiration of the transposition deadline (ie one year after the entry into force of the TSCG) mentioned in Article 3, paragraph 2, of the TSCG on the respect of the requirements (ie the debt brake and the automatic correction mechanism, see below) of this Article.

This Intergovernmental Treaty shall be applied and interpreted in conformity with the founding Treaties and its provisions shall apply insofar as they are compatible with the EU Treaties and EU law and, within five years at most following its entry into force, the necessary steps shall be taken in order to incorporate the substance of the Treaty into the legal framework of the Union

[175] See Annex 1 to the Conclusions of the meeting of the European Council, 24 and 25 March 2011.

المنارة للاستشارات

(Article 16). The core of the new Treaty consists in a formulation of the 'debt brake provision' or the so-called 'golden rule' (Article 3) which imposes a maximum structural deficit of 0.50 per cent GDP. A correction mechanism shall be triggered automatically in case of significant observed deviation from the medium-term objective or the adjustment path towards it (Articles 3(1)c) and 3(2). These rules are to be inserted—under the control of the Commission and European Court of Justice—in national law 'through provisions of binding force and permanent character, preferably constitutional, or otherwise to be guaranteed to be respected throughout the national budgetary processes'. This careful wording takes into account the difficulties that the necessity of a revision of national constitutions would have implied for some countries.[176] The Treaty gives to the Court of Justice, on an appeal by a Contracting Party, the competence of controlling the compliance by the Member States with the obligation to insert the 'golden rule' in their national law, on the basis of a report of the Commission concluding that a Member State has failed to comply with Article 3(2) (Article 8).[177] It includes (Article 4) the one-twentieth per year rule for the reduction of the debt, which was already provided in the six-pack. It provides for a so-called 'budgetary and economic partnership programme' for countries subject to an excessive deficit (Article 5). The Treaty also includes a commitment of the Parties to support the proposals and recommendations of the Commission where it considers that a Member State is in breach of the deficit criterion, unless a qualified majority of Member States is opposed to it (Article 7). This provision constitutes a soft way of introducing (quasi) automatism also in the 'repressive' stage of the EDP—ie for the decision based on Article 126(6) on the existence of an excessive deficit and possible sanctions under Article 126(11)—which was not meant to be possible or acceptable in the negotiation of the six-pack.

It seems evident that complete automaticity through the mechanical application of numerical data is impossible. The sanction of budgetary policy is always a matter of judgement. The (political) question still is who, from the Commission or from the Council, will exercise this judgement. The commitment of the Contracting Parties by Article 7 strengthens very much the responsibilities of the Commission while leaving the last word to the Council.

[176] It was thought that the insertion of 'preferably' could avoid the need to organize a referendum in Ireland. Nevertheless, the Irish Government decided to organize a referendum which took place on 31 May 2012 and which was favourable to the Treaty.

[177] When there is such a report by the Commission, the Contracting Parties have decided that the trio of presidencies of the EU Council would act. In the absence of such a report, a party may apply on its own. The competence of the ECJ is based on Art 273 TFEU (Article 8 being in casu the compromissory clause). If a Contracting Party does not comply with the sentence, the Court may impose a lump sum or penalty payments that shall not exceed 0.1 per cent of GDP.

المنارة للاستشارات

Member States are also requested to report ex ante on national debt issuance plans to the European Commission and the European Council (Article 6).[178] Like Article 5 on partnership programmes, the content of Article 6 was very close to the two new proposals (dubbed the 'two-pack') that the Commission submitted on 23 November 2011 and which are expressly mentioned in the Preamble of the Treaty, aiming at increased monitoring of policies of Member States. There are also some provisions on economic policy coordination and convergence which do not exceed in general the bearing of (important) declarations of intentions in a Treaty which is mainly a fiscal compact. Let us mention the obligation for the Contracting Parties to discuss ex ante 'all major economic policy reform' and, 'where appropriate' to coordinate them among themselves (Article 11). The third part of the Fiscal Compact includes a small Title on Governance which relates first to the institutionalization of the Euro Summit meetings which will meet at least twice a year (Article 12) and, second, to the organization and promotion of a conference of the chairs of the budget committees of the national parliaments and the chairs of the relevant committees of the European Parliament (Article 13). This could be the start of a development leading to a Euro parliamentary committee, a suggestion made for a long time in many quarters in order to increase the democratic legitimacy of the EMU.

The conclusion of the Fiscal Compact, as an international treaty in which not all EU members will take part, constitutes a step further towards differentiation within the EU, the more so since the Contracting Parties express their will to have recourse to enhanced cooperation among them. The Euro Plus Pact, an informal agreement, was concluded by twenty-three EU Member States, within or outside the euro area; the provisions of the six-pack on sanctions, for example, only apply to euro area members; all Member States participate to the European Semester but different rules apply to those Member States which are 'in' the EMU and those which are 'out'. The Eurogroup has recently seen its role promoted. The ECOFIN Council is more 'boring' than ever: 'real things' are happening and will continue to happen within the European Council, the Summits of the euro area, or the Eurogroup. In a word, not only is the euro area affirrming more and more its identity but the structure of the EU has become more and more confusing and complicated and at times obsolete.[179] Improvization was a feature typical of the measures adopted in order to fight the crisis. The lacunae of the Treaty provisions on EMU and the

[178] Proposal for a Regulation of the European Parliament and the Council on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area, COM(2011)821 final and Proposal . . . on the strengthening of economic and budgetary surveillance of Member States experiencing or threatened with serious difficulties with respect to their financial stability in the euro area, COM(2011)819 final, 23 November 2011. These proposals were accompanied by a Green Paper on the feasibility of Introducing Stability Bonds, COM(2011)818 final.

[179] See J Pisani-Ferry, A Sapir, and GB Wolff, 'The Messy Rebuilding of Europe', bruegelpolicybrief, 2012/01, March 2012.

المنارة للاستشارات

inadequacy of the existing rules to the situation have led to this apparent disorder.

In the light of all these considerations, the only realistic solution is to progress towards fiscal union, at least for the euro area (which in turn is a step closer towards political union). The impossible quest for automaticity has been sacrificed, while the SGP (as any other rule) cannot survive without societal legitimacy. The widespread breach of the fiscal rules has damaged the credibility of the commitment of the eurozone Member States to fiscal discipline. Going forward, we need to reconcile the interests of the citizens of the EU with the grand plans and small patches that the Union institutions have devised and continue to devise—in a frenzy of legislative and policy initiatives—to combat the twin sovereign debt and financial crisis and to ensure the survival of the euro. The law provides a framework and an opportunity for reform. However, only a Treaty change could dramatically alter the existing framework for economic policy coordination.[180]

IV. The ESCB and the ECB[181]

A. Introduction

The institutional foundations of monetary union are the euro and the European Central Bank. The latter forms together with the National Central Banks of the EU Member States the European System of Central Banks. According to its own website, 'The ECB is the central bank for Europe's single currency, the euro'.[182] The ESCB is the central banking system of the European Union. The ESCB has a dual structure with the European Central Bank (ECB) at the centre, headquartered in Frankfurt on Main, and the National Central Banks (NCBs) at the periphery.

[180] Eijffinger has pointed out that '. . . in the end only a higher degree of fiscal integration would remove the inflexibility inherent in the recourse to predefined budgetary rules'. See S Eijffinger, 'How can the Stability and Growth Pact be improved to achieve stronger discipline and higher flexibility', European Parliament Briefing Paper, November 2002, 1. See also above n 81, 780: 'Fiscal federalism is predicated on the coherence of the political system where it is practiced, and it is about balancing efficiency and equity in an optimizing fashion. Whether in a federal system or in other polities in which there are substantial budgetary flows between central and sub-national tiers of government, many of the tenets of fiscal federalism can only plausibly apply if there is a sufficient degree of political commitment.'

[181] See generally RM Lastra, *Legal Foundations of International Monetary Stability* (Oxford University Press, 2006), ch 8 and 'The Evolution of the European Central Bank' (2012) 35(5) *Fordham International Law Journal* 1260–81, and J-V Louis, *L'Union européenne et sa Monnaie*, Commentaire J Mégret (3rd edn, Editions de l'Université de Bruxelles, 2009), ch IV.

[182] See <www.ecb.int> accessed 15 March 2013. 'The ECB is the central bank for Europe's single currency, the euro. The ECB's main task is to maintain the euro's purchasing power and thus price stability in the euro area. The euro area comprises the 17 European Union countries that have introduced the euro since 1999.'

المنارة للاستشارات

The European System of Central Banks is a complex central banking system. This complexity is multi-layered. First, there is the structural complexity, which is a permanent feature of the System. The ESCB is composed of the ECB and the NCBs. Secondly, for a transitional period of unknown duration there is the division between the 'ins' (Member States whose currency is the euro) and the 'outs' (Member States not having adopted the euro or 'Member States with a derogation'). According to Article 139 TFEU, 'Member States in respect of which the Council has not decided that they fulfil the necessary conditions for the adoption of the euro shall hereinafter be referred to as 'Member States with a derogation'. The NCBs of the 'ins' and the ECB constitute the Eurosystem.[183] According to Article 282 TFEU, 'The European Central Bank, together with the national central banks, shall constitute the European System of Central Banks (ESCB). The European Central Bank, together with the national central banks of the Member States whose currency is the euro, which constitute the Eurosystem, shall conduct the monetary policy of the Union.' The Eurosystem will coexist with the ESCB and it will coincide with it if and when all Member States have adopted the euro.[184] Thirdly, the NCBs, in turn, are also characterized by a duality. On the one hand they are an integral part of the ESCB (operational arms of the ESCB), when carrying out operations that form part of the tasks of the ESCB. On the other hand, they are also national agencies when performing non-ESCB functions. For these reasons, while the law governing the ECB is solely EC law, the laws governing the status of the NCBs emanate not only from EC sources, but also from their respective national legislation (though such legislation needs to be compatible with Union law before the adoption of the euro).[185]

B. Primary and Secondary Union Law

(i) Primary Law

The primary Union law applicable to the ESCB (the ECB and the NCBs) comprises Articles 127–142 and Articles 282–284 TFEU Article 13 TEU and the Protocol on the Statute of the European System of Central Banks and the European Central Bank (ESCB Statute), which is annexed to the Treaties (Protocol No 4).[186] A novelty in the TFEU is that it enshrines in EU law the term 'Eurosystem' to refer to the ECB and the NCBs of the Member States whose currency is the euro. The Protocol on the Statute of the European System

[183] See the *Mission Statement of the Eurosystem*, 2005, on the website of the ECB, quoted in the preceding note.
[184] On the Eurosystem and its governing principles, see Louis, op cit, pp 141–8.
[185] See Art 131 TFEU.
[186] The Lisbon Treaty was published in the Official Journal C306 of 17 December 2007 for the entire text, and for the consolidated version, the Official Journal C326 of 26 October 2011, <http://eur-lex.europa.eu/JOHtml.do?uri=OJ%3AC%3A2012%3A326%3ASOM%3AEN%3A HTML> accessed 15 March 2013.

المنارة للاستشارات

of Central Banks and of the European Central Bank is annexed to the Treaties (Protocol No 4) and, as a protocol, it is an integral part of the Treaties (Article 51 TEU)[187] in principle only revisable following the procedures provided for by the Treaties themselves, except for a list of provisions bearing on collections of statistics, monetary operations, financial, and staff matters.[188]

(ii) Secondary Law: Legal Acts of the ECB

The secondary Union legislation applicable to the ESCB comprises, in addition to some EU legislation, a range of legal acts of the ECB (ECB regulations, decisions, recommendations and opinions)[189] and intra-ESCB legal instruments that are in principle only binding within the System (guidelines and instructions) between the ECB and the NCBs.[190] It is important to point out that regulations, decisions, and guidelines have become very important in the practice of the ECB.[191] Indeed, the ECB regulatory role is rather extensive (though supervision can be separated from the central bank, an independent central bank always keeps a regulatory role).

There is also secondary EU legislation regarding the ESCB, such as the European Council regulations on the euro, which could be called the 'currency law' of the Union,[192] and minimum reserves, statistical information gathering, sanctions, which constitute the so-called 'complementary legislation', and others.

With regard to the legal acts of the ECB, Article 132(1) TFEU reads as follows:

In order to carry out the tasks entrusted to the ESCB, the European Central Bank shall, in accordance with the provisions of the Treaties and under the conditions laid down in the Statute of the ESCB and of the ECB:

- make regulations to the extent necessary to implement the tasks defined in Article 3.1, first indent, Articles 19.1, 22 and 25.2 of the Statute of the ESCB and of the ECB in cases which shall be laid down in the acts of the Council referred to in Article 129(4),
- take decisions necessary for carrying out the tasks entrusted to the ESCB under the Treaties and the Statute of the ESCB and of the ECB,
- make recommendations and deliver opinions.

[187] See R Smits, 'The European Constitution and EMU: an Appraisal' (2005) 42 CMLRev 425–68 at 463.
[188] Art 129(3) TFEU includes the list of the provisions of the Protocol that can be revised through the ordinary legislative procedure. Before the Lisbon Treaty, the revision, if made on a proposal of the Commission, required a unanimous vote within the Council.
[189] See Art 132 TFEU and Art 34 of the ESCB Statute.
[190] Art 14.3 of that ESCB statute refers to 'guidelines and instructions' of the ECB to the NCBs.
[191] For a relatively recent compilation of the legal acts of the ECB, see 'Legal Framework of the Eurosystem and the European system of Central Banks', ECB Legal Acts and Instruments 2009 Update, ECB, 2009. The ECB demonstrates a marked preference for guidelines in its regulatory practice. See for a critical analysis of this practice, Louis, op cit, p 208–11 and also 'A Legal and Institutional Approach for Building a Monetary Union' (1998) 35 CMLRev 33–76 at 58–63.
[192] See below.

المنارة للاستشارات

Article 34.1 of the Statute of the ESCB/ECB repeats the content of Article 132 TFEU.

A regulation has the same bearing as EU regulations, defined in Article 288 TFEU: it has general application, is binding in its entirety, and is directly applicable in all Member States. A decision is binding in its entirety upon those to whom it is addressed. In addition, the ECB may make recommendations and deliver opinions. These have no binding force.

The ESCB Statute (Article 14.3) provides for the adoption by the ECB of guidelines and instructions addressed to the national central banks of the Eurosystem. The competences and procedures for adopting legal acts of the ECB are set out in Article 17 of the Rules of Procedure of the ECB.[193] This Article reads as follows:

17.1. ECB Regulations shall be adopted by the Governing Council and signed on its behalf by the President.
17.2. ECB Guidelines shall be adopted by the Governing Council, and thereafter notified, in one of the official languages of the European Union, and signed on the Governing Council's behalf by the President. They shall state the reasons on which they are based. Notification of the national central banks may take place by means of telefax, electronic mail or telex or in paper form. Any ECB Guideline that is to be officially published shall be translated into the official languages of the European Union.
17.3. The Governing Council may delegate its normative powers to the Executive Board for the purpose of implementing its regulations and guidelines. The regulation or guideline concerned shall specify the issues to be implemented as well as the limits and scope of the delegated powers.
17.4. ECB Decisions and Recommendations shall be adopted by the Governing Council or the Executive Board in their respective domain of competence, and shall be signed by the President. ECB Decisions imposing sanctions on third parties shall be signed by the President, the Vice-President or any two other members of the Executive Board. ECB Decisions and Recommendations shall state the reasons on which they are based. The Recommendations for secondary Community legislation under Article 42 of the Statute shall be adopted by the Governing Council.
17.5. Without prejudice to the second paragraph of Article 44 and the first indent of Article 47.1 of the Statute, ECB opinions shall be adopted by the Governing Council. However, in exceptional circumstances and unless not less than three Governors state their wish to retain the competence of the Governing Council for the adoption of specific opinions, ECB opinions may be adopted by the Executive Board, in line with comments provided by the Governing Council and taking into account the contribution of the General Council. ECB opinions shall be signed by the President.
17.6. ECB Instructions shall be adopted by the Executive Board, and thereafter notified, in one of the official languages of the European Union, and signed on the

[193] See decision of the European Central Bank of 19 February 2004 adopting the Rules of Procedure of the European Central Bank (ECB/2004/2) (2004/257/EC) available at <http://www.ecb.int/ecb/legal/pdf/l_08020040318en00330041.pdf> accessed 15 March 2013. For more information on the legal acts pertaining to the ESCB (Eurosystem) and the ECB, see the 'Legal framework' section of the ECB's website at <www.ecb.int>.

المنارة للاستشارات

Executive Board's behalf by the President or any two Executive Board members. Notification of the national central banks may take place by means of telefax, electronic mail or telex or in paper form. Any ECB Instruction that is to be officially published shall be translated into the official languages of the European Communities. All ECB legal instruments shall be numbered sequentially for ease of identification. The Executive Board shall take steps to ensure the safe custody of the originals, the notification of the addressees of consulting authorities, and the publication in all the official languages of the European Union in the *Official Journal of the European Union* in the case of ECB Regulations, ECB opinions on draft Community legislation and those ECB legal instruments whose publication has been expressly decided.

C. The ECB and the NCBs[194]

In terms of the ECB internal organizational structure, the Eurosystem is governed by the Governing Council and the Executive Board, the two main decisions-making bodies of the ECB, by which the ESCB is governed.[195] Only the NCBs of the Member States whose currency is the euro are represented in these two decision-making bodies. The NCBs of those countries that do not participate in EMU ('Member States with a derogation') either because they have opted out (the UK and Denmark), rejected membership through a referendum (Sweden),[196] or have not qualified yet (with regard to the new Member States that joined the EU in May 2004) still participate in the third governing body of the ESCB, the General Council, a body chaired by the president of the ECB and including also its vice-president, entrusted mostly with advisory functions.[197] The other rather limited tasks of the General Council can be classified into coordinating functions (between the monetary policies of the Member States with a derogation and that of the eurozone) and preparatory functions (helping the Member States with a derogation prepare for eventual eurozone membership).

It is worth recalling that neither the ESCB nor the Eurosystem have legal personality, and that, therefore, they are not carriers of rights and obligations. The entities that do have legal personality are the ECB[198] and the NCBs. Only the ECB and the NCBs, but not the ESCB, have the powers to sue and to be sued.[199]

[194] See RM Lastra, 'The Division of Responsibilities between the European Central Bank and the National Central Banks within the European System of Central Banks' (2000) 6(2) *Columbia Journal of European Law* 167–80.
[195] See Arts 129(1) and 282(2) TFEU.
[196] The Swedish, Danish, and UK cases have been discussed earlier in this chapter.
[197] See Art 141 TFEU, which refers to the General Council as the 'third decision making body of the ECB'. See ESCB Statute Arts 44–46 and the Rules of Procedure of the General Council of 17 June 2004 (esp chapter II) with regard to the involvement of this body in the tasks of the ESCB.
[198] As recognized in Art 129(2) TFEU.
[199] Article 9.1 of the ESCB Statute states that the ECB 'shall enjoy in each Member State the most extensive legal capacity accorded to legal persons under its law. It may, in particular, acquire or dispose of movable or immovable property and may be a party to legal proceedings.'

المنارة للاستشارات

A claim against a NCB is not a claim against the ECB and certainly not against the ESCB, since the latter does not have legal personality. A claim against a NCB is not a claim against the Member State of that NCB nor against the Community. Article 35.6 of the ESCB Statute allows the ECB to bring a suit before the European Court of Justice against a NCB if the latter does not comply with its obligations under this Statute.

The division of responsibilities between the ECB and the NCBs within the ESCB resembles to some extent the structure of the US Federal Reserve System. Indeed, while the ESCB functionally is reminiscent of the pre-1999 Bundesbank, geographically it resembles the Federal Reserve System. It is interesting to observe that in the congressional debates that led to the establishment of the Federal Reserve System in 1913, there was a considerable discussion as to the use of the name 'central bank' and that is why the name Federal Reserve System was adopted, to reflect the federal structure of the US, the balance of power between the Federal Government and the States. The Federal Reserve System does not have legal personality. The entities with legal personality are the Board of Governors and the Federal Open Market Committee (which are both federal agencies and, as such, public legal persons) on the one hand, and the twelve Federal Reserve Banks on the other. However, in contrast to the NCBs, which are typically public legal persons (publicly managed and, for the most part, publicly owned), the Federal Reserve Banks have private legal personality, with private ownership (100 per cent owned by the member banks in each district) and private management.[200] Nonetheless, the analogy between the Federal Reserve System and the ESCB is useful in understanding the duality of functions of the NCBs. In some instances, the NCBs act as a part of the ESCB, and in other instances on their own, ie separately and independently from the ECB. In term of its capital structure, it should be noted that the NCBs are the ECB's sole shareholders.

The analogy with the Fed is useful in understanding the process of centralization that the Fed has experienced over the years in the field of monetary policy, as illustrated by the fact that the discount rate, originally set by each Federal Reserve Bank, has become centralized.[201] However, centralization of one function does not imply centralization of all functions, as the example of the Federal Reserve Banks within the Federal Reserve System clearly manifests. The

[200] Not all NCBs are formally public legal persons: the Banque Nationale de Belgique, the Banca d'Italia, the Bank of Greece, and De Nederlandsche Bank NV are working under the form of public limited companies, ie firms with private legal personality.

[201] Journalists and commentators have often discussed the process of centralization of power within the Federal Reserve System. However, it should be pointed out that this process of centralization refers to the monetary policy functions entrusted to the Fed, and not necessarily to other functions. For instance, when the Federal Reserve Banks act in their private or commercial capacity, such as when they enter into depository agreements with the banks in their respective districts, or when they manage investment accounts for foreign central banks, they act as separate legal persons from the Board of Governors, zealously guarding their independence from the 'centre'.

المنارة للاستشارات

Federal Reserve Banks are organically independent from the Board of Governors in Washington DC and from the US Government (each has its own Board of Directors, a distinct legal personality, and private ownership) while functionally, they sometimes act in conjunction with the other components of the Federal Reserve System in the implementation of monetary policy, at other times as agents of the US Government (eg, when they act as fiscal agent or as an agent of the Treasury and the Federal Open Market Committee in the conduct of foreign exchange interventions), and in further instances as a corporate entity, performing corporate functions. The complexity of the tasks assigned to the Federal Reserve Banks is a useful reference in understanding the tasks assigned to the NCBs within the ESCB. The analogy can be taken further, when it comes to supervision and crisis management. In the USA there has been a process of federalization in the supervision and crisis management of financial institutions. Lender of last resort was federalized in 1913 with the Federal Reserve Act, while the Federal Deposit Insurance Corporation (FDIC) was established in 1933.[202]

A general principle applicable to the division of responsibilities for their operations between the ECB and the NCBs is Article 12.1 paragraph 3 of the ESCB Statute, which sets out that '[t]o the extent deemed possible and appropriate and without prejudice to the provisions of this Article, the ECB shall have recourse to the national central banks to carry out operations . . .'. The imperative of decentralization has to be combined with the requirement of efficiency, as underlined in the Mission Statement of the Eurosystem adopted by the ECB in 2005 and referred to earlier.

D. Objectives of the ESCB

The objectives of the ESCB are spelt out in Article 127(1) TFEU and Article 2 of the ESCB Statute. The primary objective of the European Central Bank is price stability, ie the control of inflation. Monetary stability is also one of the objectives of the EU listed in Article 3§3 of the TEU (Treaty on European Union, as revised by the Lisbon Treaty). The ECB is heir to the stability culture of the Bundesbank and a creature of its time: economic theory and evidence have supported the case for a price-stability oriented independent central bank since 1989, when the Reserve Bank of New Zealand Act establishing such a system was introduced. The secondary objective—the support of the general economic policies in the Community as provided in Article 3 TEU which includes full employment and balanced growth—is to be pursued without prejudice to the primary objective, maintaining price stability. The wording of this provision is heavily influenced by Article 12 of the 1957 Bundesbank

[202] Takis Tridimas in a contribution entitled 'EU Financial Regulation: Federalization, Crisis Management a=and Lender of Law Reform' published in *The Evolution of EU Law*, 2nd edn (ed by P Craig and G de Búrca, published by OUP in 2011), states: 'The evolution of EU financial law has been a journey towards federalization' (p 783).

المنارة للاستشارات

Law,[203] which was the subject of academic controversy in Germany, with one author referring to it as the 'squaring of the circle'[204] (for hundreds of years there were attempts to find a square of the same area as a circle, until in 1882 it was proved impossible . . .). The first ECB presidents have repeatedly considered that the best way for the ECB to contribute to growth and employment was by maintaining price stability in the medium term, denying an autonomous content to the second objective. In 2003, the ECB defined quantitatively the objective of price stability: a year-on-year increase of the Harmonised Index of Consumer Prices for the euro area which will keep the euro area inflation rate at below, but close to, 2 per cent, over the medium term.[205] It means that deflation has to be avoided as much as inflation. Furthermore, the reference to the medium term avoided the need for fine-tuning operations in case of a temporary rate exceeding 2 per cent.

Despite the importance of financial stability (mentioned in Article 127(5) TFEU) as a classic central banking goal (modern central banks have two core objectives: monetary stability and financial stability),[206] the drafters of the Maastricht Treaty did not include this goal as a key objective of the European Central Bank. In the light of the financial crisis, this was clearly shortsighted as we discuss further below.

Article 127(1) TFEU also refers to the rather generic requirement for the ESCB to act in accordance with the principles of an open market economy with free competition and favouring an efficient allocation of resources, and in compliance with the principles set up in Article 119 TFEU. Paragraph 3 of this latter provision refers once again to stable prices but also to sound public finances and monetary conditions as well as a stable balance of payments.

E. Tasks of the ESCB

The functions of the ESCB are divided into 'basic tasks', which are defined in Article 127(2) TFEU and reproduced in Article 3.1 of the ESCB Statute, and other functions (non-basic tasks) that are scattered throughout other provisions. Though this distinction is not always clear in our opinion, it is enshrined in the Treaties and, therefore, has legal consequences.

While the language applicable in Article 127(2) refers to the 'basic tasks to be carried out through the ESCB' (the ESCB being construed as the compound of its constituent parts, ie both the ECB and the NCBs), the language applicable to

[203] It is remarkable that this Article provided for the stability of the currency without distinguishing between internal or external stability but the practice of the Bundesbank was clearly orientated towards price stability.
[204] See K Stern, *Das Staatsrecht der Bundesrepublik Deutschland* (C.H. Beck, 1980), pp 463–508.
[205] See ECB, *The monetary policy of the ECB*, 2011, p 9.
[206] On the financial stability function of a modern central bank, see Bank for International Settlements, *Issues in the Governance of Central Banks*. A report from the Central Bank Governance Group, Chair: Guillermo Ortiz, May 2009.

المنارة للاستشارات

the other tasks typically mentions the ECB and the NCBs separately (with the one significant exception of Article 127(5) TFEU, which refers to the ESCB).

(i) Basic Tasks

According to Article 127(2) TFEU, the basic tasks 'to be carried out through the ESCB' are four: (1) to define and implement the monetary policy of the Community, (2) to conduct foreign exchange operation consistent with the provisions of Article 219 of TFEU, (3) to hold and manage the official foreign reserves of the Member States and, (4) to promote the smooth operation of payment systems.[207]

(a) Monetary Policy

The formulation and implementation of monetary policy is the first and most important basic function to be 'carried out through' the ESCB. Responsibility for monetary policy has been clearly transferred from the national arena to the supra-national arena for the Member States whose currency is the euro. In this sense, it is both accurate and entirely appropriate to talk about a 'single monetary policy' (for the Eurosystem). Indeed, while the single market has not been fully realized, the idea of a single currency has been fully achieved through the introduction of the euro on 1 January 1999. The transfer of monetary policy powers from the national to the supra-national arena signifies the surrender of one of the classic attributes of sovereignty of the nation-state,[208] a sovereignty that had become purely nominal in most of the Member States of the EU.

According to Article 3(4) TEU, 'The Union shall establish an economic and monetary union whose currency is the euro'. The Union's monetary policy is the monetary policy of the Member States whose currency is the euro. Article 282(1) TFEU is clear in this regard: 'The European Central Bank, together with the national central banks of the Member States whose currency is the euro, which constitute the Eurosystem, shall conduct the monetary policy of the Union.'

Though monetary policy in the Eurosystem is 'one and indivisible', there still remains an operational distinction between the ECB and the NCBs in the sense that while the decision-making stage of monetary policy is fully centralized at the ECB, the implementation stage is decentralized taking into account the role of the Executive Board in the implementation of monetary policy in accordance with the guidelines and decisions laid down by the Governing Council, in accordance with Article 12.1 of the ESCB Statute. In doing so, the Executive Board shall give the necessary instructions to national central banks. Thus, it is the responsibility of the NCBs of the Eurosystem to conduct the monetary policy operations according to instructions set out by the Executive Board.

[207] Art 127(2) TFEU and Art 3.1 ESCB Statute.
[208] See generally RM Lastra, *Legal Foundation of International Monetary Stability* (Oxford University Press, 2006), ch 1.

المنارة للاستشارات

Article 14.3 clearly states that '[t]he NCBs are an integral part of the ESCB and shall act in accordance with the guidelines and instructions of the ECB'.[209] Accordingly, in the implementation of their ESCB (Eurosystem) tasks, ie monetary policy and other responsibilities resulting from the TFEU and the ESCB Statute, the NCBs act in their capacity as a constituent part of the ESCB (Eurosystem), and not as national agencies.

(b) Foreign Exchange Policy

Since we discuss this function in detail elsewhere in this chapter, suffice is to state here that the second basic task of the ESCB according to Article 127(2) TFEU is to conduct foreign exchange operations consistent with Article 219 TFEU and that the conduct of foreign exchange policy involves the determination of the exchange regime and the determination of the exchange rate. While the ECB has sole responsibility for monetary policy in the euro area, the responsibility for exchange rate policy is divided between the Council (primary role) and the ECB.

(c) Management of Official Foreign Reserves

The management and holding of the official foreign reserves of the Member States is one of the basic tasks to be 'carried out' through the ESCB according to Article 127(2) TFEU. However, only part of the reserves has been transferred to the ECB (according to Article 30 of the ESCB Statute), while part of the reserves is held by the NCBs (according to Article 31 of the ESCB Statute). Further complexity is added by the fact that Member States must comply with their international obligations and hold reserves with such organizations, in particular the IMF, as discussed above.

(d) Promotion of the Smooth Operation of Payment Systems

According to Article 127(2) TFEU, the ESCB is entrusted with the 'smooth operation of payment systems'. Article 22 of the ESCB Statute refers to the constituent parts of the ESCB, ie to both the ECB and the NCBs, when it states that '[t]he ECB and national central banks may provide facilities, and the ECB may make regulations, to ensure efficient and sound clearing and payment systems within the Union and with other countries'. The ECB and the NCBs are both competent to offer facilities for EU-wide payment systems (typically through Trans-European Automated Real-time Gross-settlement Express Transfer, TARGET) and SEPA (the Single European Payments Area),[210] but only the ECB—not the NCBs—is given regulatory powers in this area.[211]

[209] ESCB Statute, Art 14.3.

[210] See <http://ec.europa.eu/internal_market/payments/framework/index_en.htm> and Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market amending Directives 97/7/EC, 2002/65/EC, 2005/60/EC and 2006/48/EC and repealing Directive 97/5/EC (Text with EEA relevance).

[211] On TARGET, see KM Löber and KJ Petersen, 'The Target system', *Euredia*, 2001–2002, p 157 *et seq*. The functioning of the System has been improved by TARGET 2 which includes a

المنارة للاستشارات

Because payment systems are largely conducted—though not necessarily nor exclusively—through the banking system, it is often difficult to dissociate payment system supervision (a basic ESCB task) from banking supervision (a 'non-basic ESCB task'), which for the most part remains a national competence, as we further discuss below.

(ii) Non-Basic Tasks

There are other 'non-basic' tasks (ie not included under the umbrella of 'basic tasks'), in particular: (1) issue of banknotes, (2) contribution to prudential supervision and stability of the financial system, (3) consultative powers, advisory functions and collection of statistical information and, (4) international cooperation and 'external operations'.

(a) Issue of Banknotes

According to Article 128 TFEU, 'the ECB shall have the exclusive right to authorize the issue of euro banknotes within the Union. The ECB and the NCBs may issue such notes. The banknotes issued by the ECB and the national central banks shall be the only such notes to have the status of legal tender in the Union.' Article 128(2) TFEU further adds that 'Member States may issue coins subject to approval by the ECB of the volume of the issue'. Article 16 of the ESCB Statute is the relevant provision in the ESCB Statute with regard to the issue of banknotes.

(b) Prudential Supervision and Stability of the Financial System

Much has been written about this function in the context of the financial crisis. It is worth recalling that the Draft Statute of the ESCB—released by the Committee of Governors of the EC Central Banks in November 1990—included coordination in the field of prudential supervision amongst the basic tasks of the ESCB. However, the opposition of some countries to such an inclusion means that the final version of the ESCB Statute and of the EC Treaty (as revised by the Maastricht Treaty) only referred to supervision in a limited way, as a non-basic task, according to the language of Article 127(5) to 127(6) TFEU, and Articles 3 and 25 of the ESCB Statute.

The reform of EU financial supervision in the aftermath of the financial crisis had up to 2012 not advanced in the direction permitted under the enabling clause of Article 127(6) TFEU that left the door open for a possible transfer of direct supervisory responsibilities to the ECB. Instead, following the

single shared platform (SSP) managed by the three more important central banks of the Eurosystem: France, Germany, and Italy. In 2008, a TARGET2 Securities (T2S) has been launched in view of centralizing the settlement of operations on securities denominated in euro, in central bank money, for participating institutions. Here, the Bank of Spain has joined the three other big central banks in the SSP. See J-M Godeffroy, 'Ten frequently asked questions about TARGET2-Securities', speech at the British Bankers Association, 20 September 2006, *T2S Newsletter*, 6, July 2006. This text as many others on T2S can be found on the ECB's website.

المنارة للاستشارات

recommendations of the Larosière Report, financial supervision—though still a national competence—is further coordinated at the European level through the new three European Authorities, which are the successors of the so-called Lamfalussy Committees.[212] The ECB has assumed the responsibility of the secretariat *lato sensu* of the European Systemic Risk Board. It means that the ECB shall provide 'analytical, statistical, logistical and administrative support' (Regulation No 1096/2010, Article 2).

It is a pity that the Treaty of Lisbon came into force at a time when the debate in Europe had moved forward in other directions, in particular with regard to the appropriate arrangements for financial supervision and crisis management of institutions that operate on a cross-border basis, according to tenets of the Single Market in Financial Services. We would also like to criticize the fact that the Treaty of Lisbon, due to the rigorously limited mandate given to the negotiators, did not attempt to introduce substantial changes to the enabling clause of the ECB, even though it is an anachronism to refer—as Article 127(6) TFEU does—to 'prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings'. Financial developments in the last decades have rendered this exception meaningless, since nowadays financial conglomerates encompass banking, securities, and insurance undertakings.

The abandonment of the coincidence between the area of jurisdiction of monetary policy and the area of jurisdiction of banking supervision was a major novelty brought about by the advent of EMU, as Tommaso Padoa-Schioppa pointed out,[213] the inevitable tension in the EU structure between a national mandate in prudential supervision, combined with a single European currency and a European mandate in the completion of the single market in financial services.[214]

[212] The ECOFIN Council on 2 December 2009 approved the creation of the new three European Supervisory Authorities, which together with the European System Risk Board (for which broad political agreement was reached on 20 October 2009) form the new EU supervisory structure. See <http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ecofin/111706.pdf>. In September 2010, the European Parliament and the Council reached an agreement on the legislative package creating the three authorities and the ESRB. The acts were published in [2010] OJ L331, 15 December 2010 and the reform entered into force on 1 January 2011. See *inter alia* Stijn Verhelst, *Renewed Financial Supervision in Europe—Final or Transitory*? Egmont Papers No 44, Royal Institute for International Relations, Brussels, 2011. See <http://www.publications.parliament.uk/pa/ld200809/ldselect/ldeucom/106/106i.pdf> accessed 15 March 2013.

[213] T Padoa-Schioppa, 'EMU and Banking Supervision', Lecture at the London School of Economics (24 February 1999) <http://fmg.lse.ac.uk/events/index.html> accessed 15 March 2013, also published in C Goodhart (ed), *Which Lender of Last Resort For Europe?* (Central Banking Publications, 2000), ch 1. See also T Padoa-Schioppa, *Regulating Finance* (Oxford University Press, 2004), ch 8 on 'Central Banks and Financial Stability', p 121. Padoa-Schioppa refers to the current approach as one based on 'European regulation with national supervision'.

[214] See N Thygesen, Comments on 'The Political Economy of Financial Harmonisation in Europe' in J Kremer, D Schoenmaker, and P Wierts (eds), *Financial Supervision in Europe* (Edward Elgar, 2003), p 145.

المنارة للاستشارات

The mandate to achieve financial stability is both national and European. At the national level, the Member States which have adopted the Euro rely both on the European Central Bank and on their own supervisory authorities for the pursuit of this objective; the Member States with a derogation or an opt-out, on the other hand, rely on their own national central banks and on their supervisory authorities (if supervision is conducted by a separate agency). At the European level, the picture is also complex, since the ECB's role in financial stability is shared with national authorities (which have the primary responsibility), with other EU institutions, a number of Committees (the Economic and Financial Committee, the Banking Supervision Committee of the European Central Bank, the Financial Services Committee), and, most notably since 2011, with the European Systemic Risk Board and the European Supervisory Authorities (EBA, ESMA and EIOPA) and ESRB. As mentioned earlier, the basis of the new supervisory structure is the so-called Larosière Report, a report by a high-level group on financial supervision in the EU, chaired by Jacques de Larosière, presented to the European Commission, on 25 February 2009.[215] The report was endorsed by the European Commission in May 2009 and by the European Council in June 2009.[216] On 23 September 2009, the EU Commission presented legislative proposals to implement its recommendations.[217] These included proposals for regulations establishing a European Banking Authority (EBA), a European Insurance and Occupational Pensions Authority (EIOPA), and a European Securities and Markets Authority (ESMA), as well as a European Systemic Risk Board (ESRB) and a decision entrusting the ECB with specific tasks concerning the ERSB.[218] In October 2009, the Commission proposed a directive amending a number of directives in respect of the EBA, the EIOPA, and the ESMA. ECOFIN reached a broad consensus regarding the main features of the ESRB at its meeting on 20 October 2009 and on 2 December 2009, ECOFIN approved creation of the new European Supervisory Authorities.[219] The new authorities and the ESRB took up their

[215] Report of the High Level Group on Financial Supervision in the EU, published on 25 February 2009 ('Larosière Report') available at <http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf> accessed 15 March 2013.

[216] See Commission Recommendation of 27 May 2009 endorsing the Larosière Report, <http://ec.europa.eu/internal_market/consultations/2009/fin_supervision_may_en.htm> accessed 15 March 2013.

[217] And <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/1347&type=HTML> (accessed 15 March 2013) Commission adopts legislative proposals to strengthen financial supervision in Europe(see MEMO/09/404 and MEMO/09/405), 23 September 2009.

[218] The legal basis of the regulations is Art 114 of the Treaty on the Functioning of the European Union (TFEU) and the legal basis of the regulation granting certain tasks to the ECB is Art 127(5) TFEU.

[219] See <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/1347&type=HTML> accessed 15 March 2013. Commission adopts legislative proposals to strengthen financial supervision in Europe (see MEMO/09/404 and MEMO/09/405), 23 September 2009. The ECOFIN Council on 2 December 2009 approved the creation of the three new European Supervisory Authorities, which together with the European System Risk Board (for which broad political

المنارة للاستشارات

duties at the beginning of 2011.[220] They all are part of the new European System of Financial Supervision (ESFS) with national supervisory authorities and the Joint Committee of the three Authorities (ESAs) which form a network of authorities under the regulations.

The ESRB was established by Council Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board.[221] This Board is surely the most innovative element of the new ESFS. It answers to a necessity underscored by the G20 London meeting of April 2009 which led to the transformation of the Financial Stability Forum into a Financial Stability Board and the creation in the US of the Financial Stability Oversight Council (FSOC), as part of the Dodd-Frank reform in the Summer 2010.[222] This move is due to the consensus existing among authorities and economists on the need for taking into account the role of systemic factors and macro-economic aspects in the outbreak and the development of the crisis. This was stressed, in particular, in the Larosière Report (paragraphs 146, 153, and 173).

Regulation No 1092/2010 gives the following definition of 'systemic risk': 'a risk of disruption in the financial system with the potential to have serious negative consequences for the internal market and the real economy' (Article 2(c). The practice of the authorities will help to specify this evolving concept which is particularly difficult to enclose in a strict definition.

The ESRB has its seat in Frankfort/Main. Recital No 15 of Regulation No 1092/2010 defines it as an 'independent body without legal personality'. Article 7 relates to the impartiality of its members who will act 'solely in the interest of the Union as a whole'. The same Article adds that 'Neither the Member States, the

agreement was reached on 20 October 2009) form the new EU supervisory structure. See <http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ecofin/111706.pdf> accessed 15 March 2013. The European Banking Authority (EBA) was established by Regulation (EU) No 1093/2010 of the European Parliament and the Council of 24 November 2010. The European System of Financial Supervision was established by Art 2 of that Regulation and of Regulation (EU) No 1094/2010 of 24 November 2010 establishing a European Supervisory Authority (EIOPA), and Regulation (EU) No 1095/2010 of 24 November 2010 establishing a European Supervisory Authority (ESMA).

[220] See L Garicano and RM Lastra 'Towards a New Architecture for Financial Stability: Seven Principles' (2010) 13(3) *Journal of International Economic Law* 604–5.

[221] [2010] OJ L331, 15 December 2010, p 1. On the ESRB, see F Resine, "Towards a new regulatory model for the single European financial market" (2009) 4 RTDF,8–18; J-V Louis, 'Le Comité européen du risque systémique' (2010) 5–6 CDE 645–81.

[222] See also the Council of Financial Regulation and Systemic Risk established in France in October 2010, the Interim Financial Policy Committee (FPC) established within the Bank of England in February 2011 and the Council of Cooperation on Macro-prudential Policy created by the Sveriges Riksbank and the Finansinspektionen at the beginning of 2012, mentioned in M Posch and R Van der Molen, 'The macro-prudential mandate of national authorities', in *Macro-prudential Commentaries*, ESRB, Issue No 2, March 2012, p 5.

المنارة للاستشارات

Union institutions nor any other public body shall seek to influence the independence of the ESRB in the performance of the tasks set out in Article 3(2)'.

The ESRB has no legally binding powers. Its instruments are warnings and recommendations. Article 3(2) lists the tasks of the ESRB: collecting and exchanging information; identifying and prioritizing systemic risk; issuing warnings and recommendations, where appropriate, made public; cooperating with other parts of the ESFS; participating, where appropriate, in the joint Committee of the ESAs; and coordinating with international organizations. Called to collaborate closely with micro-supervisory authorities,[223] the ESRB is in a way the interface of the IMF, FSB, and BIS, and their natural correspondent in the field of financial stability as well as of the FSOC in the United States.[224] Up to now, the ESRB has published two recommendations on 16 January 2012, respectively on the macro-prudential mandate of national authorities and on funding of banks in US dollars, as well as a letter of 2 April 2012 to EU legislators on Principles for macro-prudential policies in EU legislation on the banking sector.

Article 4 of Regulation No 1092/2010 relates to the structure of the ESRB. 'The ESRB will have a General Board, a Steering Committee, a Secretariat, an Advisory Scientific Committee and an Advisory Committee.' The General Board (GB) is the decision-making organ. It brings together the CB governors as well as high-level representatives of the financial supervisory authorities from all EU Member States, the president and vice-president of the ECB, a member of the EU Commission and the chairs of the ESAs, the chair and the vice-chair of the Advisory Scientific Committee (ASC), and the chair of the Advisory Technical Committee (ATC) as well as the chair of the Economic and Financial Committee (EFC) (Regulation No 1092/2010, Article 6). So, the GB includes sixty-five members, thirty-seven voting members and twenty-eight non-voting (the representatives of national supervisory authorities and the president of the EFC).

The question of the chair of the GB was the object of a compromise within the Council, which is reflected in Article 5(1) of Regulation No 1092/2010.[225] This very large organ holds at least four meetings a year with the possibility to hold extraordinary meetings (Article 9(1)).

There is a Scrutiny Committee of fourteen GB members which is in charge of assisting in the decision-making process by preparing the meetings of the

[223] See F Dierick, P Lennartsdotter, and P Del Favero, 'The ESRB at work—its role, organisation and functioning', *Macro-prudential Commentaries,* ESRB, Issue No 1, February 2012.
[224] V Constâncio, "Macro-prudential regulation as an approach to containing systemic risk: economic foundations, diagnostic tools and policy instruments", Speech, 27 September 2010, p 2. <http://www.ecb.europa.eu/press/key/date/2010/html/sp100927_3.en.html> accessed 15 March 2013.
[225] 'The ESRB will be chaired by the President of the ECB for a term of 5 years following the entry into force of the Regulation. For the subsequent terms, the Chair of the ESRB shall be designated in accordance with the modalities determined on the basis of the review provided for in Article 20.'

المنارة للاستشارات

GB, reviewing the documents to be discussed, and monitoring the progress of the ESRB's ongoing work (Regulation No 1092/2010, Article 4(3). The Secretariat, exercised by the ECB, 'shall be responsible for the day-to-day business of the ESRB' (Article 4(4)). It shall provide 'high quality analytical, statistical, administrative and logistical support to the ESRB under the direction of the Chair and the Steering Committee in accordance with Council Regulation (EU) No 1096/2010' conferring specific tasks upon the ECB concerning the functioning of the ESRB.[226] 'It shall also draw on technical advice from the ESAs, national central banks and national supervisors.' Article 2 of Regulation No 1096/2010 describes in more detail what the 'support of the ESRB' means.

The head of the Secretariat shall be appointed by the ECB, in consultation with the GB of the ESRB (Article 3(2) Regulation No 1096/2010). The twenty-plus Secretariat staff are located at the ECB's premises and are supported by the ECB's infrastructure.[227] 'Nevertheless; the ESRB and the ECB are institutionally and functionally distinct and independent bodies.'[228]

There are two advisory committees, the Advisory Scientific Committee, ASC[229] and the Advisory Technical Committee, ATC.[230] The ASC result from an initiative of the European Parliament.

Article 18 of Regulation No 1092/2010 provides for original and extensive 'Accountability and reporting obligations'. Like the Regulations on ESAs, the Regulation establishing the ESRB includes a review clause (Article 20). 'By 17 December 2013, the European Parliament and the Council shall examine on the basis of the report from the Commission and, after having received an opinion from the ECB and the ESAs, shall determine whether the mission and organisation of the ESRB need to be reviewed.' There are indeed a number of shortcomings in the present statute of the ESRB which should be addressed. The GB is an assembly more than a committee and, unfortunately, there is no possibility to delegate powers to the Steering committee which has a more reasonable format. The ASC has observed that "the quarterly cycle of meetings" between the organs of the ESRB 'is appropriate for dealing with long-term structural issues, but may be problematic in times of crisis'. It has also noticed that 'in order to identify the channels for contagion and the building up of systemic

[226] [2010] OJ L331, 15 December 2010, p 162.
[227] See *Macro-prudential Commentaries*, Issue No 1, cit, p 6.
[228] Ibid.
[229] See the Decision of the ESRB of 20 January 2011 on the procedures and requirements for the selection, appointment and replacement of the members of the ASC of the ESRB [2011] OJ C39, 8 February 2011, p 10. And the mandate of this Committee <http://www.esrb.europa.eu/pub/pdf/ASC-mandate.pdf?37160b72b89ccfe3e9c6ee6cca84aac8> accessed 15 March 2013.
[230] See the Mandate of the ATC of the ESRB <http://www.esrb.europa.eu/pub/pdf/ATC-mandate.pdf?2484bd80a9563ab86437bbfa3b5821a8> accessed 15 March 2013.

المنارة للاستشارات

risk . . . the ESRB needs adequate and sufficiently granular data, aggregate data are likely to be insufficient'.[231]

The legal powers of the ESRB are limited to warnings and recommendations. Under ESAs Regulations, it is for the Council—not for the ESRB—to decide on emergencies. The ESRB may only give advice on this matter. The role of the ECB will be greatly expanded with regard to micro supervision if and when the Commission Proposals of 12 September 2012, which plan to create a banking union in the euro area, with the adoption of centralized supervision (via the SSM or Single Supervisory Mechanism) first, and then centralized resolution and deposit insurance, are adopted. The legal basis for the granting of supervisory responsibilities to the ECB is Article 127(6), the so-called enabling clause (a provision that has been criticized by some as an insufficient legal basis). The European Council conclusions of 29 June 2012 invited the President of the European Council to develop a road map for the achievement of genuine Economic and Monetary Union. On the same day, the euro area Heads of State or Government Summit pointed out that when an effective single supervisory mechanism is established involving the ECB for banks in the euro area, the ESM could, following a regular decision, have the possibility to recapitalize banks directly which would rely on appropriate conditionality.

On 12 September 2012, the European Commission published proposals for a single supervisory mechanism (SSM) for banks in the eurozone, following the 28/29 June EU Council conclusions and the report of the President of the European Council, Herman Van Rompuy, *Towards a Genuine Economic and Monetary Union*. The proposals, consisting of two Regulations ('the ECB Regulation' and 'the EBA regulation') and one Communication, are a first step in the road to a banking union, and we further discuss the progress in this area in Section 7 below.[232]

One of the main economic arguments in favour of European Monetary Union was the need to solve the 'inconsistent quartet' of policy objectives: free trade, full capital mobility, pegged (or fixed) exchange rates and independent national monetary policies.[233] The only long-term solution to this inconsistency was to complement the internal market with monetary union,[234] thus abandoning national control over domestic monetary policies. A similar argument is now being made with regard to financial supervision. As Thygesen has

[231] See *Macro-prudential Commentaries*, Issue No 1, cit, p 6 and Art 15 of Regulation No 1092/2010 on 'Collection and exchange of information'.
[232] See <http://ec.europa.eu/internal_market/finances/banking-union/index_en.htm>.
[233] Others referred to the 'trilemma' in macro-economic policy of three desirable yet contradictory or inconsistent policy objectives: fixed exchange rates, capital mobility, and independent monetary policy. See eg A Rose, 'Explaining Exchange-Rate Volatility: An Empirical Analysis of the 'Holy Trinity' of Monetary Independence, Fixed Exchange Rates and Capital Mobility' (2003) 15 *Journal of International Money and Finance* 925–45.
[234] See generally T Padoa-Schioppa, *The Road to Monetary Union in Europe: The Emperor, the Kings and the Genies* (Oxford University Press, 2000).

المنارة للاستشارات

pointed out, it is difficult to achieve simultaneously a single financial market and financial stability while preserving a high degree of nationally based supervision.[235] Schoenmaker referred to these inconsistent objectives as the 'trilemma in financial supervision': a stable financial system, an integrated financial market, and national financial supervision.[236]

There is one particular point of contention with regard to the ECB responsibilities and the pursuit of financial stability and that concerns the lender of last resort role of the central bank. Central banks with or without supervisory responsibilities typically act as lender of last resort (LOLR). From a legal point of view, if a central bank is in charge of both monetary policy and LOLR, as the Federal Reserve System and the Bank of England are, they can use both instruments in response to the crisis (indeed, this is what the Federal Reserve System and the Bank of England did in 2008). The situation is different though with regard to the ECB. Though it has a clear mandate to conduct monetary policy (according to Article 127(2) TFEU, and Article 18 of the ESCB Statute) it has a more limited role than the Bank of England or the Federal Reserve System with regard to the provision of liquidity assistance.[237] Though central banks can create liquidity (a point emphasized by Charles Goodhart), only the fiscal authorities can provide for new injections of equity capital (using taxpayers' money).[238] Hugely expanded liquidity operations by the European Central Bank (ECB) were constrained by this 'fiscal limit'[239] and by Treaty provisions. We have discussed these issues elsewhere.[240] Suffice it to recall that there are two main types of crisis situations where the provision of emergency liquidity assistance could be critical. The first is the case of a general—in many if not all financial markets—liquidity dry up (of which we have ample examples in the last four years) leading to a widespread and generalized questioning of the liquidity of different sorts of financial institutions. Open market operations are the classic instrument in this type of crisis and the ECB has clear competence in this regard according to Article 127(2) TFEU and Article 18 ESCB Statute. The second, the classic case of LOLR assistance (elaborated by Thornton and Bagehot, as further explained below), refers to

[235] See N Thygesen, Comments on 'The Political Economy of Financial Harmonisation in Europe' in J Kremer, D Schoenmaker, and P Wierts (eds), *Financial Supervision in Europe* (Edward Elgar, 2003), p 145.
[236] See D Schoenmaker, *Financial Supervision: from National to European?* (Financial and Monetary Studies (NIBE-SVV), 2003).
[237] As we have already discussed, the ECB and NCBs must also comply with the prohibition of Art 123 TFEU, regarding the monetary financing of governments as well as 'bail-out' prohibition of Art 125 TFEU.
[238] See C Goodhart, 'The Political Economy of Financial Harmonisation in Europe' in J Kremer, D Schoenmaker, and P Wierts (eds), *Financial Supervision in Europe* (Edward Elgar, 2003), pp 133–6.
[239] <http://www.ecb.int/press/key/date/2009/html/sp090713.en.html>.
[240] See eg, Lastra, above n 184, ch 10. See also RM Lastra and A Campbell, 'Revisiting the Lender of Last Resort' (2009) 24(3) *Banking and Finance Law Review* 453.

المنارة للاستشارات

collateralized loans to an illiquid banking sector. A particular crisis situation can arise, for example, when one or more financial institutions gets into trouble due to problems which originate in the payment system and which can lead to a payment system gridlock. If the crisis originates in the payment system the ECB has competence to act according to Article 127(2) TFEU. If the crisis does not originate in the payment system, the ESCB has adopted a restrictive reading of the ECB competences, concluding in 1998 that LOLR/ELA was a national task of the National Central Banks (NCBs), in line with Article 14.4 of the ESCB Statute (a provision which allows NCBs to perform non-ESCB tasks on their own responsibility and liability).[241] Though this interpretation is contested by some authors, such as René Smits,[242] and though it is clouded with a degree of uncertainty, it is the line the ECB has advocated so far.[243] The provision of emergency liquidity assistance (ELA) by the European Central Bank raises difficult and sensitive issues in the light of its institutional mandate. The difficulty is in any case greater when the direct potential beneficiaries of the assistance are the Member States. The ECB refused to finance the ESM because it was of the opinion that Article 123 TFEU on the prohibition of monetary financing would not allow the ESM to become a counterparty of the Eurosystem under Article 18 of the Statute of the ESCB. 'Monetary financing prohibition in Article 123 TFEU is one of the basic pillars of the legal architecture of EMU both for reasons of fiscal discipline of the Member States and in order to preserve the

[241] The following is an excerpt from the ECB Annual Report 1999 (p 98):

> The institutional framework for financial stability in the EU and in the euro area is based on national competence and international cooperation . . . Co-ordination mechanisms are primarily called for within the Eurosystem. This is the case for emergency liquidity assistance (ELA), which embraces the support given by central banks in exceptional circumstances and on a case-by-case basis to temporarily illiquid institutions and markets . . . If and when appropriate, the necessary mechanisms to tackle a financial crisis are in place. The main guiding principle is that the competent NCB takes the decision concerning the provision of ELA to an institution operating in its jurisdiction. This would take place under the responsibility and at the cost of the NCB in question. [. . .] The agreement on ELA is internal to the Eurosystem and does not affect the existing arrangements between central banks and supervisors at the national level or bilateral or multilateral co-operation among supervisors and between the latter and the Eurosystem.

[242] <http://books.google.nl/books?id=sAoHvFX4GkAC&pg=PA269&dq=ecb+lender+of+last+resort+rene+smits#PPA271,M1> accessed 15 March 2013, pp 269–72 See also R Smits, 'The Role of the ESCB in Banking Supervision', *Legal Aspects of the European System of Central Banks. Liber Amicorum Paolo Zamboni Garavelli* (European Central Bank, 2005), n 32.

[243] The following is an excerpt from the ECB Monthly Bulletin February 2007 (p 80): 'One of the specific tools available to central banks in a crisis situation is the provision of emergency liquidity assistance to individual credit institutions against adequate collateral. Generally, this tool consists of providing liquidity support in exceptional circumstances to a temporarily illiquid credit institution which cannot obtain liquidity through either the market or participation in monetary policy operations. This exceptional and temporary liquidity provision should respect the prohibition of monetary financing embodied in the Treaty.' 'A credit institution cannot, however, assume automatic access to central bank liquidity. As a central banking function, the provision of ELA is within the discretion of the national central bank, which will consider the relevant factors that may justify the access to this lending of last resort.' The *ECB Financial Stability Review*, December 2006 (p 172) states that '*since ELA is not a Eurosystem function*, the decision concerning its provision lies with the competent NCB regarding an institution operating in its jurisdiction'.

المنارة للاستشارات

integrity of the single monetary policy as well as the independence of the ECB and the Eurosystem.'[244] At the end of the day, if the ECB makes losses it will be for the NCBs and, indirectly, their respective States to come and help.[245] The deepest pockets in terms of recapitalization are always the Government's. The ECB faces a particular problem in that there is not one government but seventeen governments standing behind and that therefore losses on LOLR loans (if the situation turns out to be of insolvency not illiquidity) will ultimately be borne by the seventeen Member States under the current institutional setting. No doubt the LOLR role tests the limits of the mandate of the ECB in the pursuit of its objectives and hence the ambiguity that surrounds the provision of ELA.

Since May 2010 the ECB has entered into uncharted territory with regard to measures adopted to deal with the crisis—a crisis that mutated from a banking crisis into a sovereign debt crisis and which, can again mutate into a banking crisis. The ECB has used standard and non-standard measures of monetary policy in response to the crisis in order to maintain or restore the monetary policy transmission mechanism.[246] Following standard measures (in accordance with Article 18 of the ESCB Statute) the ECB lowered interest rates in November and December 2011.

It was in the Summer of 2007 that the ECB started to adopt non-standard measures, meant to be transitory and exceptional, in order to address the paralysis in the interbank market. From September 2007 the ECB provided extra liquidity as well as liquidity in dollars, following a swap agreement with the Federal Reserve System.[247] In October 2008, following the collapse of Lehman Brothers on 15 September and almost the implosion of the financial system, the

[244] See Opinion of the European Central Bank of 17 March 2011 on a draft European Council Decision amending Article 136 of the Treaty on the functioning of the EU with regard to a stability mechanism for Member States whose currency is the euro (CON/2011/24), OJ C140/8, 11 May 2011.

[245] See H Hannoun, 'Monetary policy in the crisis: testing the limits of monetary policy', <http://www.bis.org/speeches/sp120216.pdf> February 2012. A different opinion, in favour of the LOLR function for the ECB, is held by P De Grauwe, in 'Fighting the wrong enemy' VOX, 19 May 2010, <http://www.voxeu.org/index.php?=node/5062>. The same author is of the opinion that the Outright Monetary Transactions programme announced by the ECB on 6 September 2012 gives it the role of lender of last resort. See 'The ECB was right to intervene as lender of last resort, but structural reforms are still needed to save the Eurozone' <http://blogs.lse.ac.uk/europpblog/2012/09/12/ecb-eurozone/> accessed 15 March 2013. One can indeed ask the question whether we are not with the OTM before a specific kind of exercise of the lender of last resort function.

[246] See ECB Monthly Bulletin, 'The ECB's non-standard measures—impact and phasing out', July 2011; <http://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1290.pdf> accessed 15 March 2013; <http://www.europarl.europa.eu/document/activities/cont/201208/20120820ATT49767/20120820ATT49767EN.pdf> and RM Lastra, 'The role of central banks in monetary affairs: a global and comparative perspective' forthcoming in T Cottier, RM Lastra, and C Tietje (eds), *The Rule of Law in Monetary Affairs*, to be published by Cambridge University Press.

[247] Since December 2007, the Federal Open Market Committee (FOMC) has authorized dollar liquidity swap lines with the European Central Bank and other central banks to provide liquidity in US dollars to overseas markets, in accordance with section 14 of the Federal Reserve Act and in compliance with authorizations, policies, and procedures established by the FOMC. See Decision of the ECB of 6 December 2011, 'Tender Procedure for the Provision of US Dollars to Eurosystem

المنارة للاستشارات

ECB decided on extraordinary liquidity measures, carrying out weekly refinancing operations with a fixed rate tender procedure will full allotment, ie with the interest rate set in advance and the ECB providing as much liquidity as the banks requested, provided they offered collateral of sufficient quality. In June 2009 the ECB Governing Council decided to start a purchase programme of covered bonds to help revive this segment of the market which is important for the refinancing of banks.[248] This Covered Bonds Purchase Programme (CBPP) started in July 2009, both on the primary market and on the secondary market. The ECB Decision (ECB/2009/16) of 2 July 2009 gave four objectives to the programme: (a) promoting the ongoing decline in money market term rates, (b) easing funding conditions for credit institutions and enterprises, (c) encouraging credit institutions to maintain and to expand their lending to clients, and (d) improving market liquidity in important segments of the private debt securities market. The first programme covered 60 billion euros of bonds from July 2009 to July 2010; the second one which covers 40 billion euros was decided in October and started in November 2011 for one year.

The Securities Markets Programme was established by the ECB in May 2010 as an instrument of monetary policy (non-standard measure adopted by the ECB bearing in mind the constraints of the Treaty) following the Greek debt crisis. As stated in (3) of the Preamble to the Decision establishing the SMP (Decision of the European Central Bank of 14 May 2010 establishing a Securities Markets Programme), the objective was to restore the monetary policy transmission mechanism:

> (1) Pursuant to Article 18.1 of the Statute of the ESCB, national central banks of Member States whose currency is the euro (hereinafter the 'euro area NCBs') and the European Central Bank (ECB) (hereinafter collectively referred to as the 'Eurosystem central banks') may operate in the financial markets by, among other things, buying and selling outright marketable instruments.
> (2) On 9 May 2010 the Governing Council decided and publicly announced that, *in view of the current exceptional circumstances in financial markets, characterised by severe tensions in certain market segments which are hampering the monetary policy transmission mechanism and thereby the effective conduct of monetary policy oriented towards price stability* in the medium term, a temporary securities markets programme (hereinafter the 'programme') should be initiated. Under the programme, the euro area NCBs, according to their percentage shares in the key for subscription of the ECB's capital, and the ECB, in direct contact with counterparties, may conduct outright interventions in the euro area public and private debt securities markets.

counterparties' and Annex I of Guideline ECB/2007/7 of 31 August 2000 on monetary policy instruments and procedures of the Eurosystem ([2000] OJ L310, 11.12.2000, p 1).

[248] See V Autori, 'The impact of the Eurosystem's covered bond purchase programme on the primary and secondary markets', ECB Occasional Paper Series, No 122, January 2011. See also 'The ECB's non-standard measures—Impact and Phasing-Out' ECB, Monthly Bulletin, July 2011, pp 55–69.

المنارة للاستشارات

(3) *The programme forms part of the Eurosystem's single monetary policy* and will apply temporarily. The *programme's objective is to address the malfunctioning of securities markets and restore an appropriate monetary policy transmission mechanism*.
(4) The Governing Council will decide on the scope of the interventions. The Governing Council has taken note of the statement of the euro area Member State governments that they 'will take all measures needed to meet their fiscal targets this year and the years ahead in line with excessive deficit procedures' and the precise additional commitments taken by some euro area Member State governments to accelerate fiscal consolidation and ensure the sustainability of their public finances.
(5) *As part of the Eurosystem's single monetary policy*, the outright purchase of eligible marketable debt instruments by Eurosystem central banks under the programme should be implemented in accordance with the terms of this Decision. (emphasis added)

In December 2011, at a time in which the problems were significant in a number of euro area Member States,[249] the Governing Council of the ECB announced additional enhanced credit support measures to support bank lending and liquidity in the euro area money market.[250] In lieu of the short-term *Mainstream refinancing operations* (MROs), the ECB Governing Council decided to conduct two *Long-term refinancing operations* (LTROs) at the rate of 1 per cent with a maturity of 36 months and the option of early repayment after one year, and to increase collateral availability by (i) reducing the rating threshold for certain asset-backed securities (ABS) and (ii) allowing national central banks (NCBs), as a temporary solution, to accept as collateral additional performing credit claims (ie bank loans) that satisfy specific eligibility criteria.[251] The first LTRO in December 2011 provided 489 billion euros in liquidity to the banking sector and the second LTRO in February 2012, an amount of 529 billion euros.[252] These operations met with a great success among credit institutions, especially in peripheral countries. The volume of deposits with the ECB increased. The increase of the liquidity allowed financial institutions to buy sovereign bonds, which resulted in a significant drop in their interest rate. This provision of liquidity to financial institutions was useful in a period of paralysis of the interbank financing; however, according to some commentators it further reinforced the vicious link between banks and sovereigns. It seems also that the contribution to lending to the economy was very limited.

In a letter to MEP, Mr Francisco Sosa Wagner of 21 February 2012, Mr Mario Draghi explained that '[t]he 3-year funds provide banks with an

[249] As mentioned earlier, on 8 December 2011 the Heads of State and Government also decided to negotiate the 'Fiscal Compact'.
[250] See <http://www.ecb.int/press/pr/date/2011/html/pr111208_1.en.html> accessed 15 March 2013.
[251] Decision of ECB of 14 December 2011 ([2011] OJ L341) on additional temporary measures relating to the Eurosystem refinancing operations and eligibility of collateral.
[252] A number of operations came to maturity around this time, which reduced the net liquidity supply to respectively 210 and 310 billion euros. These figures are given by José Manuel González-Paramo, ECB Executive Board member, 'De la crisis sub-prime a la crisis soberana: el papel del BCE', Speech, Madrid, 5 March 2012.

المنارة للاستشارات

insurance against the risk of facing a lack of liquidity. The liquidity supplied facilitates refinancing loans to the economy, also at medium term maturities, which cannot easily be (re)financed currently on impaired markets. This helps preventing a potentially major funding constraint for the banking system, which could have very adverse consequences for credit supply and therefore for the economy.' But he cautiously adds: 'The decision on how to use the liquidity are (sic) fully up to the individual banks themselves; it is their business decision.'

In August 2012[253] the ECB Governing Council announced its bond purchasing program: 'Outright Monetary Transactions' (OMTs). On 6 September 2012, the president of the ECB announced the adoption by the Governing Council of decisions on a number of technical features of the OMT in secondary sovereign bond markets.[254] The legal basis of this OMT programme is Article 18.1 of the ESCB Statute; its objective is to safeguard the monetary policy transmission mechanism in all countries of the euro area, to preserve the singleness of the ECB's monetary policy and to address severe distortions in government bond markets which originate from fears on the part of investors about the reversibility of the euro. The ECB felt that, if not addressed, these conditions would have severe consequences for the maintenance of price stability.

As told by Mr Draghi, 'we aim to . . . ensure the proper transmission mechanism in all countries of the euro area.'[255] It was an 'almost unanimous decision' of the Governing Council. The ECB will subordinate the launching of an OMT to the conditionality attached to an appropriate EFSF/ESM programme, providing the possibility for these bodies of primary market purchases. The Governing Council will decide 'following a thorough assessment . . . on the start, continuation and suspension of OMT in full discretion and acting in accordance with its monetary policy mandate'. As President Draghi explained in the Press conference, 'there are no ex-ante limits on the amount of OMT.'

The two-leg action was justified in order to react at the same time to interest rate developments explained by unfounded fears of investors for the reversibility of the euro ('self-fulfilling expectations that feed upon themselves and generate very adverse scenarios') and to excessive volatility finding its explanation in structural imbalances in the State concerned in which conditionality can play a role.

The ECB announced, at the same time, that the SMP was terminated following this decision. It is not to be excluded that the legality of this programme will be contested before the ECJ as contrary to the prohibition of monetary financing (Article 123 TFEU), an idea supported by many in Germany and

[253] See <http://www.ecb.int/press/pr/date/2012/html/pr120906_1.en.html> accessed 15 March 2013.

[254] ECB. Press Release. 6 September 2012, 'Technical Features of Outright Monetary Transactions' <http://www.ecb.int/press/pr/date/2012/html/pr120906_1.en.html> accessed 15 March 2013.

[255] ECB. Introductory statement of Mario Draghi, president of the ECB, Vitor Constâncio, vice-president, Frankfurt am Main, 6 September 2012, <http://www.ecb.int/press/pressconf/2012/html/is120906.en.html> accessed 15 March 2013.

المنارة للاستشارات

especially by the president of the Bundesbank, Mr Weidmann who did not vote in favour of the programme and repeatedly expressed his opposition to it. In an *obiter dictum*, the German Constitutional Court gave an indication of its view on the subject in its decision of 12 September 2012, on the constitutionality of the ESM and ESCG Treaties, quoted earlier. It obviously seems to be close to the Bundesbank conviction at this regard.

While the Bank of England and the US Federal Reserve System have adopted programmes of quantitative easing (non-standard monetary policy operations), the ECB—due to the restrictions of the bail-out clause and the Treaty provisions and in the absence of a fiscal union—has had its room for manœuvre constrained, and the SMP as well as the OMT programmes are in the eye of some experts contrary to the spirit of the Maastricht Treaty. Bundesbank President Jens Weidmann recently stated that it [the ECB's bond purchasing programme] was too close to State financing via the money press.[256]

(c) Consultative powers, advisory functions, collection of statistical information

According to Article 127(4) TFEU, other EU institutions, bodies, and Member State authorities are to consult with the ECB regarding any EU act or draft national legislative provision within its field of competence. In addition, the ECB may *ex officio* submit opinions to EU or national authorities on matters within its field of competence (Articles 4 and 34 ESCB Statute).[257]

These consultative powers of the ECB have proven to be fundamental and rather extensive. As an example of the proliferation of these powers, it is worth pointing out that with regard to the many national responses to the financial crisis (as well as European measures) the authorities had to consult with the ECB.[258] Article 5 of the ESCB Statute refers to the collection of statistical information by both the ECB and the NCBs.

(d) International cooperation and 'external' relations

Since we discuss the external relations of the euro elsewhere in this chapter, suffice is to say that in globalized markets, European responses need to be aligned with international responses and that, therefore, effective international cooperation in monetary, economic, and financial affairs is key to the success of EMU.

[256] Interview with *Spiegel* (29 August 2012), at <http://www.spiegel.de/international/europe/spiegel-interview-with-bundesbank-president-jens-weidmann-a-852285.html> accessed 15 March 2013.

[257] The ECB published a *Guide to Consultation of the ECB by National Authorities Regarding Draft Legislative Provisions*, June 2005, 38 pages and another booklet: *The ECB's Advisory Role. Overview of Opinions (1994–2008)* May 2009, 69 pages.

[258] With regard to the regulatory powers of the ECB, we have already pointed out the increasing importance in the practice of the institution of regulations, decisions, and guidelines in particular. Indeed the concession of a regulatory power is one of the guarantees of functional independence.

المنارة للاستشارات

It is also important to point out—as mentioned above—the particular character within the EU (hence 'internal') of the relations between Member States with a derogation (and their NCBs) and the Member States that have adopted the euro as the single currency (and their NCBs) and that EU Member States (with the exception of the United Kingdom and Denmark) are expected to adopt the euro once the conditions of economic convergence are met, following the procedure set out in Article 121 140 TFEU. The relations between EEA Member States and EU Member States are also *sui generis* in the light of the obligations of the single market, in particular with regard to financial services (as exemplified by the case of Iceland).

F. The Constitutional Position of the European Central Bank

The structural and functional duality of the ESCB/Eurosystem, its organizational complexity, and the novelty of a truly 'independent institution' within the Community's institutional structure, triggered a heated legal debate with regard to the constitutional position of the European Central Bank.[259] The *OLAF* case clarified the legal position of the European Central Bank. '[T]he ECB, pursuant to the EC Treaty, falls squarely within the Community framework.'[260] The issue is now settled with the Lisbon Treaty, since Article 282 TFEU clearly states that European Central Bank is an institution endowed with legal personality:

> The European Central Bank shall have legal personality. It alone may authorise the issue of the euro. It shall be independent in the exercise of its powers and in the management of its finances. Union institutions, bodies, offices and agencies and the governments of the Member States shall respect that independence.

The ECB is included within the EU's main institutional framework (following the entry into force of the Lisbon Treaty, Article 13 TEU lists the institutions of the EU: the European Parliament, the European Council, the Council, the

[259] Chiara Zilioli and Martin Selmayr regarded the ECB as 'an independent specialised organisation of community law'. They first elaborated this theory in an article on 'The External Relations of the Euro Area: Legal Aspects' (1999) 36 CMLRev 286 drawing on the previous work done by Selmayr. They further polished their views in 'The European Central Bank: an Independent Specialized Organization of Community Law' (2000) 37 CMLRev 591–644 and in *The Law of the European Central Bank* (Hart Publishing, 2001), p 29. Ramon Torrent argued that the ECB is the central bank of the European Community. See R Torrent, 'Whom is the European Central Bank the Central Bank of? Reaction to Zilioli and Selmayr' (1999) 36 CMLRev 1231. Smits suggests that the ECB is an organ of the European Community, 'not an organ in the same sense as the EC's institutions but as an independent agency of the performance of the monetary policy attributed to the Community level of government and for the execution of several other tasks within the overall price-stability objective'. See T Smits, 'The European Central Bank in the European Constitutional Order' (Eleven International Publishing, 2003), pp 24–5. This was his inaugural address on accepting the Jean Monnet Chair of the Law of the Economic and Monetary Union at the Faculty of Law of the University of Amsterdam on 4 June 2003.

[260] See Case 11/00 *Commission of the European Communities v European Central Bank* [2003] ECR 00, para 92. This case is referred to as 'the *OLAF* (European Anti-Fraud Office) case'.

المنارة للاستشارات

European Commission, the Court of Justice of the European Union, the European Central Bank, and the Court of Auditors).

(i) Independence

The independence from governmental direction of the ECB and the independence of the National Central Banks constitute a key feature of the ESCB. Heir to the stability culture of the Bundesbank and a child of the economic theories of its time, the ECB is a highly independent institution. On the one hand, it is independent from the other institutions and bodies of the EU and, on the other hand, it is independent from the national authorities. This 'dual independence' is another expression of the duality that characterizes the ESCB.

The independence of the NCBs is a criterion of 'legal convergence' for any prospective member of the euro area, as indicated already. As specified in Article 131 TFEU, Article 14.1 of the ESCB Statute, any country wishing to join the euro area needs to ensure that its national legislation including the statutes of its national central bank is compatible with the TFEU and the ESCB Statute.

The independence of the ECB is enshrined in Article 130 TFEU. The ECB and the NCBs are independent in the exercise of their powers and in the carrying out of their tasks and duties. Article 130 TFEU prohibits the ECB, the NCBs and the members of their decision-making bodies from seeking or taking any instruction from the Community institutions or bodies, from any government of a Member State or from any other body, and also prohibits those Community institutions or bodies and the national governments from seeking to influence the members of the decision-making bodies of the ECB and the NCBs in the performance of their tasks.

The European Court of Justice clarified the extent of the independence of the ECB in the *OLAF* case.[261] The Court advocated that the ECB 'should be in a position to carry out independently the tasks conferred upon it by the Treaty'.[262] The Court further stated that Article 108 ECT (now Article 130 TFEU) sought 'to shield the ECB from all political pressure in order to enable it effectively to pursue the objectives attributed to its tasks, through the independent exercise of the specific powers conferred on it for that purpose by the EC Treaty and the ESCB statute'.[263] The Court was clearly in favour of a limited notion of independence, limited by the functions, by the tasks and powers specifically conferred upon the ECB. The Court upheld a concept of 'independence within the Community structure' (not independence from the Community) that is reminiscent of the notion of 'independence within government'.[264] The 'recognition that the ECB has such independence does not have

[261] *OLAF* case, above n 263, paras 130–135.
[262] Ibid, para 130.
[263] Ibid, para 134.
[264] See Board of Governors of the Federal Reserve System, 'The Federal Reserve System Purposes and Functions' Washington DC (1984), p 2.

المنارة للاستشارات

the consequence of separating it entirely from the European Community and exempting it from every rule of Community law'.[265]

Article 282 TFEU, mentioned above, clarifies that the ECB 'shall be independent in the exercise of its powers and in the management of its finances. Union institutions, bodies, offices and agencies and the governments of the Member States shall respect that independence', thus reinforcing the notion of financial autonomy in a primary law provision (independent in the management of its finances). Accordingly, the ECB is independent both in the exercise of its powers and in the management of its finances.

The ECB is independent 'organically', 'functionally', and 'financially'.[266] The 'organic independence' is evidenced by a number of safeguards or guarantees such as the appointment and removal procedures of the members of its governing bodies (eg Article 11.2 and 11.4 of the ESCB Statute with regard to the Executive Board and Article 10 ESCB Statute with regard to the Governing Council). The 'functional' independence is enshrined in Article 108 ECT, Article 130 TFEU, and is also safeguarded by other provisions, such as those dealing with the prohibition to finance public sector deficits via central bank credit (eg Article 21.1 of the ESCB Statute) or those dealing with the regulatory powers of the ECB. The 'financial autonomy' is recognized in Chapter 6 of the ESCB Statute ('Financial Provisions of the ESCB') and Article 282 TFEU.

[265] *OLAF* case, above n 263, para 135.

[266] See eg RM Lastra, *Legal Foundations of International Monetary Stability* (Oxford University Press, 2006), ch 2 and *Central Banking and Banking Regulation* (London School of Economics, 1996), ch 1 for a description and analysis of these guarantees. The history of central bank independence shows that such independence is often challenged by politicians. A recent example in the EU is provided by a new draft constitutional law promoted by Prime Minister Orban, which would authorize the legislator to merge the Magyar Nemzeti Bank (MNB), the central bank of Hungary, with the Financial Supervisory Authority and create a new institution. This draft constitutional law has not been submitted to the ECB for consultation. However, on 22 December 2011 the Governing Council of the ECB adopted Opinion CON/2011/106 on the independence of Magyar Nemzeti Bank. In this opinion, the Governing Council of the ECB expresses its concern about, *inter alia*: provisions in the draft law on the MNB that could undermine the central bank's independence. In particular, against the backdrop of constant changes in the composition of the MNB's decision-making bodies, the increase in the number of members of the Monetary Council, together with the possibility of increasing the number of deputy governors—without due consideration of the MNB's needs—gives rise to concern as to whether this could be used to influence the decision-making process, to the detriment of central bank independence; and provisions in the new draft constitutional law that affect the personal independence of the central bank's governor. In particular, by appointing a new President with authority over the Governor of the MNB, who would become the Vice-President of the new institution, the personal independence of the MNB's Governor would be impaired and Article 14.2 of the Statute of the European System of Central Banks concerning the possible reasons for dismissing the Governor of a national central bank would be breached. The Governing Council of the ECB requested the Hungarian authorities to bring their consultation practice into line with the requirements of European Union law and to respect the obligation to consult the ECB. Three major revisions of the central bank law in eighteen months are incompatible with the principle of legal certainty. See <http://www.ecb.int/press/pr/date/2011/html/pr111222.en.html>.

المنارة للاستشارات

The ECB is independent within the limits of the powers expressly conferred upon it by the Treaty and the ESCB Statute. The 'controls' to which the ECB is subject constitute another limit. The European Court of Justice in the *OLAF* case specifically mentions the review by the Court of Justice and the control by the Court of Auditors.[267] These are, in fact, important mechanisms of accountability.

(ii) Accountability

We support the notion of 'accountable independence'.[268] An independent central bank is a particular kind of institution that is independent in some respects, but highly constrained in others, constrained by the goal, by the statutory objective, and by the demands of democratic legitimacy and accountability.[269] Though a consensus has been reached on the definition and adequate quantum of independence, a debate is still going on regarding the definition and the adequate quantum of accountability. The ECB has often been criticized for its alleged lack of accountability and transparency. But what do we mean by accountability and transparency? There are several paradigms and forms of accountability.[270] And depending on which paradigm one judges the institution [the ECB], one reaches different results. Amtenbrink[271] argues that the existing democratic deficit of the European Central Bank is an expression of the democratic deficit of the European Community at large, rather than a particular deficiency of the institution. Zilioli[272] argues that the ECB is accountable if we use a new 'economic paradigm of accountability' rather than the traditional 'formalistic' notion of accountability based on the theory of the division of powers and the existing system of checks and balances. The economic notion of accountability (performance accountability) is based on the assessment of the results achieved in relation to the specified statutory objective, namely price stability. We would further suggest that the new paradigm is also based on participation (consultation) and transparency (disclosure).

[267] *OLAF* case, above n 263, para 135.
[268] RM Lastra, 'The Independence of the European System of Central Banks' (1992) 33 *Harvard International Law Journal* 475 at 476–82.
[269] See RM Lastra and G Miller, 'Central Bank Independence in Ordinary and Extraordinary Times' in J Kleineman (ed), *Central Bank Independence. The Economic Foundations, the Constitutional Implications and Democratic Accountability* (Kluwer Law International, 2001), pp 31–50.
[270] See also RM Lastra, 'How Much Accountability for Central Banks and Supervisors?' (2001) 12(2) *Central Banking* 69 and RM Lastra and H Shams, 'Public Accountability in the Financial Sector' in E Ferran and C Goodhart (eds), *Regulating Financial Services and Markets in the Twenty First Century* (Hart Publishing, 2001), pp 165–88.
[271] See F Amtenbrink, *The Democratic Accountability of Central Banks: A Comparative Study of the European Central Bank* (Hart Publishing, 1999), p 9.
[272] See C Zilioli, 'Accountability and Independence: Irreconcilable Values or Complementary Instruments for Democracy? The Specific Case of the European Central Bank' in G Vandersanden et al (eds), *Mélanges en Hommage à J-V Louis* (ULB, 2003), pp 402–5.

المنارة للاستشارات

When it was created, the ECB was influenced by the Bundesbank model of stability and independence. The Bundesbank Law contained scarce provisions regarding the accountability of the central bank, relying instead on the support of public opinion and the statutory objective to legitimize its existence in a democratic society. This contributes to explaining, in our opinion, why accountability only played a 'subsidiary role' in the negotiations that led to the establishment of the ECB. But accountability can only be judged through the life of the institution. Accountability cannot be guaranteed by the fact that the initial stage of its creation is legitimate democratically. It is in its continuing operations and policies that the institution must be subject to appropriate mechanisms of accountability. And if the ECB gives 'proper account',[273] explains and justifies the actions or decisions taken (or omitted) in the exercise of its responsibilities, is subject to judicial review[274] and to audit control and respond to Parliament through reports and regular hearings, by what is called the 'monetary dialogue', based on Article 284(3) TFEU then it can be judged to be sufficiently accountable.

Needless to say, the debate about the accountability of the ECB in the exercise of supervisory responsibilities is a fundamental issue of institutional design, which must be discussed ex ante.[275]

V. The Euro

A. From a Basket of Currencies to an Abstract Currency

The euro is the inheritor of the ecu. The official 'monetary unit' of the EMU the ecu, was not a success for a number of reasons. Its legal nature has always been contested. It suffered from its precarious creation through quarterly renewable swaps of gold and foreign currencies between NCBs and the European Fund for Monetary Co-operation (EFMC), and it served mainly as an accounting unit for the Fund, more than as a real currency. Some central banks were reluctant to accumulate ecus in their balance sheet and preferred receiving national currencies for the settlement of debts incurred in market interventions by other central banks.

The so-called 'private ecu' also met with difficulties. If a number of states assimilated legally, the ecu, as used by the market, to a foreign currency, which permits its relative development, Germany resisted for years to such an assimilation and regarded the use of the 'private ecu' as the recourse to a (prohibited) indexation clause. It is certainly true that the relative success of the private use of

[273] See the 'reporting commitments', ESCB Statute, Art 15.
[274] On judicial review of the acts of the ECB, see Statute, Art 35 and TFEU, Arts 263, 265, and 267.
[275] See generally Lastra, 'Accountability and Governance—Banking Union Proposals', Duisenberg School of Finance, Policy Paper No. 30, November 2012, <http://www.dsf.nl/home/research/publications> accessed 15 March 2013.

المنارة للاستشارات

the ecu in the markets was primarily due to the basket nature of this unit, offering an exchange guarantee.

The EC Treaty in its Maastricht version mentioned in Article 121, paragraph 1, subparagraph 2, the development of the ecu,[276] without distinguishing among its private and public uses, as an accessory convergence criterion for the adoption of the single currency. Nevertheless, the context we have briefly described above explains why there were some doubts in the markets about the conversion one to one of the ecu into the euro. It was said that the so-called 'recurrent link' that exists between an old and a new currency that is substituted to it under monetary law[277] could not possibly be extended, without an explicit provision, to cover the succession from the ecu, a 'unit of account', to the euro. It is the reason why it has been thought necessary to legislate in this matter.

B. The Two Core Regulations

The Madrid scenario for the realization of the monetary union, adopted by the European Council in December 1995 provides that

> A Council Regulation, whose technical preparatory work shall be completed at the latest by the end of 1996, will enter into force on 1 January 1999 and provide the legal framework for the use of the Euro, which, from this date, will become a currency in its own right, and the official ECU basket will cease to exist. This regulation will establish, as long as different monetary units still exist, a legally enforceable equivalence between the Euro and the national units. The substitution of the Euro for national currencies should not of itself alter the continuity of contracts, unless otherwise provided in the contract. In the case of contracts denominated by reference to the official ECU basket of the European Community, in accordance with the Treaty, substitution by the Euro will be at the rate of one to one, unless otherwise provided in the contract.

Considering the doubts expressed in some financial centres, especially in London, New York, and Singapore, as well as by some professional associations advocating the necessity of legal certainty in such a delicate field, the Commission and the EMI opted for preparing the adoption of two regulations and not just one that could only be adopted after the decision on the changeover, under Article 123, paragraph 4 of the ECT. At the same time the regulation adopted well in advance of the decision on the final stage of EMU would give a legal basis in Community law to the name given by the European Council

[276] See point 2.3.5.

[277] See International Law Association, Taipei Conference (1998), Committee on International Monetary Law, 10 February 1998, p 17: 'the State of issue of issue of a currency, or a group of States adopting a common currency, has the exclusive competence to define its currency, to change the definition of such currency and to define the rate of exchange between any new monetary unit and the former monetary unit or units it is intended to replace (the so-called recurrent link).'

المنارة للاستشارات

to the future currency: the euro. Legal certainty was important in this respect also.

The two regulations form the basis of monetary law of the Community: Regulation No 1163/97 of 17 June 1997 on certain provisions relating to the introduction of the euro[278] and Regulation No 974/98 of 3 May 1998 on the introduction of the euro.[279] A third Regulation was adopted in order to determine the fixed exchange rate to which the irrevocable conversion of the national currencies into euro would take place.[280] The first Regulation was adopted on the basis of Article 308 ECT, the second one on the basis of Article 123, paragraph 4, third sentence.

We have opted for analysing together Regulations Nos 1163/1997 and 907/98 because they are complementary. The European Council 'politically' adopted the texts of both already in June 1997. They refer to each other and the Regulation of 1997 includes topics like the denomination of the currency and the rules on conversion and rounding, which pertain to monetary law.

C. The Euro: Denomination and Definition

The Lisbon European Council decided that the euro would be the name of the new currency.

It explained this choice in the following way:

> 2. The name of the new currency is an important element in the preparation of the transition to the single currency, since it partly determines the public acceptability of Economic and Monetary Union. The European Council considers that the name of the single currency must be the same in all the official languages of the European Union, taking into account the existence of different alphabets; it must be simple and symbolize Europe.
> The European Council therefore decides that, as of the start of Stage 3, the name given to the European currency shall be Euro. This name is meant as a full name, not as a prefix to be attached to the national currency names.
> The specific name Euro will be used instead of the generic term 'ECU' used by the Treaty to refer to the European currency unit.
> The Governments of the fifteen Member States have achieved the common agreement that this decision is the agreed and definitive interpretation of the relevant Treaty provisions.

One immediately realizes that this decision includes two elements, ie an authentic interpretation of the Treaty: the name 'ECU' is a generic name, and a

[278] [1997] OJ L162, 19 June 1997, p 1 slightly modified by Regulation No 2595/2000, of 27 November 2000 [2000] OJ L100, 29 November 2000, p 1.
[279] [1998] OJ L139, 11 May 1998, p 1, modified by Regulation No 2169/2005 [2005] OJ L346, 29 December 2005, p 346 and each time a new country adopted the euro.
[280] See Regulation No 2866/98 of 31 December 1998 on the conversion rates between the euro and the currencies of the Member States adopting the euro [1998] OJ L359, 31 December 1998, p 1. Such a regulation was needed at each new adoption of the euro by a Member State.

المنارة للاستشارات

decision: the specific name will be the euro.[281] This implies that, in the view of the Heads of State or Government meeting in the European Council, they have the right to give an authentic interpretation of the Treaty. This conviction reflects a conception familiar to 'internationalists', which gives to the authors of a treaty a right of official interpretation, a prerogative that under Community law pertains to the Court of Justice. An orthodox view of Community law, which was supported by the Commission after the Maastricht Treaty, would have required a revision of the Treaty in order to replace 'ecu' by 'euro'. The view that 'ecu' was only an acronym was indeed not unanimously shared and could appear as contrary to the letter of some linguistic versions. But for nobody was the question a vital one or one worth a revision of the Treaty, some years after its difficult adoption. And now the question of the denomination has been definitely settled by the Lisbon Treaty which introduced the name 'euro' right from Article 3, paragraph 4 of the TEU.

Both regulations have in their Preamble a recital summing up the reasoning of the European Council and making the distinction between the decision on the interpretation and the one on the denomination.[282]

Article 1, 5th indent of Regulation No 1103/97 provides that:

> 'euro unit' shall mean the unit of the single currency as defined in the Regulation on the introduction of the euro which shall enter into force at the starting date of the third stage of Economic and Monetary Union.

Article 2 of Regulation No 974/98, as modified by Regulation No 2169/2005, gives the definition of the euro as referred to by Regulation No 1103/97:

> With effect from the respective euro adoption dates, the currency of the participating Member States shall be the euro. The currency unit shall be one euro. One euro shall be divided into one hundred cent.

Article 1 gives the list of the countries having adopted the euro which obliges modification of the Regulation at each adoption of the euro by a new Member State. The euro is declared to be the currency of the participating Member States and not of the European Community/Union despite an amendment proposed by the European Parliament. The reference to the participating Member States was explained in order to be sure that *lex monetae*,[283] which includes the right of

[281] Different reasons were mentioned to explain why ecu was not accepted in particular by Germany. The ecu did not have a good reputation as far as stability was concerned. In Germany, its use was submitted to restrictions. The word was not harmonious to German ears and perhaps too French as there has been a currency called 'écu' in French monetary history. The requirement that the name should be the same in all the official languages would later on create a problem in the relations with Bulgaria which requested, after its accession to the Union, the right to adopt a denomination expressed in its Cyrillic alphabet, holding for a national value pertaining to national identity.

[282] See the Preambles of Regulation No 1103/97 and Regulation No 974/98, recitals 2.

[283] See FA Mann, *The Legal Aspects of Money* (5th edn, Oxford University Press, 1992), p 271 *et seq*; G van Hecke, *Problèmes juridiques des emprunts internationaux* (Leiden, 1955), p 138; AV Dicey and JHC Morris, *The Conflicts of Laws,* 2, 11th edition under the responsibility of L Collins (Sweet &

المنارة للاستشارات

a State to change its currency, would apply to the succession of the heritage currencies in each and every country adopting the euro. This was supposed to give more strength to Article 3 which provides: 'The euro shall be substituted for the currency of each Member State at the conversion rate.' On the other hand, political considerations also inspired this choice. Member States with a special status in regard of the single currency did not want to put in evidence the euro as the currency of the Community. One could observe that this no longer seems to be a problem as Article 3, paragraph 4 of the (new) TEU provides now that the euro is the currency of the European Union.

Additionally, the UK and Denmark also wanted to avoid Regulation No 904/98 appearing to be applicable to their countries. They obtained that the traditional 'promulgation clause' that appears at the end of the Regulation would read as follows: 'This Regulation shall be binding in its entirety and directly applicable in all Member States, *in accordance with the Treaty, subject to protocols 11[25] and 12 [26] and Article 109k(1) [the latter abrogated by the Lisbon treaty].*' No such mention was thought to be necessary for Regulation No 1103/97 based on Article 308 ECT (now, Article 352 TFEU). The words added to the clause were accepted as a compromise by the partners of the UK and Denmark, in the conviction that they added nothing to the existing legal situation and did not deprive the Regulation of its nature of Community law.

The definition of the euro included in Article 2 of Regulation No 907/98 is an abstract one in conformity with modern conceptions of the law of money.[284] The euro is defined by its name and not by reference to another currency or, which is no longer allowed under the Articles of Agreement of the IMF, in terms of gold. It is divided into a hundred cents.

Article 4 of Regulation No 974/98 provides that

> The euro shall be the unit of account of the European Central Bank (ECB) and of the central banks of the Community.

This provision could also come as a surprise because one could ask, as the European Parliament did in its opinion, why the euro was not considered as the unit of account of (all) the institutions. The answer was made that the generalization of the euro as the unit of account for the budget raised an accounting and financial question, one that did not find its place in a text about monetary law which pretended to have an *erga omnes* and permanent value. Transitory measures could be needed for the generalization of the role of the euro. Nevertheless, recital

Maxwell, 1987), p 1427. See also B Wahlig, 'European Monetary Law: The Transition to the Euro and the Scope of *Lex monetae*', in M Giovanoli (ed), *International Monetary Law*, op cit, pp 121–36, and 122–3.

[284] See J-C Cabotte and A-M Moulin, 'Le statut juridique de la monnaie unique', *Bulletin de la Banque de France*, December 2002, p 35 *et seq*, at p 43. Compare with the traditional views expressed by C Santulli, 'L'Euro. Analyse juridique de la « crise de la dette »' (2011) *Revue générale de droit international public* 833–51.

المنارة للاستشارات

9 referred to Regulation No 1103/97, in mentioning that the euro was the unit of account of the institutions. On the other hand, there was a need to designate the unit of account that the ECB would use, something on which the Statute of the ESCB and ECB was silent. It was imperative to make clear that from the start of the final stage, the monetary policy would be in euro.

Regulation No 1193/97 is also important for the way it enounces the continuity between the ecu and the euro. Not only is the continuity of contracts addressed, as in the Madrid conclusions, but also all legal instruments which are defined in Article 1, first indent: 'legislative and statutory provisions, acts of administration, judicial decisions, contracts, unilateral legal acts, payment instruments other than banknotes and coins, and other instruments with legal effect.' There will be a rebuttable presumption that the ecu referred to in the instrument will be the ecu under its official definition.[285] In this case, the conversion will be of one to one. This rule that, at the time before the adoption of the Regulation, was not unanimously admitted, as we have mentioned, derived from Article 123, paragraph 4 ECT indicating that the replacement of national currencies and the euro would not change the external value of the ecu, ie the value in relation with both third countries and Member State currencies. So, the Treaty was in favour of the succession of the euro to the ecu with a conversion rate of one to one.

Under Article 14 of Regulation No 974/98, references to national currencies should be considered as references to the euro at the conversion rates.

We will now look at the way the transition towards fiduciary currency is organized by the same Regulation, as well as the conversion and rounding and the famous Article 3 on the continuity of contracts and other legal instruments. These three last points have given rise to interesting decisions of the Court of Justice.

D. The Transition to the Fiduciary Euro: The Scenarios

The introduction of the banknotes and coins in euro "was the greatest change of currency of the history. More than 15 billions of banknotes and 51 billions of coins were produced and exchanged against 9 billions of banknotes and 107 billions of coins in circulation.'[286]

For Member States which adopted the euro in the first wave, on 1 January 1999, the transitory period was of three years before the definitive changeover to the fiduciary euro, on 1 January 2002, an exclusive changeover after a small

[285] There were indeed in some contracts references to a so-called 'closed basket' meaning a basket whose composition was fixed once and for all at the moment of the conclusion of the contract or of the drafting of another legal instrument.

[286] Communication de la Commission au Conseil européen. Bilan des opérations d'introduction de l'euro fiduciaire (COM(2002)124 final, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52002DC0124:FR:NOT> accessed 15 March 2013 (our translation).

المنارة للاستشارات

double circulation regime. Hence the necessity to provide for dispositions applicable to the three-year period which was one of monetary union without euro cash, a situation strange for the classical doctrine of money that defined it as chattels denominated in a unit of account.[287] Money was during the transition exclusively scriptural money. But it was real money, the single currency, a substitute for national currencies at the rate of exchange and only the euro was used in monetary policy.

In order to eliminate all doubts on the nature of the euro from 1 January 1999 and to contribute to the irreversibility of the process, the European Council of Madrid, following the report of the ECOFIN Council, based on the advice received from the Commission and the EMI, assigned to the Regulation on the introduction of the euro the objective of establishing

> a legally enforceable equivalence between the Euro and the national currency units ('legally enforceable equivalence' means that each monetary amount is assigned, in a legally enforceable way, an unchangeable counter value in terms of the Euro unit at the official conversion rate and vice versa). For the period before the deadline set for the completion of the changeover, the Regulation will ensure that private economic agents will be free to use the Euro; at the same time they should not be obliged to do so. As far as possible, they should be allowed to develop their own mechanisms of adjustment to the changeover; however, the implementation of these principles should take into account market practices in terms of standardization. The Regulation will also provide that national banknotes will continue to remain legal tender within the boundaries of the respective national territories until the completion of the changeover to the single currency. The technical preparatory work for this Regulation shall be completed at the latest by the end of 1996.

In order to realize this 'legally enforceable equivalence', Regulation No 974/98 provided that

> The euro shall be divided into the national currency units according to the conversion rates. Any subdivision thereof shall be maintained. Subject to the provisions of this Regulation the monetary law of the participating Member States shall continue to apply. (Article 6(1) and Preamble, recital 8)

This formula made national currencies into non-decimal subdivisions of the euro. It eliminated the idea of the coexistence of two currencies.

The Madrid scenario also provided for the recognition of two basic principles of the transition: the principle of no compulsion and the principle of no restriction in the use of the euro. These principles are developed in Article 8 of the

[287] See FA Mann, op cit, p 8 who defined the currency in these words: 'In law, the quality of money is to be attributed to all chattels which issued by the authority of the law and denominated with reference to a unit of account, are meant to serve as universal means of payment in the State of issue.' P De Vecchis, 'Moneta et carte valori. I Profili generali e diritto privato', *Enciclopedia giuridica italiana*, vol XX (Rome, 1990), p 3, defines the currency by three elements: the physical object ('*res*'), the measured good ('*mensurata*') and the unit of account ('*mensura*'). See also RM Lastra, *Legal Foundations of International Monetary Stability* (Oxford University Press, 2006), pp 14–21.

المنارة للاستشارات

Regulation.[288] Limited exceptions are provided to the principle of non-compulsion by paragraphs 3 and 4 in Article 8 of the Regulation. One should add that if a Member State was free to allow for the general use of the euro in its territory (recital 10), only Community legislation could impose the obligation to use it in more cases than those provided by the exceptions established by the Regulation (cf. Article 8, paragraph 5 and recital 16).

Regulation No 2169/2005 of 21 December 2005 amending Regulation No 974/98 has been adopted in order to take into account that now monetary signs in euro are available at the moment of the adoption of the euro by a new participating country, contrary to the situation when the first wave of Member States adopted the single currency. Under the amended Regulation, Member States adopting the euro, could follow three scenarios:[289]

– the so-called Madrid style scenario, with the corrective that the transition originally provided by Regulation No 974/98 should 'last three years at the most but should be as short as possible' (recital 5);
– the *big bang scenario*, 'in which the euro adoption date and the cash change-over date fall on the same day' (recital 6); the 'cash changeover date' means the date on which euro monetary signs acquire the status of legal tender in a given participating Member State (Article 1, paragraph 1, letter (e)); and
– the *big bang scenario with a 'phasing-out period'*, ie 'a period of one year at the most beginning on the euro adoption date, which can only apply to member states where the euro adoption and the cash changeover date falls on the same date (Article 1, paragraph 1, letter (i)'.

In either the Madrid style scenario or the big bang scenario, the Regulation allows for a dual circulation of euro and national currency denominated cash for a period 'until six months after the respective cash changeover date' (Article 15, as amended by Regulation No 2169/2005).

Regulation No 2169/2005 introduced in Regulation No 974/98 a new Article 9*a* which described the features of the phasing-out period. The text reads as follows:

> In legal instruments created during the phasing-out period and to be performed in that Member State, reference may continue to be made to the national currency unit. These references shall be read as references to the euro unit according to the respective conversion rates. Without prejudice to Article 15, the acts performed under these legal instruments shall be performed only in the euro unit. The rounding rules laid down in Regulation (EC) N° 1103/97 shall apply.

[288] More details about that in J-V Louis, 'The New Monetary Law of the European Union', in M Giovanoli (ed), op cit, pp 137–59, at 144–9.
[289] T Schäfer, 'The Legal Framework for the Enlargement of the Euro Area', EC. *European Economy Occasional Papers*, 23 April 2006, p 12 *et seq*. We borrow the familiar expressions of the different scenarios from this author.

المنارة للاستشارات

The Member State concerned shall limit the application of the first subparagraph to certain types of legal instrument, or to legal instruments adopted in certain fields.
The Member State concerned may shorten the period.

This Article should be read in conjunction with the definition of the phasing-out period in Article 1, paragraph 1, letter (i) we have referred to before. The reference to Article 15 concerns the limited period of dual circulation already mentioned.

The analysis of Article 9*a* demonstrates that the phasing-out has a limited meaning which makes it somewhat unattractive. Recital 6 of the Regulation explains that it 'would give economic actors in such a Member State more time to adapt to the introduction of the euro and therefore ease the transition'. It could help in making the changeover more acceptable, which gives to it a more psychological purpose than a legal one. Among the Member States which have adopted the euro since 2005, only Malta has adopted the big bang scenario with a phasing-out period. Among the countries which published some years ago a national plan concerning the adoption of the euro, only the Czech Republic and Hungary seem to have also made this choice.

E. The Modalities of Conversion and the Rounding

Article 123(4) ECT originally provided that

At the starting date of the third stage, the Council shall, acting with the unanimity of the Member States without a derogation, on a proposal from the Commission and after consulting the ECB, adopt the conversion rates at which their currencies shall be irrevocably fixed and at which irrevocably fixed rate the ecu shall be substituted for these currencies, and the ecu will become a currency in its own right. This measure shall by itself not modify the external value of the ecu . . .

Article 140(3) of the TFEU updates this paragraph in one sentence:

If it is decided, in accordance with the procedure set out in paragraph 2, to abrogate a derogation, the Council shall, acting with the unanimity of the Member States whose currency is the euro and the Member State concerned, on a proposal from the Commission and after consulting the European Central Bank, irrevocably fix the rate at which the euro shall be substituted for the currency of the Member State concerned, and take the other measures necessary for the introduction of the euro as the single currency in the Member State concerned.

Regulation No 1103/97 provides some essential modalities concerning the conversion technique which are applicable to the first introduction of the euro and to any conversion operated afterwards by either the public or the private sector. It also formulates rules on rounding.

Articles 4 and 5 of this Regulation are respectively relative to conversion and to rounding. These matters, in principle distinct one from the other, are nevertheless linked, as two cases raised before the Court by national tribunals have

المنارة للاستشارات

demonstrated.[290] The questions also relate to the principle of continuity of contracts.

Articles 4 and 5 of the Regulation provide for a certain number of principles and methods to follow. Article 4, paragraph 1 imposes conversion rates with 'six significant figures' for the euro in terms of national currencies. Recital 12 specifies that it means 'a rate, which counted from the left and starting with the first no-zero figure, has six figures'. The six figure rate will allow a high level of precision in the operations of conversion. Another important rule inspired by the same preoccupation is the prohibition of inverse rates because, as it explains in recital 10, inversed rates would imply rounding which 'could result in significant inaccuracies, notably if significant amounts are concerned'.

Article 5 is about rules first on rounding 'monetary amounts to be paid or accounted for' after a conversion into the euro unit. These amounts 'shall be rounded up or down to the nearest cent'. Second, it provides rules of perhaps a lesser interest for rounding 'monetary amounts to be paid or accounted for' converted into a national currency unit.

The concept of 'monetary amounts to be paid or accounted for' is not defined by the Regulation. The interpretation of this concept was at the core of the case *Verbraucher-Zentrale Hamburg* which concerned O2 (Germany) GmbH & Co, a telephone company. This company had rounded, after conversion into the euro unit, intermediary amounts relative to phone calls which gave a different result for the total than if only the total amount of the telephone bill of the clients had been rounded. The company considered the intermediary amounts as 'amounts to be paid or accounted for'.

Following the conclusions of the Advocate General, who proposed a finalist interpretation of Article 5, the Court underlined the objectives of legal certainty and transparency pursued by the rules on rounding and it referred to the principle of continuity of contracts, included in Article 3 and qualified as a general principle of law in the Preamble, to which we will return later. It quoted in point 33 the principle of neutrality as the basis of the adoption of the single currency (recital 11). No practical reason imposed a rounding of intermediary amounts. They do not constitute amounts to be paid or to be accounted for. National rules could only be justified if they introduce a higher level of precision. The Court concluded that

> 1. A tariff, such as the per-minute price at issue in the main proceedings, does not constitute a monetary amount to be paid or accounted for within the meaning of the first sentence of Article 5 of Council Regulation (EC) No 1103/97 of 17 June 1997 on certain provisions relating to the introduction of the euro and thus is not to be

[290] CJ (great chamber), 14 September 2004, Case C-19/03 *Verbraucher-Zentrale Hamburg et al.*, ECJ Rep I-8183 and CJ (2nd chamber), 18 January 2007, *Estager et al.*, ECJ Rep I-587. The judgments were both adopted with the concurring conclusions of Advocate General Miguel Poiares Maduro.

المنارة للاستشارات

rounded in every case to the nearest cent. The fact that the tariff relates to a particular multiple of the unit on the basis of which the final amount of the invoice is calculated or that for the consumer the tariff represents the decisive factor as regards the price of the goods or services does not affect that finding;
2. Regulation No 1103/97 must be interpreted as not precluding the rounding to the nearest cent of amounts other than those which are to be paid or accounted for, provided that that rounding practice is consistent with the principle of continuity of contracts safeguarded by Article 3 of the regulation and with the objective pursued by the regulation that the transition to the euro should be neutral; in other words, provided that the rounding practice does not affect contractual obligations entered into by economic agents, including consumers, and that it does not have a real impact on the price actually to be paid.

The second judgment of the Court, *Estager SA*, concerned the adaptation of a tax on cereals in the process of conversion of the tax to the euro. A French legislative act (an 'Ordonnance') provided that one could adapt the result obtained after the application of the rules on conversion if the result would be not very legible or easy to remember. That would imply the use of euro amounts without decimals or more significant values. But it was intended by the text that the pure and simple application of the rules of conversion should remain the principle. In the case before the Court, the tax had been increased and a producer requested compensation for the excess amount he had to pay.

The Court referred to the principles which had inspired its earlier judgment: legal certainty, neutrality, transparency, and continuity of legal instruments. France was not deprived of its fiscal competence implying the right to modify taxes but it had to effect the conversion in respect of these basic principles. The advocate general had in advance underlined that to admit that a State could increase a tax covering it under the operation of conversion would be contrary to the confidence of the citizens in the introduction of the euro.

F. The Continuity of Legal Instruments

The subject of the continuity of legal instruments,[291] and especially of contracts, was one of the main reasons for the early adoption of Regulation No 1103/97 with the purpose of reassuring the markets, and international markets in particular. The principle is stated in Article 3 but the whole Regulation is based on the idea of the neutrality of the changeover to the single currency. We have seen

[291] A judgment of the Civil Service Tribunal has dealt with the question of the transfer to the Community scheme of the actuarial equivalent of the pension rights a civil servant had acquired in her country, see judgment of 14 November 2006, Case F-100/05 *Eleni Chatziioannidou v Commission*, a judgment which was submitted to an appeal by the Commission to the Court of First Instance, and confirmed by a judgment of the CFI of 12 September 2007 in Case No 20/07 P. Contrary to the thesis of the Commission, the two jurisdictions have applied Art 3 of Regulation No 1103/97 on continuity, to undertakings included in the statute of the EC civil servants.

المنارة للاستشارات

the importance of the continuity principle in the decisions analysed above, in questions relative to the interpretation of the rules on conversion and rounding.

The Treaty itself is inspired by the same idea. The requirement of complying with convergence criteria in order to be able to adopt the euro (Article 121, paragraph 1 ECT), the obligation to maintain the external value of the ecu (becoming the euro) when the irrevocable conversion rate had to be fixed (Article 123, paragraph 4, ECT) reflect the desire to preserve stability or, in legal terms, continuity.

Article 3 provides that:

> The introduction of the euro shall not have the effect of altering any term of a legal instrument or of discharging or excusing performance under any legal instrument, nor give a party the right to alter or terminate such an instrument. This provision is subject to anything which parties may have agreed.

As for other provisions of the Regulation, the Preamble gives indications about the will of the authors of the text but does not resolve all the problems. For example, the concept of 'introduction of the euro' is not defined. Recital 8 puts the term in relation with the modification by a Member State of its monetary law, an act preceding the adoption of the euro, reflecting the political will to take the decision, or coinciding with the changeover. The EMI in its opinion on the Regulation would have preferred to express in the text itself the need for a broad interpretation of the concept.[292]

'Legal instruments' are defined in Article 1, first indent. As an example of continuity between national currencies and the euro, recital 7 mentions that 'in the case of fixed interest rate instruments the introduction of the euro does not alter the nominal interest rate payable by the debtor'. Questions have been raised concerning the continuity of contracts bearing on two disappearing currencies, such as, for example, a swap agreement between the DM and the French franc. For some, these contracts were necessarily null and void because their cause no longer existed. It seems that one can only conclude on the caducity of a contract if its object has disappeared.[293]

The provision safeguards the contractual freedom of the parties. Recital 7 specifies that the principle of continuity 'should be compatible with anything which parties might have agreed *with reference to the introduction of the euro*'. The words in italics are not in the text of the Article. The EMI had asked in its already quoted opinion to add the words in Article 3 but its opinion arrived

[292] See Opinion of 29 November 1996, [1996] OJ C205, 5 July 1997. The International Swaps and Derivatives Association (ISDA) had proposed in a communiqué to adopt such a broad concept in a continuity clause to be inserted in the Master Agreements concluded under its auspices. The list it gave of different elements to be considered as the introduction of the euro was not exhaustive.

[293] See, for the discussion, A-M Moulin and J-C Crédot, 'L'introduction de l'euro et la continuité des contrats: synthèse des réflexions juridiques menées sur la place financière de Paris', *Agefi*, 4 and 5 July 1996 and A Maffei, 'La continuité des contrats financiers dans *Banque et Droit*', mai–juin 1997, p 18 *et seq*, at 22 and 24.

المنارة للاستشارات

after a political agreement was reached on the specific content of the very sensitive Article. Only the Preamble could be modified at this stage. But nobody objected to the idea. The aim of the addition was to avoid the invocation against continuity, of doctrines such as *force majeure*, impossibility of execution, *Wegfall der Geschäftsgrundlage*, or the Common Law doctrine of frustration, ie reasons not linked with the introduction of the euro. In any case, it is clear that the existence of the conditions necessary for alleging such reasons for discontinuing the execution of a legal act, should national law offer such possibility, would be difficult to demonstrate. EMU was not an *unforeseeable* change of circumstances, a condition often required in order to permit the invocation of a change of circumstances. It has been for years a perspective of which citizens and operators should have expected the realization and prepared for it.

For the authors of the Regulation and, in particular for the Commission, the affirmation of continuity had only a declaratory value. It pertains to the monetary law of the Community and, as such, it has to be respected by foreign countries. Recitals 7 and 8 express this view. First, the principle of continuity of contracts and other legal instruments 'is a general principle of law' but 'in order to reinforce legal certainty and clarity, it is appropriate explicitly to confirm' it (recital 7). Second, the principle of continuity is associated in recital 8 with the principle of *lex monetae*.

There is no common view on the fact that continuity of legal instruments pertains to monetary law. For many, it is part of contract law.[294] So, if the change of currency in itself benefits from the continuity under *lex monetae*, the consequences for the contracts and other instruments would be decided under the law applicable, for example, to the contract. This strict dichotomy and the importance allocated to the controversy are not easily compatible with the principle of nominalism[295] that is applicable in many legal systems. Anyway, the continuity provided by Article 3 was binding in the Community legal order. But the extraterritorial effect of such a principle was contested in some countries.

Some American States and Singapore have believed necessary to adopt legislation in order to avoid litigation. On the one hand, they asked the Community to adopt rules on the continuity of contracts; on the other, they found it necessary to provide for their own guarantees.[296]

[294] See B Wahlig, 'European Monetary Law: The Transition to the Euro and the Scope of *Lex Monetae*', in M Giovanoli (ed), *International Monetary Law*, op cit, pp 121–36, at 131 *et seq*.

[295] See P de Lapasse, 'The legal status of the euro', *Legal Aspects of the European System of Central Banks*, Liber Amicorum Paolo Zamboni Garavelli (ECB, 2005), pp 235–41.

[296] See N Lenihan, 'The Legal Implications of the European Monetary Union under US and New York Law', European Commission, *Economic Papers*, No 126, 1996; JH Freis Jr, 'Continuity of contracts after the introduction of the Euro: the US Response to European Economic and Monetary Union', (1997–98) 53 *The Business Law* 701 *et seq*; M Gruson, 'The Introduction of the Euro and its Implications for Obligations Denominated in Currencies Replaced by the Euro' (1997) *Fordham International Law Journal* 65 *et seq*.

المنارة للاستشارات

G. The Issue of Banknotes and Coins

The organization of the issue of cash in the euro area reflects the specificity of the monetary union and, in particular, the decentralized features of the Eurosystem. A single Article of the Treaty (Article 128 TFUE) offers the framework for the issue. It reads as follows:

1. The European Central Bank shall have the exclusive right to authorise the issue of euro banknotes within the Union. The European Central Bank and the national central banks may issue such notes. The banknotes issued by the European Central Bank and the national central banks shall be the only such notes to have the status of legal tender within the Union.
2. Member States may issue euro coins subject to approval by the European Central Bank of the volume of the issue. The Council, on a proposal from the Commission and after consulting the European Parliament and the European Central Bank, may adopt measures to harmonise the denominations and technical specifications of all coins intended for circulation to the extent necessary to permit their smooth circulation within the Union.

One should not conclude from the first sentence of paragraph 1 that other authorities than the ECB could authorise in the euro area the issue of banknotes denominated in another currency than the euro.[297] The provision should be read taking into account Article 119(2) TFEU which provides for a single currency, the euro.

Article 16 of the Statute of the ESCB and the ECB repeats paragraph 1 of this Article and adds a second subparagraph, which was requested by the UK in order to allow for the continuation of the issue of banknotes by some banks in Northern Ireland and in Scotland, covered by the Bank of England:

The ECB shall respect as far as possible existing practices regarding the issue and design of banknotes.

Regulation No 974/98 is silent about the right of issue. In the version of Regulation No 2169/2005, it only provides in Article 10 that

With effect from the respective cash changeover dates, the ECB and the central banks of the participating Member States shall *put into circulation* banknotes denominated in euro in the participating Member States.[298]
Without prejudice to Article 15,[299] these banknotes denominated in euro shall be the only banknotes which have the status of legal tender in participating Member States.

Obviously the use of the terms 'put into circulation' was justified by the choice that the Treaty allows between the Member States' central banks or the ECB as

[297] *Contra* but wrongly, C Santulli, 'L'euro, analyse juridique de la « crise de la dette »' (2011) *Revue générale de droit international public* 833-851 at 849, note 20.
[298] Italics are ours.
[299] We have seen that this Article provides for a short period of dual circulation.

المنارة للاستشارات

the *issuers* of the banknotes. We will see that the wording of Article 11 relative to coins refers to the issue of euro coins by the Member States.

One had to wait for a decision of the ECB of 6 December 2001 on the issue of banknotes,[300] some three weeks before the start of the cash changeover, to officially settle the question of who will be the issuer(s) of banknotes. This decision is based on Article 16 of the Statutes. This Article does not expressly enable the ECB to make a regulation, in the meaning of Article 34 of the Statute, in this matter of which some underlined the vicinity to monetary policy (where a regulatory power is attributed to the ECB). It is the reason why a *sui generis* decision was adopted. The decision has now been repealed by a decision of 13 December 2010 on the issue of euro banknotes.[301]

Before entering into analysis of the more important features of this decision, it is perhaps necessary to recall what the right to issue banknotes means in contemporary monetary law.[302] The inconvertibility of banknotes in gold or silver and the resulting establishment of the '*cours forcé*' have deprived the banknote of its quality as an individual written promise to pay back to the bearer the amount written on the note, in the standard metal. So, the banknote no longer incorporates the individual claim of the bearer to a payment by the issuer. It has become a means of payment with legal tender on a given territory.

The stock of banknotes still figures on the passive side of the balance sheet of the central bank but its liabilities have changed in nature. They include the undertaking of the central bank to assure a circulation of good quality and, in particular, to exchange damaged banknotes, or, in case of withdrawal, or simply on demand, banknotes for the same value. They also reflect the fact that banknotes are issued on demand;[303] this creates a corresponding claim on banks that will be on the active side or diminution of their deposits with the central bank which are on the passive side of its balance sheet.

Under the terms of the decision of 13 December 2010, 'Union law has foreseen a system of a plurality of issuers of banknotes. The ECB and the NCBs issue euro banknotes' (recital 1). Article 2 provides that '[t]he ECB and NCBs *shall* issue euro banknotes'. As a matter of fact, the Treaty gives some discretion to the ECB for deciding on the matter but the 'plurality of issuers' corresponds better to the nature of the Eurosystem, which privileges decentralization if it is compatible with efficiency, to the idea that NCBs should

[300] [2001] OJ L337, 20 December 2001, p 52, many times modified.
[301] [2011] OJ L35, 9 February 2011, p 26.
[302] See R Smits, *The European Central Bank*, op cit, pp 203–4 and 206–7; B Krauskopf, 'How euro banknotes acquire the properties of money', *Liber Amicorum Zamboni Garavelli*, op cit, p 243 *et seq* at 246–8; H Weeninck, 'The Legal Nature of Euro Banknotes' (2003) *Journal of International Banking Law and Regulation,* 433–9.
[303] See Preamble of the Decision ECB/2001/15 of 30 December 2001 on the issue of euro banknotes [2001] OJ L337, 20 December 2001, p 52: 'The issue of euro banknotes needs not be subject to quantitative or other limits, since putting banknotes into circulation is a demand driven process' (recital 4).

المنارة للاستشارات

preserve important prerogatives, and above all to the logic of the rules on allocation of income within the System, as provided by Article 32 of the Statutes.[304] Euro banknotes are defined by Article 1(b) as 'those banknotes complying with the requirements of Decision ECB/2003/4 and with the technical specifications laid down by the Governing Council'. Under recital 2 of the Preamble, 'Euro banknotes are expressions of the same and single currency, and subject to a single legal regime'. It is for the ECB to establish this single legal regime. It has under the Treaty (Article 128 TFEU) the right to authorize the issue. This gives it the control over the issue. It establishes common rules concerning the denominations, specifications, reproduction, exchange and withdrawal of banknotes.[305] 'There is no distinction between banknotes of the same denomination' (recital 4). No matter who has put the note in circulation, it 'should be subject to identical acceptance and processing requirements. The regime for the issue of euro banknotes is based on the principle of non-repatriation' (recital 5) contrary to what happened before the cash changeover where national banknotes were repatriated.

The decision allocates the issue among NCBs under the key applicable to the subscription to the capital of the ECB. The ECB has a quota of 8 per cent. As a new Member State adopts the euro, the 'banknote allocation key' has to be modified.

Article 3, practically unchanged since the decision of 2001, establishes the obligations of issuers in conformity with the principles stated above:

1. NCBs shall put into and withdraw from circulation euro banknotes, and perform any physical handling in relation to all euro banknotes, including those issued by the ECB.
2. NCBs shall accept all euro banknotes on the request of the holder for exchange against euro banknotes of the same value or, in the case of account holders, to be credited to accounts held at the recipient NCB.
3. NCBs shall treat all euro banknotes accepted by them as liabilities and process them in an identical manner.
4. NCBs shall not transfer euro banknotes accepted by them to other NCBs andshall keep such euro banknotes available for reissue. As an exception, and in accordance with any rules laid down by the ECB's Governing Council:

(a) mutilated, damaged, worn or withdrawn euro banknotes may be destroyed by the recipient NCB; and

[304] In particular the concept of 'monetary income', ie the income produced by the assets which are the counterpart of the issue. See Decision of the European Central Bank of 6 December 2001 on the allocation of monetary income of the national central banks of participating Member States from the financial year 2002 [2001] OJ, 20 December 2001, p 55.

[305] See Decision ECB/2003/4 of 20 March 2003 on the denominations, specifications, reproduction, exchange and withdrawal of euro banknotes [2003] OJ L78, 25 March 2003, p 16. See also the Guideline ECB/2003/5 of 20 March 2003 on the enforcement of measures to counter reproductions of euro banknotes and on the exchange and withdrawal of euro banknotes, ibid, p 20.

المنارة للاستشارات

(b) euro banknotes held by NCBs may, for logistical reasons, be redistributed in bulk within the Eurosystem.

As all euro banknotes are to be treated equally by all the NCBs which means that they have to accept them and put them back into circulation, except in the case provided in Article 3, paragraph 4, a and b, of this Article, the difference between the value of the banknotes allocated by the decision and the value of the banknotes effectively put into circulation creates intra-system claims. For its part, the ECB also obtains intra-system claims on the NCBs for a value equivalent to its part of the issue (Article 4).

H. Specific Provisions on Euro Coins

We refer to the already quoted Article 128(2) TFEU on the right of issue of coins by Member States. The Treaty in principle leaves open the designation of the issuer but, except for the Sveriges Riksbank, the issue of coins is a traditional prerogative of the Treasury in the Member States of the Union. The volume of the issue has to be approved by the ECB, for evident reasons of monetary policy. The Council, by a special procedure, can adopt measures in order to harmonize denominations and technical specifications of euro coins intended for circulation, to the extent necessary to permit the smooth circulation of these coins. It has used this enabling clause by Regulation N°975/98 of 3 May 1998, on denominations and technical specifications of euro coins intended for circulation.[306] This decision adopted on a proposal of the Commission is largely based on a report requested to the Mint directors of the Community by the Council that mandated them to study and elaborate a report for a single European coinage. The Preamble of the Regulation (recitals 5 to 9) enunciates the objectives of the new system that made absolutely necessary the adoption of technical specificities by the Council for coins being legal tender on the whole territory of the euro area. Let us mention the necessity of a secure, reliable, and efficient system; the acceptability of the coins; and their distinguishability through their different sizes and through visual and tactile characteristics. Perhaps one of the most important features consists in the fact that the coins would have one European and one national face.[307] Recital 19 of the Preamble justified this by observing that it 'is an appropriate expression of the idea of European monetary union between Member States and could significantly increase the degree of acceptance of the coins by the European citizens', a consideration that was apparently not hold crucial for banknotes! As a matter of fact, there was no

[306] [1998] OJ L139, 11 May 1998, p 6, modified by Regulation No 423/99 of the Council of 22 February 1999, [1999] OJ L52, 27 February 1999, p 2. The denominations are: 1, 2, 5, 10, 20, 50 cents, 1 and 2 euros.

[307] A prescription essential for 'La Monnaie de Paris' and the Royal Mint, both very active in the preparatory works.

المنارة للاستشارات

consensus among national mints about a euro coinage with only 'European' features.

The Commission has published a communication with the characteristics of the euro coins, included those of the territories where the euro was introduced by special agreements, like the Vatican State, the Republic of San Marino, Monaco and, recently, Andorra.

In view of avoiding the confusion of fantasy coins with the real ones, first the Commission adopted recommendations and eventually, the Council adopted Regulation No 2182/2004 of 6 December 2004[308] on medals and tokens similar to euro coins. The principle is the prohibition of such issues with the existence of derogations and the possibility of authorizations.

The Commission adopted recommendations for the issue of commemorative and collectable coins. The Council also adopted conclusions on 5 November 2002 on the issue of collectable coins.[309] Binding rules for the issuance of euro coins were necessary in the interest of transparency and legal certainty. These rules were adopted following the ordinary legislative procedure in a Regulation based on Article 133 TFEU.[310] This Regulation provides specific rules for coins intended for circulation which include a limited proportion of 2-euro coins intended to commemorate a specific subject, and collector coins, not issued with a view to entering into circulation. Some rules are imposed in particular for the issue of commemorative and collectable coins for the detail of which we refer back to the provisions of the Regulation. One will observe that the Commission was charged with conducting an impact assessment on the continued issuance of 1- and 2-cent coins; this assessment shall include a cost-benefit analysis, a subject on which views differ.

I. Legal Tender of Euro Banknotes and Coins

There is no definition of legal tender either in the Treaty or in the regulations that we have analysed. Obviously the authors of the Treaty and the institutions after them have not found it necessary to harmonize the concept. Some insisted on differences for example, between the concepts of continental '*cours légal*' and the common law 'legal tender' and the nuances in the case law of some continental regimes as well. But among the many problems to be solved treatment of the matter at Community level was not seen as a priority. The Commission has more recently taken the initiative of a reflection on the subject. A working

[308] [2004] OJ L373, 21 December 2004, p 1, modified by Regulation No 46/2009 of 18 December 2008 [2008] OJ L17, 22 January 2009, p 5, made applicable to Member States not having adopted the euro by a Regulation of the same day based on the then Art 308 ECT (now Art 352 TFEU), ibid, p 7.

[309] See these texts in EC, DG Ecfin, *Compilation of Legislation on Economic and Monetary Union*, July 2004.

[310] Regulation (EU) No 651/2012 of the European Parliament and the Council of 4 July 2012 on the issuance of euro coins [2012] OJ L201, 27 July 2012, p 135.

المنارة للاستشارات

group consisting of representatives of Ministries of Finance and NCBs was created on the subject and a recommendation of the Commission, based on the main conclusions of this group, was adopted.[311] Under this text, the legal tender of euro banknotes and coins should imply three elements: *mandatory acceptance*, unless the parties have agreed on other means of payment, *acceptance at full face value*, and *power to discharge from payment obligations*. The recommendation also includes a variety of provisions of which some are common sense rules, as for example the application of the 'good faith principle' for the exceptional refusal of euro banknotes and coins for payments in retail transactions, but others are more controversial, such as, in particular, those admitting the total destruction of 'small quantities' of notes and coins by individuals and tolerating the 'mutilation of notes and coins for artistic purposes'.[312]

The legal tender principle originates from the end of the 19th century.[313] It was intended to promote or to impose the use of banknotes that would substitute first temporarily and then definitely the metallic (gold and/or silver) signs. In some countries, like France, the '*cours légal*' is more precisely a '*cours forcé*' because conventions excluding among parties the use of national currencies in internal transactions were held to be contrary to the '*ordre public*'. In others, such conventions are licit as are indexation clauses (banned in Germany). Regulation No 974/98 is a model of liberalism in this respect as it admits conventions adopted on the occasion of the introduction of the euro that would exclude the continuity of legal instruments and thus the reference to the new currency (Article 3).

It is by chance that the concept of legal tender was included in Article 16 of the Statutes and in the IGC, in Article 106 ECT (later on, Article 128 TFEU), mainly for symbolic reasons: as euro cash would replace nationally denominated cash, it had to benefit of the same features. But legal tender of euro coins was not provided for in the Treaty. It is in Article 11 of Regulation No 974/98 that an indication appeared on their legal tender. The text reads as follows:

> Without prejudice to Article 15 (NB: allowing for a temporary dual circulation), these coins *shall be the only coins* which have the status of legal tender in all these (NB: participating) Member States.[314]

[311] See Commission Recommendation of 22 March 2010 on the scope and effects of legal tender of euro banknotes and coins [2010] OJ L83, 30 March 2010, p 70.

[312] B Angel (with A Margerit), 'Quelle est la portée du cours légal de l'euro?' *Revue du Marché commun et de l'Union européenne*, October–November 2009.

[313] See RM Lastra, op cit, p 21.

[314] The words we put in italics are also to be found in Art 10 on euro banknotes. It is an allusion to the fact that possibly in addition to coins and banknotes, there could be other means of payment with legal tender. The idea was that section 6 of the Dutch Civil Code included such a provision. In virtue of this section, a payment made to the account of a creditor is in full discharge. The possession of such an account is held by the Code to include a presumption, rebuttable by the creditor, that he accepts the payment made to this account. This provision does not confer legal tender on bank accounts as some pretended during the preparatory works of the Regulation, see R Smits 'Four Aspects of

المنارة للاستشارات

The Regulation adds: 'Except for the issuing authority and for those persons specifically designated by the national legislation of the issuing Member State, no party shall be obliged to accept more than 50 coins in any single payment.' The meaning of this exception is doubtful. We do not consider such pragmatic provision as derogating from the legal tender of coins but as a measure adopted for the commodity of the creditor, which, of course, does not deprive the coins of their legal tender. They can be converted into banknotes at the central bank where the product of any kind of modest or important fund raising is submitted for exchange.

Other forms of limitation or exclusion of the acceptance of cash exist, whether on the basis of legislation or at the initiative of supermarkets or other shops and petrol stations that refuse high denomination banknotes. Motives of security inspire these regulations or practices. As far as an act of authority is concerned, these provisions are to be assimilated to the obligation of paying the creditor through a proxy, be it a bank or a post office. If it is a restriction adopted by a merchant in relation to his clients, this could be interpreted as a convention with the clients that they are presumed to have accepted if they go shopping in this store. Correct communication, visible and previous to the payment, is necessary for tolerating this practice and justifying the interpretation of it as part of a contract.

The recommendation mentioned earlier submits any refusal of banknotes and coins to the so-called 'good faith principle', for example, the retailer has no change available or the face value of the banknote tendered is disproportionate compared to the amount owed to the creditor of the payment (points 2 and 3). No reference is made to motives of security.

The Commission will review the recommendation three years after its adoption.

J. The Regulation and Protection of the Issue

One of the first texts adopted by the ECB, on a draft elaborated by the EMI, was a Recommendation of 7 July 1998 regarding the adoption of certain measures to enhance the legal protection of euro banknotes and coins.[315] This act addressed to the institutions and to the Member States is a catalogue of seven fields where, in the view of the ECB, action, including legislative texts, should be adopted, during the transition period before the cash changeover, in order to protect the new currency.

There are a number of measures taken by the ECB in its role as regulator of the issue in order to organize the euro cash changeover and to warrant a secure circulation of euro banknotes. Security considerations interfere in the

European Monetary Law', in *Mélanges en l'Honneur de Jean-Victor Louis*, vol 2, (Editions de l'Université de Bruxelles, 2003), p 328.

[315] [1999] OJ C11, 15 January 1999, p 13.

المنارة للاستشارات

organization of the changeover. The actions of of the ECB regarding banknotes were accompanied by measures taken by the Council with regard to coins. The protection of euro banknotes and coins also includes criminal law actions for which the ECB is not competent and where the EU itself disposes of limited competence, but also preventive measures that imply the intervention of a number of actors, technical and monitoring centres, etc. among which a close collaboration should be organized. The intervention of national police forces and bodies such as Europol and Interpol in the repression of counterfeiting is also necessary. It is not possible to describe all the instruments that have been put in place, in addition to those already mentioned.

Among these, the Decision of 20 March 2003[316] is particularly important as regards the protection of banknotes against copying by a set of common rules in order to allow the public recognition of the new means of payment. Like other central banks, the ECB affirms its copyright on euro banknotes as a means of fighting irregular reproductions. Common rules were also necessary for the exchange of mutilated and damaged banknotes, as well as for the withdrawal of banknotes when they are to be replaced by a new type of banknote.

Security needs, to be balanced with the requirement of undistorted competition, are also to be imposed for the making of banknotes.[317] A Decision of the ECB of 15 May 2008 on security accreditation procedures for manufacturers of euro secure items for euro banknotes (ECB/2008/3) completes the Guideline of 2004.[318] A more recent Decision of the ECB of 25 November 2010 bears 'on the quality accreditation procedure for manufacturers of euro banknotes'[319] and another of 21 June 2011 'on the environmental and health and safety accreditation procedures for the production of euro banknotes'.[320]

The process of cash changeover has also to take into consideration the requirements of security. These are present in the ECB Guideline of 14 July 2006 on certain preparations for the euro cash changeover and on frontloading and sub-frontloading of euro banknotes and coins outside the euro area (ECB/2006/9).[321]

But action—both legislative and administrative—is also necessary in the field of criminal law. The euro having already become one of the most important international currencies would inevitably attract counterfeiters. Article 12 of Regulation No 974/98 imposed upon Member States the obligation to 'ensure adequate sanctions against counterfeiting and falsifications of euro banknotes'. Most of the Member States are parties to the International Convention

[316] See note 25.
[317] See Guideline ECB/2004/16 of 16 September 2004 on the procurement of euro banknotes, OJ L320, 21 October 2004, p 21.
[318] [2008] OJ L140, 30 May 2008, p 26.
[319] [2010] OJ L330, 15 December 2010, p 14.
[320] [2011] OJ L176, 5 July 2011, p 52. Other legal acts on euro banknotes production are to be found on the ECB website.
[321] [2006] OJ L207, 28 July 2006, p 39.

المنارة للاستشارات

for the Suppression of Counterfeiting Currency, signed at Geneva on 20 April 1929,[322] which includes important principles, such as the protection by all parties to the Convention of cash issued by whichever other party, and which also establishes a network of communication between authorities in charge of the research and the repression of counterfeiting. This Convention was considered as assuring a minimal protection that EU Council legislation has been completed. One should mention at this regard the Council framework Decision of 29 May 2000 on increasing protection by criminal penalties and other sanctions against counterfeiting in connection with the introduction of the euro.[323] There is also Council Regulation No 1338/2001 of 28 June 2001 laying down measures necessary for the protection of the euro against counterfeiting.[324] A decision of the ECB of 16 September 2010 related to the authenticity and fitness checking and recirculation of euro banknotes adds administrative measures to protect the integrity of euro banknotes and to enable a proper detection of counterfeits.[325]

Provisions on analysis and research have been adopted which involve the ECB, the NCBs, Europol,[326] Eurojust, the Commission (OLAF), and national authorities. Actions have been promoted in the field of training, like the Pericles programme, created in 2001 and extended in 2006.[327]

The cooperation of the financial industry against counterfeiting was also organized. Regulation No 1338/2001 was amended by Regulation No 44/2009 of 18 December 2008.[328]

Most important amendments concern the obligation of national centres[329] to the ECB and the Commission of transferring counterfeit banknotes and coins and the strengthening of the obligations of credit institutions and other intermediaries. These economic agents 'shall be obliged to withdraw from circulation all euro notes and coins received by them which they know or have sufficient

[322] *League of Nations Treaty Series*, No 2623 (1931), p 372. In the Community of fifteen, only Luxembourg and Sweden were not parties to the Convention. They have acceded to it as, progressively, all the new Member States after the great widening of the Union in 2004/2007.
[323] [2000] OJ L140, 14 June 2000, p 1.
[324] [2001] OJ L181, 4 July 2001, p 6. Regulation No 1339/2001 of the same date extends the effect of this Regulation to non-participating Member States, ibid,, p 11. See also note 40.
[325] OJ L267, 9 October 2010, p 1.
[326] See the Agreement between Europol and the ECB [2002] OJ C23, 25 January 2002, p 9
[327] See the Decision of the Council of 17 December 2001 establishing an exchange, assistance and training programme for the protection of the euro against counterfeiting [2001] OJ L339, 21 December 2001, p 50 extended to no participating countries by a Decision 2001/924, ibid, p 55. Two decisions of 20 November 2006 prorogued the Pericles programme [2006] OJ L258, 5 October 2006, p 28 and p 30.
[328] Council Regulation (EC) No 44/2009 of 18 December 2008 amending Regulation (EC) No 1338/2001 laying down measures necessary for the protection of the euro against counterfeiting [2009] OJ L17, 22 January 2009, p 11. The application of this Regulation was extended to Member States not having adopted the euro by Regulation No 4/2009, ibid, p 4.
[329] See later in the text.

المنارة للاستشارات

reason to believe to be counterfeit. They shall immediately hand them over to the competent national authorities.'

Information and cooperation are assured between competent authorities. A Counterfeit Analysis Centre (CAC) and a Counterfeit Currency Database (CCD) were created under the aegis of the ECB.[330] Later on the CCD was renamed Counterfeit Monitoring System (CMS), active for banknotes as well as for coins.[331] In particular, Member States have to designate or establish competent authorities that will receive and have the obligation to transmit all relevant information to the ECB. National Analysis Centres (NACs) and Coin National Analysis Centres (CNACs) will have access to the CMS. Some access is also allowed for foreign authorities.

The responsibility of the European Technical and Scientific Centre (ETSC), originally located at the French Mint was given to the Commission (OLAF) by a Council Decision of 8 December 2003 concerning analysis and cooperation with regard to counterfeit euro coins.[332] The ETSC is specifically in charge of analysing and classifying counterfeit euro coins.

Council Decision 2005/511 JHA of 12 July 2005 on protecting the euro against counterfeiting, by designating Europol as the Central Office for combating euro counterfeiting,[333] within the meaning of Article 12 of the Geneva Convention, is also an important decision. Article 12 relates to the creation in every jurisdiction (here the EU) of a central organism in charge of organizing research in the field of counterfeiting. But it pertains to each Member State to make a declaration designating Europol as their central authority and to specify in it which responsibilities would remain national.

Eurojust, an EU agency for judicial cooperation, also has responsibilities in the field of counterfeiting. It can intervene in the investigations on counterfeiting.

The number of bodies with responsibilities in the field of the protection of the euro banknotes and coins against counterfeiting is such that a simplification of the architecture in this matter would be welcome. Agreements of cooperation have been concluded among competent authorities, eg between the Commission and Europol or Europol with the ECB.

[330] See Guideline ECB/1999/3 of 7 July 1998 on certain provisions regarding banknotes, as amended on 29 August 1999, see ECB, *Legal Framework of the Eurosystem and the European System of Central Banks*, ECB Legal Acts and Instruments, July 2008, p 22 and especially note 44.
[331] See ibid, the references to a decision of the ECB of 8 November 2001 on certain conditions regarding access to the CMS.
[332] [2003] OJ L325, 12 December 2003, p 44.
[333] [2005] OJ L185, 16 July 2005, p 35.

المنارة للاستشارات

VI. External Relations of the Euro[334]

A. Introduction and Economic Considerations

The ESCB is entrusted by the Treaty with sole responsibility for monetary policy, which is an exclusive EU competence (albeit geographically limited to the Member States that have adopted the euro).[335] Despite the indissoluble link that exists between a single monetary policy (geared towards internal price stability) and external monetary relationships, in the euro area the responsibility for the latter is divided between the Council (primary role) and the European Central Bank under a cumbersome set of Treaty provisions, the result of a calculated obfuscation for political purposes.[336]

The substance of Article 111 ECT—which was the core provision concerning the external aspects of EMU—is now divided between Articles 138 and 219 TFEU. While Article 111 was located in Chapter 2 ('Monetary Policy') of Title VII ('Economic and Monetary Policy') ECT, Article 138 is located in Part Three ('Union Policies and Internal Actions'), Title VIII ('Economic and Monetary Policy'), Chapter 4 ('Provisions Specific to Member States whose Currency is the Euro'), while Article 219 TFEU is located in Part Five ('External Actions by the Union') Title V concerning 'International Agreements'.

There is a degree of inconsistency, and possibly conflict, between giving the ECB independence of political control in the conduct of a price stability-oriented monetary policy, while leaving the exchange regime (fixed, pegged, floating, or managed float) and the determination of the exchange rate in the hands of the political authorities. The room for manoeuvre in the field of exchange rate policy—traditionally the domain of the Treasury or Minister of Finance—varies from country to country, with some central banks deciding on the exchange rate (eg the Swedish Riksbank)[337] and others with freedom only to implement the foreign exchange policy formulated by the government. Before the advent of EMU, governments or Ministers of Finance in the EU Member States (with the exception of Sweden) had the last word on exchange rate matters. Therefore, the agreement reached at Maastricht reflected the status quo, ie political responsibility for the external aspects of exchange rate policy.

[334] See generally RM Lastra, *Legal Foundations of International Monetary Stability* (Oxford University Press, 2006), ch 8 and J-V Louis, *L'Union européenne et sa monnaie* (Editions de l'Université de Bruxelles, Commentaire Mégret, 2009, 3rd edn), ch VI.
[335] See Art 3(1)(c) TFEU.
[336] Art 111(1), (2), (3), and (5) ECT have become Art 219 TFEU. With regard to Art 111(4) ECT, the equivalent provision in TFEU is Art 138. As for the 'labour pains' that accompanied the creation of Art 111 ECT, see R Smits, *The European Central Bank. Institutional Aspects* (Kluwer Law International 1997), p 375, quoting R Stadler, *Der rechtliche Handlungsspielraum des Europäischen Systems der Zentralbanken* (Nomos, 1996), p 172.
[337] According to the Swedish Central Bank Law of 1991, art 4 (SFS 1988: 1385), the Riksbank is responsible for Sweden's foreign exchange and credit policies.

المنارة للاستشارات

As acknowledged, the exchange rate has a dual dimension. On the one hand, it is the external anchor, the external dimension of monetary stability (and, in this respect, the ESCB has a vested interest in safeguarding it). On the other hand, it is an instrument of the general economy policy of a country, closely linked to its trade and employment objectives.[338] For this reason, independent central bankers committed to price stability-oriented monetary policy (interest rate policy), but deprived of parallel powers in the field of exchange rate policy, are likely to clash with politicians who have other objectives to pursue besides price stability.[339]

The European arrangement reflects nonetheless the norm in many countries, where the conduct of external monetary affairs involves an uncomfortable dialogue between the central bank and the Treasury or Ministry of Finance. Politicians are typically involved in tactical decisions concerning the exchange rate regime, while central banks are involved in operational issues. The problem at the European level is that while the voice of the ECB with regard to monetary policy is a 'single voice', the Council represents many voices, the views of all the Member States. This adds an extra layer of complexity to the conduct of exchange rate policy in Europe.

Given the intergovernmental character of the EU Council, as representative of the Member States, one is inclined to think that a degree of 'political meddling' may go into the decision-making. National politicians in the euro area appear to be somehow reluctant to release completely their powers over exchange rate issues. This may help explain the proposals put forward by the former German Minister of Finance, Oskar Lafontaine, with regard to the adoption of target zones for the euro, the US dollar and the yen in order to diminish the volatility of exchange rate movements[340] or the proposals put forth in 2004 by the Italian government.[341]

The depoliticization of monetary policy (in the hands of an independent central bank) contrasts with the possible politicization of exchange rate policy.

[338] See RM Lastra, *Central Banking and Banking Regulation* (Financial Markets Group, London School of Economics, 1996), p 276, note 454, for a quote of former German Chancellor Helmut Schmidt who had stated in his memoirs, that he 'regarded exchange rate policies . . . as an important part of general foreign and strategic policy'.

[339] See S Fischer, *Modern Central Banking* (a paper presented at the Bank of England's Tercentenary Celebration) (1994), p 4, in which Fischer contends that in today's world, interest rate and exchange rate policies are increasingly interrelated. Fischer also contends that the very effectiveness of central bank independence will depend on the government's choice of exchange regime. Under floating rates, monetary policy affects the exchange rate, whereas a system of fixed exchange rates greatly curtails and independent central bank's room for manoeuvre in the conduct of monetary policy.

[340] See P Norman, 'Finance Minister in Waiting' *Financial Times*, 4 October 1998; Wolfgang Munchau, 'Return to Keynes' *Financial Times*, 26 October 1998. See also, for example, F Bergsten, 'How to Target Exchange Rates' *Financial Times*, 20 November 1998, p 24, for a more academic explanation with regard to the proposed adoption of target zones.

[341] See *Financial Times*, 11 November 2004, 'Italy raises the prospect of intervention on euro'.

المنارة للاستشارات

This is, however, not necessarily a bad thing, since important strategic decisions concerning the exchange rate (such as a hypothetical scenario in which the euro were to be pegged to the US dollar) need to be subject to democratic, ie political, control, as such decisions should not be taken against the wishes of democratically elected governments.

The stability of exchange rates (the exchange rate being the price of a currency in another currency) and the issue of which is the best exchange rate arrangement for a given country (fixed, floating, or some version of managed float) remain a matter of great controversy in the economic literature. This means that the law tends to refer to the external dimension of monetary stability (the stability of the currency) in rather ambiguous terms.

B. Primary Law Regarding Exchange Rate Policy

The second basic task of the ESCB[342] according to Article 127(2) TFEU is 'to conduct foreign-exchange operations consistent with the provisions of Article 219'.

The conduct of foreign exchange policy involves the determination of the exchange rate and the exchange regime and the management of the official foreign reserves (gold reserves, foreign currency reserves, and reserve positions at the IMF, including Special Drawing Rights, SDRs). Article 219 TFEU deals with the division of responsibilities with regard to the determination of the exchange rate and the exchange regime. The management and holding of the official foreign reserves of the Member States is one of the basic tasks to be 'carried out' through the ESCB according to Article 127(2) TFEU.[343]

The area of jurisdiction of the euro is supra-national. In an ECB opinion of 4 November 2004, it is clearly stated that 'the euro area's exchange rate policy is an exclusive Community competence'.[344]

The language of the Treaty provisions and the provisions in the proposed EU Constitution regarding exchange rate policy remains somewhat confusing. In particular, should the concept of monetary policy be understood *stricto sensu* or

[342] As a matter of fact, when the Treaty and Protocols mention the ESCB, one should read the Eurosystem.

[343] Only part of the reserves have been transferred to the ECB (according to Art 30 of the ESCB Statute), while part of the reserves are held by the NCBs (according to Art 31 of the ESCB Statute). The distribution among the members of the System is irrelevant for the communal holding and managing of the reserves that are no longer for the Member States to own and decide upon. See the ECB's Opinion CON/2004/6 of 13 February 2004 on cover for exchange losses by the Banque de France, at: <http://www.ecb.int/ecb/legal/pdf/en_con_2004_6_f_sign.pdf> accessed 15 March 2013.

[344] See para 13 of the ECB's Opinion of 4 November 2004 at the request of the Belgian Ministry of Finance on a draft law introducing a tax on exchange operations involving foreign exchange, banknotes and currency (CON/2004/34), <http://www.ecb.int/ecb/legal/pdf/en_con_2004_34_f_sign.pdf> accessed 15 March 2013.

المنارة للاستشارات

lato sensu?[345] Smits and Zilioli consider that exchange rate policy, as an integral part of monetary policy *lato sensu*, is an exclusive Community competence.[346] In our view, both the internal and the external competences regarding the management of the euro lie with the EU alone. We understand the term 'monetary policy' in a narrow sense as 'interest rate policy', in line with established economic theory.[347] While the ESCB/Eurosystem has exclusive responsibility for 'internal' monetary policy (interest rate policy), there is a sharing of responsibilities between the Council (with a primary role) and the ECB (with an important operational role) with regard to exchange rate policy.

Article 219 TFU (which replaces Article 111(1)—(3) and (5) ECT) governs the exchange rate policy of the euro.

(i) Formal Exchange Rate Agreements

Formal exchange rate agreements between the euro and one or more currencies of third States, are the responsibility of the Council in accordance with the first indent of Article 219(1) TFEU:[348]

> 1. By way of derogation from Article 218 [the general treaty- making procedure], the Council, either on a recommendation from the European Central Bank or on a recommendation from the Commission and after consulting the European Central Bank, in an endeavour to reach a consensus consistent with the objective of price stability, may conclude formal agreements on an exchange-rate system for the euro in relation to the currencies of third States. The Council shall act unanimously after consulting the European Parliament and in accordance with the procedure provided for in paragraph 3.

This means that any formal agreement related to the choice of exchange regime vis-à-vis the dollar or other currencies is the responsibility of the Council. The language, however, is convoluted and the reference to the procedure in paragraph 3, further analysed before, complicates an already cumbersome provision.

An Annexed Declaration on Article 111 TEC clarified that the term 'formal agreements' as used now in Article 219(1) TFEU was not intended to create a

[345] For a discussion on this issue, see J-V Louis, 'Monetary Policy and Central Banking in the Constitution', *Legal Aspects of the European System of Central Banks, Liber Amicorum Paolo Zamboni Garavelli* (European Central Bank, 2005), pp 29–30.

[346] See R Smits, 'The European Constitution and EMU: an Appraisal' (2005) 42 CMLRev 425, 455. See C Zilioli, 'The Constitution for Europe and its Impact on the Governance of the Euro' in F Torres, A Verdun, and H Zimmerman (eds), *EMU and Democracy: Governance in the Eurozone*, forthcoming (to be published by Nomos).

[347] Though it should be noted that under Art 3(1)(c) TFEU (Art 3 TFEU lists the exclusive competences of the Union) monetary policy should receive a broad interpretation, covering both external and internal aspects.

[348] The second indent of Art 111(1) and Art 219(1) TFEU deals with the adoption, adjustment, or abandonment by the Council of the central rates of the euro within the exchange rate system, following a procedure similar to the one the Council must comply with in the case of the adoption of formal exchange rate arrangements.

المنارة للاستشارات

new type of international agreements in Community law.[349] Smits observes that only 'Bretton Woods-type arrangements' were intended in paragraph 1, while less formal exchange rate arrangements, such as those which emanated from the so-called Plaza and Louvre accords, would only give rise to the 'general orientations' that are mentioned in Article 219(2) TFEU.[350]

While Smits argues that the difference between Article 219(1) TFEU which provides for 'formal agreements establishing exchange rate systems' and Article 219(3) TFEU which provides for 'agreements concerning monetary and foreign exchange regime matters' is one of procedure,[351] Zilioli and Selmayr consider that Article 219(3) TFEU includes not only procedural aspects but also the Community's explicit external competence to enter into public international law agreements on monetary and exchange regime matters.[352] We agree with Zilioli and Selmayr.

(ii) Floating Exchange Rates

The provisions of Article 219(1) TFEU have yet to be used. The euro floats freely in international financial and money markets in conformity with current obligations under the IMF's Articles of Agreement, which no longer prescribe fixed exchange rate arrangements. In the present situation, the provisions of Article 219(2) TFEU, are of major practical importance. In a situation where no formal exchange rate agreements have been concluded in relation to one or more non-Community currencies, the Council may 'formulate general orientations for exchange-rate policy in relation to these currencies'.

As to the legal nature of these 'general orientations' for exchange rate policy, the term 'orientations' does not refer to an established legal instrument, and according to Smits, these orientations lack legal binding force.[353] During its Luxemburg meeting on 12 and 13 December 1997, the European Council adopted a Resolution[354] in which it stated that 'in general, exchange rates should be seen as the outcome of all other economic policies'. General orientations may be adopted by the Council only 'in exceptional circumstances, for example in the case of a clear misalignment'. Even in this case, 'such general orientations should always respect the independence of the ECB and be consistent with the primary objective of the ESCB to maintain price stability'.[355]

[349] Declaration on Article 109 of the Treaty Establishing the European Community [1992] OJ C191/99.
[350] See R Smits, *The European Central Bank-Institutional Aspects* (Kluwer Law International, 1997), 380.
[351] Ibid, 377.
[352] See C Zilioli and M Selmayr, 'The External Relations of the Euro Area: Legal Aspects' (1999) 36 CMLRev 296.
[353] Smits, 399.
[354] [1998] OJ C35/1.
[355] Ibid.

المنارة للاستشارات

As mentioned above, the ESCB is responsible for the conduct of foreign exchange operations and for the management of the Community's foreign reserves. That is, under the present regime, the ESCB is operationally responsible for exchange rate policy, even though the Council could at any time issue 'general orientations'.

(iii) International Agreements in Monetary Matters

Article 219(3) TFEU contains an explicit external competence of the Union with regard to the negotiation of international agreements concerning monetary matters and foreign exchange regime matters, which constitutes a derogation from the normal treaty-making procedures between the Union and third countries or international organizations.

Article 219(3) TFEU states:

> By way of derogation of Article 218, where agreements concerning monetary or foreign exchange regime matters need to be negotiated by the Community with one or more States or international organizations, the Council, acting by a qualified majority on a recommendation from the Commission and after consulting the ECB, shall decide the arrangements for the negotiation and for the conclusion of such agreements. These arrangements shall ensure that the Union expresses a single position. The Commission shall be fully associated with the negotiations.

This provision refers to situations in which the monetary regime of the euro is extended to a third country, eg if a third country wants to use the euro as its currency under a currency board arrangement, or as parallel legal tender on its territory and is allowed to do so by the Community.[356]

(iv) The Residual Role of the Member States

Article 219(4) TFEU, Article 111(5) ECT, refers to the residual role of the Member States to negotiate in international bodies (international organizations and other groupings) and to conclude agreements as regards economic and monetary union. It states: 'Without prejudice to Community competence and Community agreements regarding economic and monetary union, Member States may negotiate in international bodies and conclude international agreements.' We discuss below the obligations of IMF membership for the individual Member States of the euro area.

[356] The agreements with the principality of Monaco, the Republic of San Marino, the principality of Andorra and the Vatican City with regard to the use of the euro in their territories are included under this category of 'monetary matters'. See eg ML Escudero, *El Euro en el Sistema Monetario Internacional* (Tecnos, 2004), p 57. For an update, see by the same author, 'La politique de change de l'euro' (2011) CDE p 2.

المنارة للاستشارات

C. International Relations

Article 138 TFEU deals with the role of the euro. Article 138(1) to (3) TFUE is part of a chapter including provisions specific to Member States whose currency is the euro, starting with Article 136 which played a great role in the adoption of the rules on the new economic governance. It substitutes with interesting changes Article 111(4) ECT and reads as follows:

1. In order to secure the euro's place in the international monetary system, the Council, on a proposal from the Commission, shall adopt a decision establishing common positions on matters of particular interest for economic and monetary union within the competent international financial institutions and conferences. The Council shall act after consulting the European Central Bank.
2. The Council, on a proposal from the Commission, may adopt appropriate measures to ensure unified representation within the international financial institutions and conferences. The Council shall act after consulting the European Central Bank.
3. For the measures referred to in paragraphs 1 and 2, only members of the Council representing Member States whose currency is the euro shall take part in the vote.

One should remark that paragraph 1 is a 'shall' provision' and paragraph 2, a 'may' one. This difference surely reflects the more delicate feature of the theme of 'a unified representation' which requires a political decision in conformity with its charter from the part of the institution or conference concerned. Nevertheless this enabling clause includes also an objective to be pursued by the euro area institutions. McNamara and Meunier argue that a single external voice for the euro is needed both to defend its value on international exchange markets and to influence decisions on a wide range of international macro-economic policy issues (normally in the G7 or the IMF), such as international policy coordination on fiscal, monetary, and exchange rate policy; the construction of a new international financial architecture; and the management of international financial crises.[357] Some have spoken of the President of the Eurogroup as Mr Euro, while this denomination has also been appropriated on some occasions by the President of the ECB.[358] The press has echoed

[357] See KR McNamara and S Meunier, 'Between National Sovereignty and International Power: What External Voice for the Euro?' (2002) 78 *International Affairs* 849, 851.

[358] See eg *Financial Times,* 17 September 2004, p 9: 'Jean-Claude Trichet, ECB President said last weekend: As far as the currency is concerned, I am evidently Mr Euro'. At the ECB Press Conference of 8 January 2004, one question posed to Mr Trichet was the following: 'Your predecessor said: The euro is me, I am Mr Euro. Hence, your refusal to give as an indication of the exchange rate policy is rather surprising.' At another ECB Press Conference on 4 March 2004, Mr Trichet was asked the following question: 'The European Central Bank is supposed to be the key spokesman for the euro, but over the last few weeks there has been a lot of noise from finance ministers and Heads of State. [Chancellor] Schröder was in Washington and talked to [President] Bush about the euro—does this bother you in any way as Mr Euro?' And this was his answer:

We have a system which is very clear. The Governing Council of the European Central Bank takes a number of decisions. The President of the ECB is the "porte parole" or spokesperson of the institution, which has the unique

المنارة للاستشارات

this uncertainty:

> Who exactly speaks for Europe's single currency? We do, says the European Central Bank, because we run monetary policy and are therefore the guardians of its worth. We do, say the governments whose countries make up the European Union, because we created the euro, and the unelected people who run the central bank should have a vocal political counterweight. Too many people already speak for it, mutter currency traders . . . (The Economist, 16 September 2000)

Under the Treaties, both the ECB and the Council speak for the euro. The former is a single voice, the latter represents the voices of all Member States (while the 'informal' Eurogroup represents the voices of the eurozone Member States, as its president did, with the ECB President and the EMU Commissioner in bilateral consultations with China some years ago). The former president of the ECB, Jean-Claude Trichet, proposed in the last months of his mandate in 2011 the appointment of a euro area Finance Minister. He was thinking more in term of strengthening fiscal discipline than in order to unify external representation. The idea of a Treasury cabinet was also advanced in the report of 26 June 2012 presented at the Summits of 28 and 29 June on which we will come back in the Conclusion. And there are more than one candidate for the post: the EMU Commissioner, the president of the Eurogroup (who perhaps will become a full-time job) are the more often mentioned. The SCG Treaty has formally added the president of the euro area Summits (Article 12).

An entity needs legal personality in order to act in international relations, to create rights and obligations under international law.[359] Neither the European System of Central Banks nor the Eurosystem have legal personality. Therefore they do not have the capacity to enter into international legal relations. The entities with legal personality are the ECB and the NCBs, the Union, and the Member States.

(i) The Union for the Euro Area?

The Treaty on European Union (TEU) as revised by the Treaty of Lisbon states in Article 1 that the Union shall replace and succeed the Community and then in Article 47, it states that the Union shall have legal personality. Although it is in principle for the Commission to represent the Union (Article 17(1) TEU)

and extraordinary responsibility of having to run a monetary policy, a single monetary policy, for 306 million citizens belong to 12 different economies and countries. On the side of the executive branches we have an organisation called the "Eurogroup", which is the college of the 12 ministers of finance of these countries, the members of the euro area, and we have a president of the euro area, which is currently Charlie McCreevy, the Irish finance minister, and we also have the Commission, of course. So the equivalent of the executive branch is the combination of the President of the Eurogroup and the role of Pedro Solbes and the Commission. We have an organised system, and when we were together in the United States for the Boca Raton meeting, I was, if you like, the equivalent of Alan Greenspan and Charlie McCreevy was opposite [Treasury] Secretary Snow. That's the organisation of Europe, and I believe that it is a good organization.

[359] See R Smits, *The European Central Bank. Institutional Aspects* (Kluwer Law International, 1997), p 274.

المنارة للاستشارات

except for the PESC and in other cases provided by the Treaty, Article 138 TFEU prescribes a different form of external representation. It is the Council that decides, acting on a proposal of the Commission by the qualified majority of the Member States having adopted the euro, on the euro area's representation in international financial institutions and conferences (Article 138 TFEU). Also, whenever the Union needs to enter into an agreement concerning monetary or foreign exchange regime matters, it is the Council that decides in each individual case, acting by the qualified majority of the Member States having adopted the euro, the arrangements for the negotiation and the conclusion of such agreements under Article 219(3) TFEU. This is also true for the specific case of formal agreements on an exchange rate system for the euro, dealt with under Article 219(1) TFEU and for informal understandings that could give rise to general orientations as referred to in Article 219(2) TFEU, Article 111(2) ECT.

Since the euro area as such has no legal personality, Article 138(3) TFEU clarifies that voting within the Council with regard to external euro matters is restricted to the Ministers of the Member States whose currency is the euro. Herrmann contends that all the fundamental decisions a monetary sovereign can take from the perspective of international law are to be taken by the Council (entering into formal exchange rate systems like Bretton Woods, restricting the flow of capital and payments, or entering into monetary or foreign exchange regime agreements) not by the ECB. He considers that the operational tasks of the ECB to conduct foreign exchange operations and to hold and manage the foreign reserves of the Member States are inferior to the basic tenets of monetary sovereignty.[360] Slot also considers that the Council is in the driver's seat.[361]

(ii) The European Central Bank

In the field of international monetary cooperation the European Central Bank is entrusted with competences by the Treaty and the ESCB Statute. It is important to bear in mind that though the ECB is an institution (Article 13(1) TEU) and endowed with separate legal personality (Article 282(3) TFEU), in the conduct of its monetary policy responsibilities, it exercises an exclusive Union competence.

The European Central Bank governs the ESCB through its decision-making bodies (Article 129(3) TFEU, Article 107(3) EC Treaty). In particular, the decision on external representation of the ESCB is centralized in the hands of the Governing Council of the ECB.[362] According to Article 6.1 of the ESCB Statute, 'in the field of international cooperation involving the tasks entrusted to

[360] CW Herrmann, 'Monetary Sovereignty over the Euro and External Relations of the Euro Area: Competences, Procedures and Practice' (2002) 7(1) *European Foreign Affairs Review* 6–7.
[361] P Slot, 'The Institutional Provisions of the EMU' in Curtin and Heukels (eds), *Institutional Dynamics of European Integration. Essays in Honour of Henry G. Schemers, Vol II* (Martinus Nijhoff Publishers, 1994), p 241.
[362] See Arts 6 and 12.5 of the ESCB Statute.

المنارة للاستشارات

the ESCB, the ECB shall decide how the ESCB shall be represented.' Moreover, under Article 6.2, 'the ECB and, subject to its approval, the national central banks may participate in international monetary institutions'. For instance, the ECB participates in the Bank for International Settlements since 1999.

The international legal personality of the ECB is limited to the specific fields of tasks entrusted to the ECB by the Treaty, essentially monetary policy and related matters. It should be noted that in the absence of formal exchange rate arrangements or general orientations, the management of the exchange rate is the responsibility of the European Central Bank.

Article 23 of the ESCB Statute lists the 'external operations' (explicit external competences) which the ECB and the national central banks may conduct:

- establish relations with central banks and financial institutions in other countries and, where appropriate, with international organizations;
- acquire and sell spot and forward all types of foreign exchange assets and precious metals; the term 'foreign exchange asset' shall include securities and all other assets in the currency of any country or units of account and in whatever form held;
- hold and manage the assets referred to in this Article;
- conduct all types of banking transactions in relations with third countries and international organizations, including borrowing and lending operations.

In addition to Article 23, there are other provisions in the ESCB Statute that also refer to 'external operations'. According to Article 22 of the ESCB Statute, the role of the ECB in the promotion of the smooth operation of payment systems also includes an external aspect. The ECB is competent to 'make regulations, to ensure efficient and sound clearing and payment systems within the Community and with other countries'. This regulatory competence implies a parallel external competence to negotiate and conclude, if necessary, international agreements on payment systems.[363] Up to now, the ECB has only concluded such agreements with national central banks of the EU where the ECB relies on the payment facilities and infrastructure of national central banks.[364] This is what happened with the Agreement on a Trans-European Automated Real Time Gross-Settlement Express Transfer System (TARGET), concluded by both the ECB and the euro-NCBs with the NCBs outside the euro area. But such agreements with non-EU NCBs are not excluded. The ECB also has the power to conclude international administrative agreements, which it has done with Interpol in the field of the fight against counterfeiting. The

[363] Zilioli and Selmayr, above n 355, 312–13.
[364] NCBs have been reluctant to have regulations under Art 22 that would have direct effect for market participants, preferring instead guidelines that are considered to have no binding effects outside the Eurosystem.

المنارة للاستشارات

agreement concluded with the country of its seat (Article 24 ESCB Statute) is not the expression of the international legal personality of the ECB.

(iii) The National Central Banks

The NCBs of the Member States that have adopted the euro are an integral part of the ESCB (operational arms of the ESCB), when carrying out operations that form part of the tasks of the ESCB.[365] They are also national agencies when performing non-ESCB functions.[366]

According to Article 6.2 of the ESCB Statute, the national central banks may continue to participate in international monetary institutions, such as the Bank for International Settlements, BIS. Though the ECB has been a member of the BIS since 1999, ten of the NCBs—the NCBs of the G10—retain their participation as BIS members. Article 31.1 of the ESCB Statute further enables the NCBs to perform transactions in fulfilment of their obligations towards international organizations in accordance with Article 23.

According to Article 43.2 of the ESCB Statute, the national central banks of the Member States with a derogation shall retain their powers in the field of monetary policy according to national law, despite their participation in the ESCB.

(iv) The EU Member States

The transfer of monetary powers from the national to the Community level has reduced the legal capacity of the Member States to act on the international level.[367] The external competences of the Member States of the euro area have a residual character,[368] as recognized in Article 219(4) TFEU.

[365] ESCB Statute, Arts 12.1 and 14.3.
[366] ESCB Statute, Art 14.4.
[367] Member States, as a rule, remain externally competent in the field of economic [fiscal] policy provided (1) that they regard their economic policies as a matter of common concern and (2) any international agreements do not circumvent the prohibitions laid down in the Treaty regarding economic policy. Eg Member States shall not enter into international agreements which would require them to grant public authorities privileged access to financial institutions. See Zilioli and Selmayr, above n 355, 290.
[368] See generally Zilioli and Selmayr, ibid, 317–32. According to Art 127(3) TFEU the competence of the ECB to hold and manage the official foreign reserves of the Member States 'shall be without prejudice to the holding and management by the governments of Member States of foreign-exchange working balances'. There is also a rather limited external competence of Member States for international agreements with regard to coins, which remain largely a national competence but these possible agreement would not include the exercise of a policy and nobody has been able up to now to describe a possible content for such agreements. There were also a number of Protocols and Declarations attached to the Treaty which reserved external competences to specific Member States and thus enable them to continue their public international law relationship. But the agreements concluded with specific countries like the Republic of San Marino, the Vatican City, and the Principality of Monaco are concluded as EU agreements. For a recent list with references of these monetary agreements, see <http://ec.europa.eu/economy_finance/euro/world/outside_euro_area/index_en.htm> accessed 21 March 2013. The case of the zone franc is somewhat

المنارة للاستشارات

However, EU Member States must still comply with their international obligations. In the following paragraphs we examine briefly the consequences of IMF membership for the Member States in the euro area.

(a) IMF Membership and Obligations of IMF Members

Under the Fund's Articles of Agreement (Article II, section 2), only 'countries' are allowed for membership. Member States that have adopted the euro remain individual members of the IMF, despite the fact that the area of jurisdiction of the euro is clearly supra-national. The membership of the Union or of the ECB would need an amendment of the Articles. The euro area as such is not able to appoint a Governor or appoint or elect Executive Directors in the IMF, even though in December 1998, the ECB was granted observer status at selected Executive Board meetings.[369]

The national/supra-national dichotomy presents a challenge for the Member States of the euro area. The differentiated integration with regard to monetary policy and to exchange rate policy, the asymmetries between monetary and fiscal policy, and between monetary policy and financial supervision and regulation further complicate the obligations of IMF membership.[370]

With regard to surveillance, regular consultations with members (under Article IV of the IMF Articles of Agreement) continue to be held with individual countries. However, an Article IV consultation with a member cannot be completed without the Fund having had an opportunity to assess monetary and exchange rate policies. Therefore, discussions with representatives of the relevant EU institutions are needed as part of the Article IV consultations with individual euro area countries. These discussions and consideration by the IMF's Executive Board of the monetary and exchange rate policies of the euro area are, as a practical matter, held separately from those with individual euro area countries, but are considered an integral part of the Article IV process for each member.[371] Discussions at the EU level also cover fiscal and structural policies from a regional perspective to provide a setting for the discussions on monetary and exchange rate policies.

Prior to EMU, the SDR basket included the currencies of the five IMF members with the largest exports of goods and services (US dollar, Deutsche

different: France was authorized to continue its relations with the zone but changes to the agreement have to be submitted to the EU.

[369] See 'The IMF & the European Economic and Monetary Union', International Monetary Fund, March 1999, available at <http://www.imf.org/external/np/exr/facts/emu.htm> accessed 15 March 2013.

[370] See J-V Louis 'The international projection of the euro and the international monetary system', in Mario Telò (ed), *The European Union and Global Governance* (Routledge, 2009), pp 64–86.

[371] See eg International Monetary Fund, PIN (Public Information Notice) No 04/79, 3 August 2004, 'IMF Executive Board Discusses Euro Area Policies'. On IMF surveillance of the euro area, see Jean Pisani-Ferry, André Sapir, and Guntram B Wolff, 'An evaluation of IMF surveillance of the euro area', Brussels, Bruegel Blueprint 14, 2011, 47 pages.

المنارة للاستشارات

mark, Japanese yen, French franc, and pound sterling). Since the advent of EMU, the euro has replaced the Deutsche mark and the French franc in the SDR valuation basket, on the basis of the weight of these two currencies. Later on, the euro was included with a percentage fixed for the new currency as such (ie no longer in proportion to the weight of the former DM and FF in the basket).

As part of their membership responsibilities, Member States hold reserve positions with the IMF. Article 31 of the ESCB Statute allows Member States of the euro area to hold some reserves so that they can fulfil their obligations towards international organizations. However, the discretion that a Member State of the euro area retains in managing its foreign reserve assets is limited: part of the assets have been transferred to the ECB (according to Article 30 of the ESCB Statute), and transactions above certain limits involving foreign assets that are retained by a country are subject to ECB approval. This is consistent with the fact that the management and holding of foreign reserves is a basic task to be carried out through the ESCB, as recognized in Article 127(2) TFEU.

According to Article 30.5 of the ESCB Statute, 'The ECB may hold and manage IMF reserve positions and special drawing rights and provide for the pooling of such assets.' In principle, only if the EU were to become a political union, or if the IMF Articles of Agreement were revised, could the IMF 'deal' directly with the EU in terms of representation and the obligations of IMF membership (Article IV consultations and others). However, we have learnt through the crisis that if there is a political will, to achieve that will, a status could be found for the EU/euro area, taking into account that only the EU has legal capacity. René Smits has advocated an alternative reading, namely that the Articles of Agreement should be interpreted in conformity with a new legal reality, not foreseen at the time of their conclusion when only 'countries' had currencies and currency unions were always between sovereign States, and that for the purposes of the IMF Articles of Agreement, the Community (Union) is a 'country'. IMF governance reform will continue to have repercussions in terms of representation of EU Member States, since the diminution in the number of Executive Directors representing EU and other European Countries is needed to make space for emerging countries.

D. Concluding Observations on the External Relations of the Euro

The Union is competent to speak and act in international fora whenever the external competences of the Union are involved.[372] The ECB is competent to speak and act in international fora whenever the tasks entrusted to the ESCB are involved. The Member States of the euro area (the 'ins') have a residual competence and also have the responsibilities of their 'individual' membership in

[372] Zilioli and Selmayr, above n 355, 336–7.

المنارة للاستشارات

international monetary organizations. The national central banks of the Member States that have adopted the euro remain competent to act in the field of financial supervision and in the exercise of the other responsibilities assigned to them by national law as national agencies, ie when performing non-ESCB tasks—although the recent programme for building a banking union as part of a number of actions to complete the EMU will change this situation.[373] We allude to this perspective in our conclusion. National Central banks also continue to participate in international organizations, such as the BIS, under Article 6 of the ESCB statute. This can raise problems that are also included in the agenda of the institutions. The Member States with a derogation (the 'outs') retain their monetary sovereignty, internally and externally, and their competence to speak and act in international fora, though they need to comply with a number of treaty provisions.[374] The national central of the Member States with a derogation retain the competences attributed to them by national law. They act as national agencies, not as an integral part of the ESCB, as opposed to the national central banks of the Member States that have adopted the euro.[375]

The problems of relying upon multiple actors[376] and the existence of a multi-layered complex system of representation in the Union with regard to EMU matters present a picture of bewildering complexity. Smits pointedly remarks: 'If unchecked, [the] panoply of uncoordinated provisions on external action, may lead, in the field of EMU, to an hexagonal representation of the Union', comprising the President of the European Council, President of the Commission, Ministers of Finance, President of the EU Council, ECB President, and the President of the Eurogroup.[377] This 'spreading of internal and external power'[378] does not augur well for 'unity' with regard to the external

[373] Though subject to the constraints imposed by Art 14.4 of the ESCB Statute, which reads as follows: 'National Central Banks may perform functions other than those specified in this Statute unless the Governing Council finds, by a majority of two thirds of the votes cast, that these interfere with the objectives and tasks of the ESCB. Such functions shall be performed on the responsibility and liability of national central banks and shall not be regarded as being part of the functions of the ESCB.'

[374] See eg Art 142 TFEU: 'Each Member State with a derogation shall treat its exchange-rate policy as a matter of common interest. In so doing, Member States shall take account of the experience acquired in cooperation within the framework of the exchange-rate mechanism.'

[375] However these NCBs of the Member States with a derogation participate in the General Council, the third governing body of the ESCB. See Art 141 TFEU and Art 45 ESCB Statute.

[376] 'One may even observe a certain competition between the Community institutions, the Member States, the European Central Bank and some national central banks to assume the role of "spokesman" for the euro area. The danger involved in such a competition is that a situation could arise which is only too familiar from the field of the common foreign and security policy: a situation in which our American counterparts would still be asking whom they should call in Europe', Zilioli and Selmayr, above n 355, 273–4.

[377] See R Smits, 'The European Constitution and EMU: an Appraisal' (2005) 42 CMLRev 455–6.

[378] Ibid. Smits cites other provisions on external action by the Union that may affect the functioning of EMU. He concludes: 'The external representation is badly organized and will lead to confusion and inter-agency debate about who is going to represent the Union, with dual (the ECB and

المنارة للاستشارات

representation of the euro. The current structure is far too complex and should be simplified.

To conclude this part on the external relations of the euro, we would like to summarize some of the points we have presented: responsibility for the conduct of exchange rate policy in the euro area is a task which is divided between the Council and the ECB under a cumbersome set of treaty provisions, the result of a calculated obfuscation for political purposes. Despite the convoluted language of the Treaty, the conduct of exchange rate policy in the euro area is an exclusive Union competence. Though the Council has the primary role according to the language of Article 219 TFEU, in the absence of formal exchange rate arrangements or general orientations, the management of the exchange rate is the operational responsibility of the European Central Bank. The external representation of the euro is complicated by the existence of multiple actors with external competences and by a multi-layered system of representation at the EU level. From the point of view of monetary law, the relations between the Member States of the euro area and the International Monetary Fund are of particular relevance. Under Article II section 2 of the current Articles of Agreement, only countries can be members of the IMF. This raises important challenges in terms of international monetary cooperation, since the area of jurisdiction of the euro is clearly supra-national, while IMF membership remains nationally based.

VII. Conclusions

The drafting of this Commentary on Economic and Monetary Union was finished at a special moment in its short history. Various events coincided. First, the European Council and the Euro Summit at their meetings of 28–29 June 2012 adopted important orientations for the future of Economic and Monetary Union. These conclusions were adopted on the basis of a report presented of 26 June by President Herman Van Rompuy and elaborated in close cooperation with the Presidents of the Commission, the Eurogroup and the European Central Bank: 'Towards a genuine economic and monetary union'. The report proposed an EMU based on four building blocks: an integrated financial framework (banking union), an integrated budgetary framework, and an integrated economic policy framework as well as ensuring the necessary legitimacy and accountability of decision-making within the EMU.

Second, in August 2012, the president of the European Central Bank announced that the ECB would do whatever it could within the limits of its

Eurogroup President) triple (including the Commission President), even quadruple or hexagonal presidencies (including the fixed and rotating presidencies of the different Council formations).' We also need to take into account the role of the President of the European Council who, for the time being, combines this post with the responsibilities of chairing the Euro Summits.

المنارة للاستشارات

mandate to save the euro. On 6 September 2012, the Governing Council adopted, with the sole contrary vote of the president of the Bundesbank, a new programme of Outright Monetary Transactions (OMT) which replaced the Securities Market Programme (SMP), suspected especially in Germany of being in conflict with the prohibition of monetary financing under Article 123 TFEU. Through OMT, the ECB can provide on demand unlimited liquidity to the market by buying in the secondary market sovereign bonds of a maximum of three years' duration. These operations should be necessarily accompanied by the intervention of the European Financial Stability Facility/European Stability Mechanism (EFSF/ESM) which should buy sovereign bonds in the primary market imposing strict conditionality upon the Member State asking for such an intervention. The adjustment programme would aim at fighting structural imbalances. The imposition of strict conditionality makes OMT a radically different instrument in comparison with the previous non-conventional measures adopted since the start of the crisis. Nevertheless, it is still at the centre of a controversy in Germany where the Constitutional Court has given an indication in its judgment of 12 September 2012 that OMT might run contrary to the prohibition of monetary financing.

Third, the main result of this decision of the German Constitutional Court was to give the green light to the ratification of the EMS Treaty by Germany. It enabled the euro area Finance Ministers to confirm that all the conditions needed for the entry into force of the new mechanism were met. The Board of Governors of the ESM held its first meeting on 8 October. The ESM will substitute the temporary instruments (the EFSM and later on the EFSF) that were hastily built in 2010. The ESM constitutes a permanent mechanism which will dispose of a capital of 700 billion euros and, from 2013, of a lending capacity up to 500 billion euros. This amount is impressive but perhaps not sufficient in the case of potential distress of a number of big economies. The possibility, opened by the euro area Summit of 28–29 June 2012, of a direct intervention of the ESM in recapitalizing banks—once a Single Supervisory Mechanism (SSM) gets established—is positive in this regard because it would prevent adding to the sovereign debt of the country concerned the amount of funds allocated to banks. This, in other words, would hopefully contribute to 'breaking the vicious circle between banks and sovereigns' (European Council conclusions, 18/19 October 2012, point 12).[379] The European Court of Justice confirmed the validity of the ESM Treaty under EU law in its recent judgment of 27 November 2012, Case C-370/12, the *Pringle* case.

[379] It remains to be decided if direct recapitalization through the ESM would be possible in order to compensate existing losses or only for new debts, ie not for existing Spanish bank losses. This latter standpoint is defended by Germany.

المنارة للاستشارات

The move towards an SSM for the euro area and other Member States, which could voluntarily join it, is part of the ambitious programme decided by the European Council in June 2012. The SSM is a first step towards a banking union. The transfer of supervisory powers from the national authorities to the ECB signifies a fundamental change in the financial landscape in the eurozone, which will be an important step beyond the European System of Financial Supervision (ESFS), given the limited powers granted to the EBA and the other European Supervisory Authorities (ESAs) following the adoption of the recommendations of the Larosière report. Article 126(7) TFEU allows specific tasks to be conferred on the ECB, although, as is clear from the Commission's proposals of 12 September, total centralization is neither possible nor desirable. A major challenge in the implementation of the SSM and the Banking Union proposals, which is recognized in the Van Rompuy Report of 26 June 2012, is the reconciliation of the needs of the Eurozone—in particular the shortcomings in the institutional framework for financial stability—with the need to preserve the unity and integrity of the single market. Hence the report proclaimed the necessity to keep an integrated financial framework—covering all EU Member States—while allowing for specific differentiations between euro area and non-euro area members. In this delicate institutional balance the EBA will keep the regulatory function, in particular with regard to the elaboration of the single rule book, as well as other specific responsibilities, such as, for example, the settlement of disputes between national authorities. However, the SSM will have to be managed at the level of the euro area. The European Council of 18/19 October 2012, while inviting the legislators to proceed with work on the legislative proposals on the SSM and confirming the objective of agreeing on its legislative framework by 1 January 2013, has decided that '[w]ork on the operational implementation will take place in the course of 2013. In this respect, fully respecting the integrity of the Single Market is crucial.' This timetable is the result of a laborious compromise between several Member States, in particular, France and Germany.

A number of concepts used in the conclusions of the European Council of October 2012 needed clarification; for example, the respective roles of the ECB and national authorities. The European Council, in point 7 of the conclusions, used a sibylline expression in this regard: 'the ECB will be able, in a differentiated way, to carry out direct supervision.' It is puzzling that no reference is made in the SSM proposals to the function of lender of last resort, in particular given the role played by the ECB with regard to the provision of extraordinary liquidity assistance since the credit crunch triggered by the subprime crisis commenced in August 2007, leading after September 2008 to a full-blown global financial crisis. Certainly, concerns about the prohibition of monetary financing under Article 123 TFEU and the limited interpretation of Article 14 of the ESCB Statute—which suggests that Emergency Liquidity Assistance (ELA) in terms of collateralized lines of credit to individual illiquid but solvent

المنارة للاستشارات

institutions remains a national task conducted by the NCBs—must be behind this fundamental omission.

Banking supervision is but a first step. Other elements of banking union will include, as we have observed, European deposit protection and European resolution, though political difficulties particularly in Germany may lead to further harmonization of national deposit guarantee schemes rather than single deposit insurance. In any case, the details for the subsequent stages have not been spelt out yet. It has been suggested that the Deposit Insurance/ Resolution Fund can be financed by contributions by banks and, if needed, by the ESM. However, the sufficiency of these resources to confront an actual banking crisis is contested despite the bail-in process by shareholders and other creditors.

If we look at the other elements of the road map adopted in June and confirmed in October 2012 by the European Council,[380] it would not be difficult to demonstrate that such reforms may need a revision of the TFEU. Of course, it is advisable to do whatever is possible on the basis of the present Treaties but there are areas of progress in which it would be impossible to advance without violating the principle of conferred competences or fundamental principles of EMU under the Treaties. Enhanced cooperation has limits, be it on the basis of Article 136 TFEU—which plays an important role in the improvement of economic governance by the six- and two-packs—or under Articles 20 TEU and 326–334 TFEU. Conditions for recourse to these clauses have been made less cumbersome by the successive revisions of the founding Treaties and especially the Lisbon Treaty. For example, qualified majority voting applies to a decision of the Council allowing for enhanced cooperation except for Common foreign and security policy, albeit subject to substantive and procedural rules. Nevertheless, obstacles exist on the way to authorization by the Council. The procedure provides for an initiative by the Commission, as guardian of the Treaties—which have to be respected—as well as of the law of the Union. In our field, it especially concerns the internal market and economic, social, and territorial cohesion. It is not a disguised way of revising the Treaty. The same is true of parallel international law treaties, like the ESM Treaty and the Treaty on stability, coordination, and governance for the euro area (the fiscal compact). They too have to be compatible with the founding Treaties and secondary law. The Pringle judgement of the Court of Justice already assigns strict limits to 'satellite' treaties.

A substantial revision of the Economic chapter of the TFEU under the procedures of Article 48 TEU seems difficult not to say impossible in the context of

[380] 'The European Council looks forward to a specific and time-bound road map to be presented at its December 2012 meeting, so that it can move ahead on all essential building blocks on which a genuine EMU should be based' (point 4).

المنارة للاستشارات

the EU at twenty-seven (and pretty soon twenty-eight and more). The attitude of the United Kingdom is, in this respect, fundamental and one can only hope that there will be clarity—the sooner, the better—on the intentions of the present government.

This reform would be necessary because the present Treaties do not address the needs of democratic and efficient governance. Complexity frustrates accountability. The distance between the intellectual elites and the citizens is growing. Texts have been added one on top of another in order to respond to pressures from the market. The result is a complex system of EU secondary law, international treaties, and soft law or political agreements. One author has evoked an 'intergovernmental bricolage'.[381] The number of addressees varies from one text to another and it is difficult to identify who is in charge of what and what is the specific legal value of the respective commitments. Procedures intertwine with each other. The result lacks transparency and does not provide legal certainty. A typical example is the European Semester which is inspired by the laudable preoccupation of globalization of the different procedures (Broad Economic Policy Guidelines, Europe 2020, Euro Plus Pact) which are said to remain distinct. The euro area has a fragmented governance which could not replace a true government. Decisions are too often taken by unaccountable summits. The citizen is far away from this process in which the visible result is an austerity policy with sacrifices that seem to be unequally allocated. Fiscal consolidation is not the same as deficit cutting. The recession in the Mediterranean countries or the slow growth foreseen in other parts of Europe encourages populist parties; the lessons of history should not be forgotten. The IMF itself conveys the message that austerity alone is not necessarily the remedy and the discrete growth and employment programme annexed to the European Council conclusions of June 2012 are perhaps a start in the right direction but surely not a panacea.

If one wishes to avoid the recurrence of sovereign debt crises in a currency union, one will have to introduce a mechanism of debt mutualization conceived in order to avoid moral hazard. The substitution of a common debtor to the States in the form of a kind of European Debt Agency[382] needs a revision of the Treaty in order to eliminate any discussion about the compatibility of this mechanism with Article 125 TFEU. It is the same with the proposals for the issue of Eurobonds. The Pringle judgement has demonstrated that a debtor substitution mechanism would be incompatible with Article 125 TFEU.

Perhaps our critical approach should be somewhat nuanced if we follow the description of the evolution of the instruments adopted to combat the crisis by

[381] See J Pisani-Ferry (2012) 'Assurance mutuelle ou fédéralisme: la zone euro entre deux modèles'. Bruegel, Brussels, 8 October, p 1.

[382] See V Auctores, 'Completing the Euro. A road map towards fiscal union in Europe', Report of the Tommaso Padoa-Schioppa Group, Notre Europe, June 2012.

المنارة للاستشارات

Viterbo and Cisotta.[383] First, they point to one of the two proposals of the so-called 'two-pack': the proposal for a Regulation on the strengthening of economic and budgetary surveillance of Member States experiencing or threatened with serious difficulties with respect to their financial stability in the euro area.[384] This Regulation which was to be adopted by the end of the year 2012 has an objective of simplification and systematization. It includes a single procedure for the adoption of an adjustment macro-economic programme by Member States benefiting from financial assistance from one or more States, the IMF, the EFSF, or the EMS. This programme should take account of and reinforce the recommendations adopted under the excessive deficit procedure, a procedure that would be suspended for the duration of the adjustment programme. The quoted Article also observes that the contamination between intergovernmental and EU procedures and the role of the institutions play in both directions.[385] One could also observe that the 'two-pack' and the 'six-pack' have considerably strengthened the executive role of the Commission.

The role of the IMF in the mechanisms created in order to fight the crisis also invites some reflection. The IMF is country oriented, member oriented. However, the IMF has from the beginning of monetary union reserved a special treatment to EMU in its consultations under Article IV of the IMF Articles of Agreement. In a factsheet updated in 2012, on 'The IMF and Europe'[386] it is recorded that the IMF holds consultations annually for the euro area as a whole. 'Similar consultations are held for other currency unions . . . However, it is only in Europe that such discussions have been formalised as an integral part of the IMF surveillance of individual currency union members.'[387] This includes regular contacts with EU institutions, the EFC, and the Euro Group but apart for an old exchange of letters of 20 January—20 March 1972 (!) on exchange of information and contacts between the two organizations, there is no formal agreement on the cooperation between the IMF and the EU/euro area. The IMF (and the World Bank) intervened in the EU with regard to financial assistance to non-euro area Member States (like Latvia, Hungary or Romania) in an action based on Articles 143–144 TFEU (ex-Articles 119–120 ECT). When the crisis reached the euro area, the IMF was also involved. After some discussion among the Member States, it joined its resources in the assistance provided to Greece and in all the operations of financial assistance to Ireland and Portugal. EU Member States collaborated to increase the resources of the

[383] See A Viterbo and R Cisotta, 'La crisi del debito sovrano e gli interventi dell'UE: Dai primi strumenti finanziari al *Fiscal Compact*' in *Il Diritto dell'Unione Europea*, XVII, Fasc. 2, (Giuffrè, 2012), pp 323–66, at p 345.

[384] 21 November 2011, COM(2011)819 final.

[385] See op cit, note 4, p 364 *et seq*.

[386] Quoted by Susanna Cafaro, *Il Governo delle Organizzazioni di Bretton Woods. Analisi critica, processi di revisione in atto e proposte di riforma* (G. Giappichelli Editore, 2012), p 162.

[387] See J Pisani-Ferry, A Sapir, and GB Wolff, 'An evaluation of IMF surveillance of the euro area', Bruegel Blueprint 14, Brussels, 2011, p IX + 46.

المنارة للاستشارات

Fund. The ESM Treaty provides in recital 8 of its Preamble that '[t]he active participation of the IMF will be sought, both at technical and financial level. A euro area Member State requesting financial assistance from the ESM is expected to address whenever possible, a similar request to the IMF.' The role of the IMF in the Troika, including also representatives of the Commission and the ECB, in all adjustment countries, is well known. The IMF is now firmly inserted in the life of the EU. But there is no specific framework agreement on the consultation procedures or on the intervention in assistance processes, despite the intensive existing collaboration. This probably reflects the past hesitation in some quarters within the EU/euro area on too close an involvement of the Washington institution in European affairs. It is perhaps also a sign of the preoccupation of the Bretton Woods institutions to appear to be devoting too much of their resources and activity to Europe. It is not to be excluded that the pressure for a balance more favourable to developing and emerging countries, not only in the allocation of quotas and votes but also in the appointment of the managing director, is partly due to the important involvement of the IMF in European affairs since the end of the nineties. It is to be regretted that the EU has not seized the opportunity to urge for a representation of the euro area within the Washington institutions as part of the reform in progress. In lieu of that, Belgium and The Netherlands recently merged their constituencies into a Benelux one and Austria created with Turkey a Centro-Eastern European constituency, both including a few euro area members and countries with derogation or non-European ones like Israel, or candidates to accession to the EU. The paradox of this move is that the double demarche does not satisfy the requirement of the Seoul G20 2010 meeting which asked for the reduction by two of the European seats on the Executive Board.

While the crisis has had some spectacular influence on the economic leg of EMU, it has also provided for dramatic changes in the implementation of monetary policy. We have repeatedly alluded to non-standard measures of monetary policy which have allowed the ECB to inject liquidity when the interbank market was almost paralysed. Other moves are also worth mentioning. The cardinal principle according to which monetary policy has to be implemented 'in a uniform manner throughout the Member States whose currency is the euro' as expressed by the 'general documentation'[388] on monetary policy has been put to the test. As it is well known, under Article 18 of the Statute of the ESCB and the ECB, the ECB and the NCBs may 'conduct credit operations with credit institutions and other market participants, with lending being based on adequate collaterals'. However, the crisis has created some heterogeneity of financial conditions affecting the transmission of monetary policy.[389] The ECB

[388] Guideline ECB/2000/7 on monetary policy instruments and procedures of the Eurosystem [2000] OJ L310, 11 December, p 1.
[389] See 'Heterogeneity in euro area financial conditions and policy implications', *ECB Monthly Bulletin*, August 2012, pp 63–75.

المنارة للاستشارات

has used non-standard measures in order to step up intermediation between banks in a situation in which the interbank money market was greatly impaired. It has allowed for derogations to the General Documentation as adopted by the Guideline of 20 September 2011. These derogations provided for some degree of discretion in the eligibility of collateral under the strict control of the Governing Council. The list of collateral is no longer totally mandatory. Derogations are temporarily allowed and a number of them need authorizations given to individual NCBs. Perhaps it would be exaggerated to see in this new practice the end of 'one size fits all monetary policy' but it is nevertheless an interesting phenomenon which paradoxically gives a substantial power to the Governing Council (the day to day control being exercised by delegation to the Executive Board and sub delegation to the directorates concerned).

In conclusion, we could underscore that if the affirmation about the asymmetry between the monetary and economic pillars that we mentioned at the beginning of this contribution is still correct, the successive crises have necessitated the development of elements of economic union beyond fiscal discipline. The building blocks of the Van Rompuy Report of 26 June 2012 open new perspectives in the direction of banking and budgetary union as well as towards political union. Social justice considerations are at stake.

In this context we would like to mention the Youth Employment Package adopted by the Commission on 5 December in order to fight a situation where the youth unemployment rate (under 25 years old) is more than twice as high as the rate for adults in most Member States. This Package constitutes a concrete step in the implementation of the Europe 2020 programme and of the 'Compact for Growth and Jobs' adopted by the European Council at its meeting of 28–29 June 2012.[390]

The European Commission has also published an important contribution to the reform in progress. In a recent important Communication including 'A blueprint for a deep and genuine economic and monetary union' intended to launch a European debate,[391] the Commission gives flesh to the framework presented by the Van Rompuy Report. Although it is clear that a number of ideas included in the Blueprint will raise objections from some or many Member States, they are interesting because they propose a consistent and forward looking view which should animate the debate. The Commission proposes 'combining substantial ambition with appropriate sequencing'. After having drawn a realistic panorama of the present situation characterized by a crisis of confidence and making the balance of what has been achieved in recent years for fighting the crisis in the field of economic governance, the paper insists on the

[390] See European Commission Press Release, Youth employment: Commission proposes package of measures, 5 December 2012, IP/12/1311.
[391] COM(2012)777 final, 28 November 2012.

المنارة للاستشارات

importance of a complete banking union and stresses the need to build on and to complement the acquis in fiscal and macro-economic coordination.

It proposes new ideas 'in order to combine more responsibility and economic discipline with more solidarity and financial support'. In the *short term* (within the next six to eighteen months), the Commission proposes the full deployment of the new economic governance tools (with the prompt adoption of the two-pack completing the six-pack) and to support growth in the euro area through a 'Convergence and Competitiveness Instrument (CCI)' within the EU budget, albeit separate (outside the ceilings) from the Multi-annual Financial Framework. It would be considered as an integral part of Macroeconomic Imbalances Procedure (MIP) enhanced by contractual arrangements to be concluded by the Member State with the Commission and by this financial support. This is an ambitious project that the Commission proposes to establish by an act of secondary law based on Article 136 TFEU. Alternatively, Article 352 TFEU could be used, if necessary, by enhanced cooperation (coupled with a decision pursuant to Article 332 TFEU which makes it possible to include in the EU budget expenses made within an enhanced cooperation). This question surely needs further analysis. Banking Union should be achieved during this period. It is remarkable that if the Commission supports the idea of a common system for banking resolution, taking into account the resistance to a more centralized project, it proposes for the longer term vision, only an effective and solid guarantee scheme in all Member States.

In the medium term (eighteen months to five years), deeper coordination of tax policies and labour market policies is needed, as well as progress in the sound conduct of budgetary policies.

For the Commission, the euro area should rely solely on own resources. A redemption fund (similar to the one proposed by the German Council of Economic Experts in November 2011) for public debts above the 60 per cent ceiling would be established. This would require a revision of the Treaty in conformity with the interpretation given by the Court of justice in the *Pringle* case on the meaning of Article 125 TFEU.

This period would also see the common issuance by euro area Member States of eurobills (short-term government debt with a maturity of up to one to two years). In the *long term* (beyond five years), the euro area would get an autonomous budget with a stabilization function and a common issuance of public debt. For the Commission, the final stage 'would require a fundamental overhaul of the Treaties'.

The Commission ends its Communication with a number of issues in case of Treaty amendment, such as the merging of Broad Economic Policy Guidelines and Employment Guidelines, the adoption of the merged guidelines by the ordinary legislative procedure, a new power of requiring by a EU legislative act a revision of national budget in line with European commitments, the integration of the ESM into EU framework, a 'euro committee' established within

المنارة للاستشارات

the European Parliament (with possibly the right to perform certain functions, something which up to now the EP has always rejected), adaptation of the collegiality principle within the Commission in favour of the vice-president in charge of Economic and Monetary Affairs, further legal bases permitting decisions to be taken within the Council with only euro area ministers voting, etc.).

The Commission observes that in a full fiscal and economic union, with a substantial central budget, based on an autonomous power of taxation and the possibility to issue EU sovereign debt, the problem of one Member State's finances having to support the burden for all its partners in case of mutualization of debts under a joint and several liability would disappear.[392]

In Annex 2 of its Communication on the 'External representation of the euro area', the Commission mentions, in particular, that it will in due course make formal proposals under Article 138(2) TFEU to establish a unified position to achieve an observer status of the euro area in the IMF executive board and, subsequently, a single seat. Let us hope . . .

President Van Rompuy presented a new version of the report 'Towards a genuine economic and monetary union'—drafted in collaboration with the presidents of the Commission, the Eurogroup and the ECB—on 5 December 2012.[393] This document proposes a three-stage approach and underscores the necessity of an *integrated economic policy framework* in addition to an *integrated financial framework*. Stage 1 contemplates *inter alia* the systematic ex-ante coordination of major economic policy reform, as envisaged in Article 11 of the Treaty on Stability, Coordination and Governance. Stage 2 considers the introduction of contractual arrangements between Member States and the EU on reforms promoting competitiveness, growth and jobs. Stage 3 foresees the creation of a 'shock-absorbing function at the central level' with 'a well-defined and limited fiscal capacity', as a kind of insurance-type mechanism between Euro area countries. This mechanism should include 'a built-in incentives-based system' to encourage Member States eligible for participation in the shock-absorbing function to continue to pursue sound fiscal and structural policies. Promoting structural reforms and absorbing asymmetric shocks should be the two functions of this mechanism to be financed by either national contributions, own resources or a combination of both.

The European Council, in its meeting of 13-14 December 2012, 'noted' the 'specific and time-bond road map for the achievement of genuine EMU' (the Van Rompuy report) and the 'comprehensive analysis' produced by the Commission. The Council welcomed 'the agreement reached within the Council on the SSM' and asked for an acceleration of the work on the proposals for a Recovery and Resolution Directive as well for a Deposit Guarantee Scheme

[392] Loc cit, 40.

[393] <http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ec/134069.pdf> accessed 15 March 2013.

المنارة للاستشارات

Directive. It also noted that the Commission would submit in the course of 2013 a proposal for a single resolution mechanism for Member States participating to the SSM 'to be examined by the co-legislators as a matter of priority with the intention of adopting it during the course of the current parliamentary cycle'.

The European Council asked the Commission to present proposals to the June 2013 European Council on a number of economic measures defined in very general terms: the coordination of national reforms, the social dimension of EMU, the feasability and modalities of mutually agreed contracts for competitiveness and growth and solidarity mechanisms for Member States entering in such contractual arrangements. The European Council concluded by evoking an 'appropriate involvement' of national parliaments as well as a 'commensurate involvement' of the European Parliament with regard to the 'further integration of policy making and greater pooling of competences'. Some observers, have noted the need to await the results of the German legislative elections before the European institutions can adopt bolder decisions.[394] Also noteworthy is the emphasis on the contractual arrangements between the EU and the Euro area Member States in order to achieve national ownership of the reform process. Whether such contractual arrangements are a second best solution to meaningful institutional reform and democratisation of the integration process needs further discussion.

In this context we should refer to the 'Common Strategic Framework' (CSF), a project adopted by the European Council in its session of 7/8 February 2013, to bring together all cohesion and structural funds with the European Agricultural Fund for Rural Development (AFRD) and the European Maritime and Fisheries Fund (EMFF) and to establish a closer link between cohesion policy and the economic governance of the Union.[395]

On 28 February 2013, the Council announces that an agreement has been reached with the European Parliament on the 'two-pack' legislation. The compromise includes a number of commitments from the Commission. The most important one provides that "the Commission will set up a group of experts to analyse the possible merits, risks, requirements and obstacles in relation to a partial substitution of national debt issuance by joint issuance in the form of

[394] As reported in the Financial Times, 14 December 2013, 'Looming large over the debate are the Bundestag elections. German opposition leaders are (...) accusing Angela Merkel, German Chancellor, of deliberately delaying ECB supervision to 2014 to keep the question of resolution out of next year's campaign. Sigmar Gabriel (...) said the chancellor was playing "hide-and- seek" over banking union by agreeing the principle of recapitalisation while delaying its use beyond 2014.'

[395] See the Conclusions of The European Council, 7/8 February 2013, points 76 et seq. The CFS Funds 'can, if necessary, be redirected to addressing the economic problems a country is facing. For this reason a gradual macro-economic conditionality will be established in the CFS regulation'. If recommendations of the Commission (under the BEPG, employment, excessive deficit procedure, etc) are not followed, part of all of payments or commitments or both should be suspended. The suspension could be lifted by the Council upon a proposal by the Commission (for details, see points 79 to 83 of the conclusions).

المنارة للاستشارات

debt redemption fund and eurobills." Needless to say, there is no undertaking on the part of the Council to accept the conclusions of a group of experts.

The most important decision taken at the end of 2012 was undoubtedly the parallel adoption by the European Parliament on 29 November and by the ECOFIN Council on 13 December of their positions on the building texts related to the SSM. The typical negotiations between the two co-legislators commenced in January 2013.

The Council has published the agreed text of the two proposals respectively for the SSM Regulation and for the EBA amending Regulation.[396] There are a number of differences between the September 2012 text and the December 2012 text of the SSM Regulation. To begin the former is much shorter and 'uncompromising' in that it granted the ECB supervisory powers over all Euro area Member States credit institutions (around 6000 institutions). The latter, the result of political compromise, grants the ECB direct supervisory powers only over a number of them (the biggest banks in the Member States participating in the SSM, still to be determined) in accordance with some 'objective' criteria defined (the ones mentioned in the December 2012 text refer to institutions with assets of more than €30 Billion or representing 20% of their home country's economic output[397]) while the rest of the 6000 or so credit institutions (including all but one of the German saving banks) will be supervised by national authorities, though the ECB retains the right to supervise them if needed (typically at the request of the European Stability Mechanism, in an emergency). The ECB will authorise credit institutions and be responsible for the withdrawal of authorisations. It will exercise this prerogative subject to specific arrangement reflecting the role of national authorities.[398] The formula is repeated in various parts of the Regulation. This reflect a reality: full centralisation is neither practically possible nor desirable. The ECB will exercise other typical prudential supervisory tasks such as the monitoring of capital, liquidity, governance arrangements, stress tests etc, as well as tasks related to early intervention.

Though the final details of the legislation need to be ironed out through the regular EU decision making process, it is important to emphasize that the

[396] Council of the European Union. Proposal for a Council Regulation conferring specific tasks on the European Central bank concerning policies relating to the prudential supervision of credit institutions—Consolidate text [14.12.2012] available at: http://register.consilium.europa.eu/pdf/en/12/st17/st17812.en12.pdf and Proposal for a Regulation of the European Parliament and the Council amending Regulation (EC) No 1093/2010establishing a European Supervisory Authority (European Banking Authority) as regard its interaction with Council Regulation (EU) No . . ./. . . conferring specific tasks to the European Central Bank concerning policies relating to the prudential supervision of credit institutions—General approach [14.12.2012] available at: <http://register.consilium.europa.eu/pdf/en/12/st17/st17813.en12.pdf> accessed 15 March 2013.

[397] Article 5.4 (a) of the SSM Regulation.

[398] See Article 4 and Article 13 of the SSM Regulation.

المنارة للاستشارات

authority of the ECB in its function as supervisor should be fully respected in order to enjoy the benefits of the proposed SSM.

With a degree of centralisation in supervision a more impartial system is expected to emerge: on the one hand, opportunities for regulatory arbitrage and regulatory capture should disappear or greatly diminish (there remain tax differences etc.), while, on the other hand, the interests of the stability of the whole system will be taken into account rather than, as recent examples demonstrate, conflicting national interests.

The needs of the banking union will in part intersect with the needs of the single market in financial services.[399] EBA will still be in charge of the elaboration of the single rulebook for the whole EU, aiming to safeguard the single market in financial services. The delicate question of the preservation of the interests of the EU Member States which will not participate to the System has been to some extent resolved by introducing a double majority voting rule within the EBA, stipulating that EBA decisions taken by qualified majority will have to be agreed with the consent of both the group of Member States participating in the SSM and the group of other EU Member States which do not participate in the SSM. Thus, the latter can block decisions that do not command a simple majority in both groups, though this rule may be revisited if fewer than five member states are outside the SSM.

Difficulties also arise from the fact that the ECB Governing Council is only open to Euro area Member States Central Bank Governors, according to the primary law of the ECB. In response to the need to find a solution which respects both the interests of the States that have not adopted the euro and the institutional structure of the ECB, clear rules have been adopted with regard to the respective roles of the Governing Council and the Supervisory Board. The latter will be composed of the authorities of each SSM participating Member States. An independent Panel of Review will also be established to carry out the internal review of the procedural and substantive legality of the decisions taken by the Governing Council and the EBA Board of Supervisors.

An observation should be made on the procedure for the adoption of the SSM. If the amendment of the EBA Regulation requires the application of the ordinary legislative procedure on the basis of Article 114 TFEU, the legal basis for conferring so-called 'specific tasks' to the ECB in the field of supervision recognises only a consultative power to the European Parliament, under Article 127, paragraph 6 TFEU since the entry into force of the Lisbon Treaty. It would

[399] See generally House of Lords report, *European Banking Union: Key Issues and Challenges*, HL paper 88, December 2012, http://www.publications.parliament.uk/pa/ld201213/ldselect/ldeucom/88/88.pdf . In response to the call for evidence by the House of Lords European Union Committee—EU Economic and Financial Affairs Sub-Committee (Sub-Committee A), chaired by Lord Harrison—with regard to its inquiry into the reform of the EU Banking Sector, one of the co-authors of this paper (Professor Lastra), contributed written and oral evidence, expressing concerns about the 'uneasy' co-existence between the banking union and the single market.

المنارة للاستشارات

be recommended to reform the text of this latter provision in order to introduce the ordinary legislative procedure (with qualified majority voting within the Council and co-decision for the European Parliament) and provide a less restrictive wording.

We should also emphasize that without a single resolution mechanism which ideally should go hand in hand with a common deposit guarantee scheme, and adequate backstops, the SSM will remain incomplete, an empty shell. The problem, of course, is that some of these elements, notably single resolution, have a fiscal dimension and the discussion of the fiscal union has been postponed.

As explained elsewhere,[400] the name 'banking union' is a bit of a conceptual accordion, with different layers. Arguably, the first layer of a banking union has already been achieved via European regulation, namely the Directives and Regulations that forms the corpus of common rules under which banks operate in the EU/EEA. [Of course, this first layer, this 'narrow' banking union, was incomplete—as evidenced by the financial crisis—due to the lack of rules on cross-border crisis management and insolvency]. The 'banking union' advocated by the Van Rompuy Report and the legislative proposals of September 2012 goes beyond regulation, and encompasses micro-prudential supervision (SSM) and two stages of crisis management: resolution (and insolvency) and deposit insurance. A 'broader' and full banking union should also encompass macro-prudential supervision (some macro-prudential powers have actually been conferred to the ECB in the December 2012 text—Article 4(a)—of the proposed SSM regulation) and lender of last resort.

Provisions on the political accountability of the ECB in its functions of supervisor have been developed by the Council with due regard to the objective of the separation between monetary policy and supervisory tasks.[401] The vote in the European Parliament is expected in the spring 2013.

As regards the progress towards a 'genuine' EMU, the outlook does not look very promising. Obstacles are considerable, as evidenced by the results of the elections in Italy (February 2013) and what is perceived as a lack of political leadership in France. Weaknesses in the banking sector further compound the challenges (much has been written about the recapitalization of the Spanish banks and the more recent problems in Cyprus). It does not help either that some countries, notably the United Kingdom, are wavering in their commitment to a more integrated Europe. The time is ripe to update the Lisbon Treaty and to reflect upon the future of the Union.

For sure, the way forward will be difficult, with important resistances on several fronts. On the one hand, the present rise of populism, regionalism,

[400] Ibid.
[401] See Lastra, "Accountability and Governance—Banking Union Proposals", Duisenberg School of Finance, Policy Paper No. 30, November 2012.

المنارة للاستشارات

and nationalism unleashes forces that can jeopardize the future of the Union as we know it. On the other hand, a number of Member States seem reluctant about an increase of the resources of the EU and especially the development of the Union's true own resources which could pave the way for employment and growth policies. The EU is indeed at a crossroads.

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