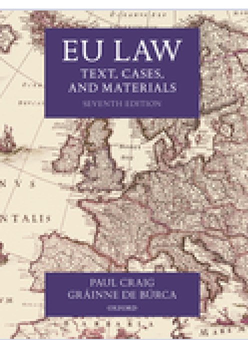

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Paul Craig and Gráinne de Búrca

p. 756

21. Free Movement of Capital and Economic and Monetary Union

Paul Craig, Emeritus Professor of English Law, St John's College, University of Oxford and Gráinne de Búrca, Florence Ellinwood Allen Professor of Law, New York University School of Law

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Abstract

All books in this flagship series contain carefully selected substantial extracts from key cases, legislation, and academic debate, providing students with a stand-alone resource. This chapter, focuses on the free movement of capital and economic and monetary union (EMU). It first considers the movement of capital, one of the four freedoms enshrined in the original Rome Treaty. It then discusses EMU and analyzes the movement towards EMU, and the Treaty provisions that set the legal framework for EMU. The chapter considers arguments for and against EMU and the position of the European Central Bank, concluding with an overview of the stresses and strains of EMU in the light of the banking and financial crisis. The UK version contains a further section analysing issues concerning free movement of capital between the EU and the UK post-Brexit.

Keywords: EU law, European Union, EMU, market integration, capital movement, European Central Bank

1 CENTRAL ISSUES

i. This chapter is concerned with free movement of capital and economic and monetary union (EMU).

ii. The discussion begins with the free movement of capital, one of the four freedoms enshrined in the original Rome Treaty. The Treaty Articles were altered radically by the Maastricht Treaty. There is now a growing body of case law on these provisions, which raises similar issues to those encountered in the context of goods, persons, establishment, and services.

iii. The discussion then moves to EMU. There is analysis of the movement towards EMU and the arguments for and against EMU. The position of the European Central Bank (ECB) is analysed. The discussion concludes with analysis of the strains on EMU in the light of the banking and financial crisis.

iv.

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The Treaties contain provisions on both monetary and economic union. Monetary union means in essence a single currency overseen by the ECB. The meaning of economic union is more diffuse. The essence of the idea is that the health of individual Member State economies can have implications for the overall health of the EU economy and for the value of the single currency, as exemplified by the way in which the Euro crisis was precipitated by concerns over the Greek economy. The Treaties therefore contain provisions to monitor the health of Member States' economies. The extent of these controls is, however, a sensitive matter, since they entail EU intrusion into domestic economic policy. The weakness of the pre-existing controls was, however, problematic, and recent legislation has strengthened this oversight.

2 FREE MOVEMENT OF CAPITAL: SCOPE

(a) THE ORIGINAL TREATY PROVISIONS

Articles 67–73 EEC contained the original provisions on free movement of capital,[1] but they were less peremptory than those applicable to goods, workers, services, and establishment. Thus, while Article 67(1) EEC imposed an obligation to abolish progressively restrictions on capital movements p. 757 ↵ during the transitional period, this was only to the extent necessary to ensure the proper functioning of the common market. This theme was carried over to Article 71, which required Member States to endeavour to avoid the introduction of new exchange restrictions on capital movements. The wording of these Treaty Articles necessarily impacted on the ECJ's approach to this area.[2] The Council enacted various directives pursuant to these Treaty provisions, the most important being Council Directive 88/361.[3]

(b) THE CURRENT PROVISIONS: THE BASIC PRINCIPLE

The Maastricht Treaty completely revised the provisions on free movement of capital, with effect from 1 January 1994.[4] Article 63 TFEU now provides:

> 1. Within the framework of the provisions set out in this Chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited.
> 2. Within the framework of the provisions set out in this Chapter, all restrictions on payments between Member States and between Member States and third countries shall be prohibited.[5]

What is now Article 63 was held to have direct effect in *Sanz de Lera*.[6] The ECJ held that it laid down a clear and unconditional prohibition for which no implementing measure was required. The existence of Member State discretion to take all measures necessary to prevent infringement of national law and regulations contained within what is now Article 65(1)(b) TFEU did not prevent Article 63 from having direct effect, because this discretion was subject to judicial review. This ruling concerned an action against the state. Treaty Articles often have vertical and horizontal direct effect, and thus can be used against the state and

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private individuals, and there is nothing in *Sanz de Lera* to indicate the contrary. It would not be difficult, as Usher states,[7] to envisage a situation in which the unilateral conduct of a financial institution could restrict payments between states. This interpretation is reinforced by the fact that Article 63 does not refer only to the state.[8] The argument to the contrary would be derived by way of analogy with Article 34 on the free movement of goods, which has been largely confined to actions against the state.[9]

p. 758 ↵ The Treaty provisions do not define movement of capital, but the ECJ held that reference can be made to the non-exhaustive list in Directive 88/361.[10] It will be for the Court to decide, with the aid of the Directive, whether a measure constitutes a restriction on the movement of capital. Thus, Article 63 caught a national prohibition on the creation of a mortgage in a foreign currency.[11] Restrictions on share dealings and 'golden shares'[12] come within Article 63.[13] So too do restrictions on the acquisition and disposal of property,[14] such as requirements of prior administrative authorization.[15] Measures taken by a Member State that are liable to dissuade its residents from obtaining loans, or making investments, in other Member States constitute restrictions on the movement of capital.[16]

While direct taxation remains within Member States' competence, they must exercise that competence consistently with EU law and avoid discrimination on the grounds of nationality.[17] It is clear moreover that Article 63 covers not only measures that discriminate on grounds of nationality, but also measures that may impede capital movements, even though they are not discriminatory.[18] The ECJ has, by way of contrast, held that a Member State can apply a tax to income, notwithstanding the fact that it has already been taxed in another Member State,[19] with the consequence that double taxation is not contrary to free movement of capital.[20]

Article 63 gives the impression that capital movements within the EU, and between Member States and non-member countries, are treated the same. This is not so, since other Treaty Articles qualify the application of Article 63 to non-member countries. Article 64(1) in effect allows lawful restrictions on capital movements that existed on 31 December 1993 to remain in being, and Article 64(2) only requires the Council to endeavour to achieve free movement with non-member countries to the greatest extent possible. The Council is also empowered under Article 66 to take safeguard measures in exceptional circumstances where capital movements to or from non-member countries cause, or p. 759 ↵ threaten to cause, serious difficulties for the operation of economic and monetary union. Such measures cannot last longer than six months, and can be taken only where strictly necessary.

(c) THE CURRENT PROVISIONS: THE EXCEPTIONS

Article 65(1)(a) concerns taxation and constitutes one of the main exceptions to Article 63. It provides that the provisions of Article 63 shall be without prejudice to the right of Member States:

> to apply the relevant provisions of their tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested.

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Article 65(1)(a) is expressly made subject to Article 65(3), which stipulates that the measures taken must not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments. The ECJ will decide whether, for example, residents and non-residents are in a comparable position, and whether there has been discrimination.[21] For a difference in treatment not to be regarded as arbitrary for the purposes of Article 65(3) it must be objectively justified.[22] The Member State must show, for example, that the differential treatment was intended to protect the integrity of the tax system and was necessary to achieve this end. The ECJ interprets this requirement strictly. Thus in *Verkooijen*,[23] it was held that a national provision making the grant of exemption from income tax on dividends paid to shareholders conditional on the company having its seat in the Netherlands was contrary to EU law. The ECJ rejected the defence that the rule was justified to encourage investment in the Netherlands, since such purely economic objectives could not justify a limit placed on a fundamental freedom. The ECJ also rejected arguments that the contested rule was justified on the ground that it was necessary to preserve the cohesion of the Dutch tax system.[24]

Article 65(1)(b) provides that the provisions of Article 63 shall be without prejudice to the right of Member States:

> to take all requisite measures to prevent infringements of national law and regulations, in particular in the field of taxation and the prudential supervision of financial institutions, or to lay down procedures for the declaration of capital movements for purposes of administrative or statistical information, or to take measures which are justified on grounds of public policy or public security.

p. 760 ↵ Article 65(1)(b) is also subject to Article 65(3): the restrictions cannot constitute a means of arbitrary discrimination, etc. Article 65(1)(b) divides into two parts.

The first part covers the whole of the Article apart from the reference to public policy and public security. It has been convincingly argued[25] that this ‘relates to the effective administration and enforcement of the tax system and the effective supervision of, for example, banks and insurance companies, rather than to matters of underlying economic policy’, the latter being dealt with under Articles 143 and 144. The Court will inquire closely before accepting this defence. In *Commission v Belgium*[26] the ECJ held that a national rule forbidding Belgian residents from subscribing to securities of a loan on the Eurobond market was caught by Article 63. The Belgian Government argued that the measure was justified under Article 65(1)(b) because it preserved fiscal coherence. This argument was rejected because there was no direct link between any fiscal advantage and disadvantage which should be preserved in order to ensure such coherence. The Belgian Government argued moreover that the contested measure prevented tax evasion by Belgian residents, and ensured effective fiscal supervision. The ECJ disagreed, and held that the national rule was disproportionate: a general presumption of tax evasion could not justify a measure that compromised a Treaty Article.

The second part of Article 65(1)(b) covers public policy and public security. The Court draws on its jurisprudence from other freedoms when interpreting these terms. This exception is interpreted narrowly and the Member State has the burden of proof. The restriction must be justified in terms of national public

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interest of a kind referred to in Article 65(1), or by grounds of overriding public interest.[27] The restriction must also be proportionate, and will be struck down if a less restrictive measure could have achieved the desired end. In *Scientology International*[28] the ECJ held that a national law requiring prior authorization for capital investments that threatened public policy or security could, in principle, come within Article 65(1)(b). However, the particular French rule, which did not specify further details about the threat to public security, was regarded as too imprecise, and hence could not come within this Article.[29] However, in *Commission v Belgium*[30] a national rule vesting the government with a 'golden share' in gas and electricity companies that had been privatized, enabling it to control certain subsequent dispositions of strategic assets, was held to fall within Article 65(1)(b) because it guaranteed energy supplies in the event of a crisis, and hence fell within public security.[31]

Article 65(2) states that the provisions of this Chapter shall be without prejudice to the applicability of restrictions on the right of establishment that are compatible with the Treaty. This Article is subject to Article 65(3). These restrictions therefore include the exception in the case of official activities contained in Article 51.

Articles 143 and 144 contain a different type of qualification from Article 63. These Articles cease to operate from the third stage of EMU, except for states with a derogation, and deal with p. 761 ↵ balance-of-payments crises. The 'strategy' is to look initially to an EU-sponsored solution via Article 143, and then to authorize unilateral action by the state if this is not forthcoming via Article 144.

3 EMU AND THE EUROPEAN MONETARY SYSTEM: EARLY ATTEMPTS

A little history is required to set matters in context. In 1969, the heads of state resolved that a plan should be drawn up in relation to EMU.[32] A committee was established chaired by Werner, the Luxembourg Prime Minister. It concluded[33] that EMU would entail either the total convertibility of the Community currencies, free from fluctuations in exchange rates, or that preferably such currencies would be replaced by a single Community currency. The report led to a Council Resolution on the attainment of EMU by stages.[34] Progress was, however, halted because of changed economic circumstances.

The Werner Report was premised on the assumption of fixed exchange rates, and this was undermined in the early 1970s.[35] Largely as a result of problems with the US economy,[36] European currencies began to float and there was an urgent need to prevent them from floating too far apart. This was the catalyst for the 'snake', which established that the difference between the exchange rates of two Member States should not be greater than 2.25 per cent. Economic pressures on particular Member States resulted, however, in departures from the 'snake', such that by 1977 only half of the ten Member States remained within it.[37]

A more general attempt to engender monetary stability occurred in 1978 through the establishment by Resolution of the European Council[38] of the European Monetary System (EMS).[39] There was growing dissatisfaction with floating exchange rates, which were perceived as detrimental to cross-border investment. Foreign currency movements were, moreover, destabilizing European currencies.[40] The EMS instituted the Exchange Rate Mechanism (ERM) and the European Currency Unit (ECU). The ECU rate was determined against a basket of Member State currencies. The ERM operated by setting for each

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participating state a currency rate against the ECU. These values were collectively determined. When the value of each currency was specified against the ECU it was then possible to determine the worth of any national currency against all other national currencies. These relative values were known as the bilateral central rates. Any participant country would not allow its exchange rate to fluctuate by more than 2.25 per cent above or below these bilateral central rates, with an exceptional band of 6 per cent. When a currency reached its bilateral limits against another currency, intervention was required by the relevant central banks to redress the matter.

The ERM was, however, thrown into disarray by the currency crises of 1992–1993. Currency dealers speculated that certain weaker currencies could not be sustained within the relatively narrow bands of the ERM. Central banks sought to preserve the integrity of the ERM, but could not resist market pressures. The lira and the pound were suspended from the ERM. Further market pressures led to the widening of the bilateral bands to 15 per cent, and to the devaluation of certain currencies p. 762 ↵ that stayed within the ERM. These measures preserved the ERM in formal terms, but undermined its primary rationale, since they significantly weakened the search for exchange rate stability.

4 ECONOMIC AND MONETARY UNION: THE THREE STAGES[41]

(a) STAGE ONE AND THE DELORS REPORT

While the Single European Act (SEA) contained no commitment to EMU, it stated in a preamble that in 1972 the heads of state approved the objective of progressing towards EMU. This was the catalyst for bringing the issue back onto the political agenda at the Hanover summit of 1988. A committee, chaired by Jacques Delors, the President of the Commission, was established to assist the European Council, and reported to the Madrid summit in 1989.[42] It recommended that EMU should be approached in three stages.[43]

Stage One was the completion of the internal market, closer economic convergence, and the membership of all states of the ERM. This did not require new Treaty powers. In Stage Two a European System of Central Banks (ESCB) would be created to coordinate national monetary policies and formulate a common monetary policy for the Community. Stage Three would see the locking of exchange rates and a single currency managed by the ESCB. The Delors Report recognized that there would have to be central control over national fiscal policy, since otherwise the action of a particular state could have deleterious consequences for inflation or interest rates in all states.

(b) STAGE TWO AND THE MAASTRICHT SETTLEMENT

The Maastricht Treaty laid the foundations for EMU, and stipulated that the second stage should begin on 1 January 1994. The ‘architecture’ of the EMU provisions was predicated on a dichotomy between monetary and economic union, which remained largely unchanged in the Lisbon Treaty.

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(i) *Monetary Policy*

Monetary union concerned the single currency and the Treaty Articles were powerfully influenced by German ordo-liberal economic thought, which demanded independence of the ECB, governance by experts and the primacy of price stability. These foundational precepts were embodied in the primary Treaty Articles. The independence of the ECB was enshrined in Article 130 TFEU, which stipulates that the ECB shall not take any instruction from EU institutions, Member States, or any other body, and is further affirmed by Article 282(3) TFEU. Governance by experts was stipulated in relation to the decision-making structure of the ECB. The Executive Board is composed of a President, Vice-President, and four other members, who must be recognized experts in monetary or banking matters.[44] The importance of expertise was further emphasized by the ESCB, which is composed of the ECB and the national central banks, although it is the ECB and the national central banks whose currency is the Euro that conduct the EU's monetary policy.[45] Price stability was accorded pride of place in the objectives of EU monetary policy from the outset, now found in Article 127 TFEU.

p. 763 ↵ It was integral to the Maastricht settlement that monetary policy structured in the preceding manner was Europeanized. This was reinforced by mandatory Treaty provisions precluding instructions or interference from any outside party, whether a Member State or another EU institution. The importance of this principle is reflected in the symmetry of Article 130 TFEU. It imposes an obligation on the ECB, national central banks, and those involved with their decision-making not to take or seek instructions from any other institution, including EU institutions, bodies, offices or agencies, any government of a Member State, or any other body. It also imposes a duty on EU institutions and Member State governments to respect this principle and not to seek to influence the members of the decision-making bodies of the ECB, or of the national central banks, in the performance of their tasks.

The Lisbon Treaty provisions on competence further reinforced the principle that monetary policy lay within the EU's domain. Article 3 TFEU stated that monetary policy for those countries that subscribed to the Euro was within the exclusive competence of the EU, with the consequence that only the EU could legislate and adopt legally binding acts, subject to the caveat that the Member States could do so if empowered by the EU or for the implementation of Union acts.[46]

(ii) *Economic Policy*

The Maastricht settlement in relation to economic policy was markedly different. It was built on two related assumptions, preservation of national authority and preservation of national liability.

The former was reflected in the fact that Member States retained fiscal authority for national budgets, subject to oversight and coordination from the EU designed to persuade Member States, with the ultimate possibility of sanctions, to balance their budgets and not run excessive deficits.

The latter, preservation of national liability, was the consequence of the former. It finds its most powerful expression in the no bail-out provision, Article 125(1) TFEU. This provides in essence that the EU should not be liable for, or assume the commitments of, central governments, regional, local, or other public authorities, or other public bodies, and nor should a Member State be liable for, or assume the

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commitments of, such bodies within another Member State.[47] The message was that national governments retained authority over national economic policy, subject to the Treaty rules designed to persuade them to balance their budgets, the corollary being that if they did not do so then the liabilities remained their own.

This was the 'deal' struck in Maastricht and the principal features were unaltered in the Lisbon Treaty, although the degree of oversight was actually weakened in the intervening years. The Member States recognized the proximate connection between economic and monetary policy. They understood that the economic health of individual Member State economies could have a marked impact on the valuation of the Euro, hence the need for some oversight and coordination of national economic policy. They were, however, mindful of the policy decisions made in national budgets, including those of a redistributive nature, and were unwilling to accord the EU too much control over such determinations, whether at the individual or aggregative level.

(c) STAGE THREE AND THE LEGAL FRAMEWORK

The third stage of EMU had to start no later than 1 January 1999. The Commission and the European Monetary Institute, the forerunner of the ECB, had to report to the Council on the progress made by p. 764 ↵ the states towards EMU. These reports would examine the extent to which the states had made their central banks independent, and whether the convergence criteria had been met, which was a condition precedent for a state to adopt the single currency.[48] Member States that did not fulfil the criteria were referred to as 'Member States with a derogation'. On the basis of these reports the Council assessed whether each Member State fulfilled the conditions for adoption of a single currency. The Council, meeting as the heads of state or government, had to decide by qualified majority, not later than 31 December 1996, whether a majority of the Member States fulfilled the conditions for the adoption of a single currency. If the date for the beginning of the third stage had not been set by the end of 1997 then the third stage was deemed to start on 1 January 1999.

The formal decision of the Council, meeting as the heads of state or government, that the applicant states, apart from Greece, had met the convergence criteria was made on 2 May 1998. The third stage of EMU duly began on 1 January 1999. The exchange rates of the participating countries were irrevocably set, and the Euro became a currency in its own right, notwithstanding those who doubted whether some states really would meet the convergence criteria,[49] given the high debt levels in Italy and Belgium. The UK negotiated an opt-out Protocol, the import of which is that it was not bound to move to the third stage of EMU even if it met the convergence criteria. On 1 January 2002, the new banknotes and coins were introduced, and national currencies were withdrawn from circulation towards the end of February 2002. There are currently nineteen Member States that have adopted the Euro: Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Portugal, Slovakia, Slovenia, and Spain.

5 EMU: ECONOMIC FOUNDATIONS

It is important before examining the provisions concerning economic and monetary union to understand in outline at least the economic arguments for and against a single currency.[50]

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(a) THE CASE FOR EMU

The case for EMU rested on two connected foundations. It was argued that EMU would foster economic growth and engender greater price stability through low inflation.

The argument that EMU would enhance *economic growth* was based on a number of factors, the most important being the *saving of transaction costs*. A single currency removes the cost of exchange-rate conversions when money moves within the EU. The Commission calculated that the total savings would be approximately €25 billion.[51]

An equally important, albeit contested, factor was the *link between the single market and a single currency*. This was captured most vividly in the Commission's slogan of 'one market, one money'.[52] It is possible to have a single market without a single currency, but it was argued that the single market would work better with a single currency. By having a single currency businesses save on 'menu costs', and do not have to maintain different sets of prices for each market. From the manufacturer's perspective, this facilitates marketing strategies for the EU as a whole. From the consumer's perspective, it enables direct price comparisons to be made of products in different countries.

p. 765 ↵ The existence of a single currency was also said to protect against the *costs associated with large exchange-rate changes and competitive devaluation*, which could 'distort the single market by unpredictable shifts of advantage between countries unrelated to fundamentals'.[53] In this sense 'the single market needs a single currency not just to push it forwards, but to stop it sliding backwards'.[54] Such currency fluctuations could slow economic growth by creating uncertainty for business, which was not conducive to investment.[55] The existence of wide price differentials fuelled by different currencies led moreover to attempts by Member States to prevent parallel imports and impede intra-EU trade.

It was argued that a single currency would in addition foster growth by *lowering interest rates and stimulating investment*. Countries would no longer have to raise their interest rates above German levels in order to stop their currencies from falling in relation to the Deutschmark.[56] Investment projects 'will become economic which were not so when they had to earn higher returns to repay expensive borrowed money, compensate for exchange rate uncertainty, and hand out high dividends to share-holders'.[57]

The case for EMU was also based on the argument that it fostered *stable prices and low inflation*. Savers tend to gain from low inflation, since their money retains its purchasing power for longer. Inflation makes it more difficult to maintain long-term business plans, and redistributes income in an arbitrary manner. Businesses incur 'menu costs' when inflation rates are high or constantly changing. The ERM exerted some discipline over inflation rates by the very fact that countries, in effect, linked their exchange rates to the Deutschmark, and limited their use of devaluation. Some countries, however, overvalued exchange rates, which was in part the rationale for the currency crises in 1992 and 1993. It was argued that EMU offered a better, cheaper, and more stable way of reducing inflation, particularly when monetary policy was run by an independent central bank, which was not subject to short-term political pressures.

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(b) THE CASE AGAINST EMU

There were a number of differing arguments made against EMU. These can for the sake of analysis be divided into 'contingent disapproval' and 'outright rejection'.

The essence of the *contingent disapproval argument* was that the Member States were not ready for EMU, since they could not meet the convergence criteria, except by creative accounting that threw the whole enterprise into disrepute. This was exemplified by the letter signed by 155 German university professors, arguing that the time was not yet ripe for EMU,[58] and it was exemplified more recently by the difficulties created for the Euro by the financial crises in Greece, Ireland, and Spain. It is moreover reasonably clear that EMU may well suit some states more than others.

The *outright rejection argument* was more complex, and was part political, part symbolic, and part economic. In political terms, some argued that a single currency was a major step towards a European super state.[59] Much economic policy was shifted from the domestic to the EU arena. National governments no longer had the ultimate option of devaluation, and parliamentary debates on inflation, interest rates, and unemployment would be largely otiose, since power over such matters would be taken from national polities and given to the ECB. It was argued that this would exacerbate problems p. 766 ↵ of democratic deficit within the EU, given that the demise of national parliamentary power over such matters would not be offset by any meaningful control through the European Parliament.[60]

In symbolic terms, a national currency was felt by some to be part of the very idea of nationhood. This point is captured well by Johnson:[61]

> Advocates of monetary and exchange rate autonomy argue that it may not be perfect, but it is preferable to the alternative. The dishonour of a national currency may seem better than its death. Monetary sovereignty is sometimes felt to be part of a national sovereignty, so that giving it up involves a loss of political independence, and ultimately political union. It is almost a case of 'my country, right or wrong'.

In economic terms, it was argued that a single currency would lead to a variety of undesirable consequences. Prices would increase, since businesses would take advantage of the change from national currencies to the Euro to raise prices before consumers were accustomed to the new money.[62] A single currency could moreover create tensions because economic conditions in Member States followed different cycles, and hence removing the possibility of exchange-rate fluctuation eliminated a significant mechanism for economic adjustment between states.

(c) EMU: ECONOMICS, POLITICS, AND LAW

It is readily apparent that the debates about EMU are only in part economic. The economic dimension shades into the political, and these often manifest themselves in legal form.

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F Snyder, EMU Revisited[63]

> The legal aspects of EMU are sometimes extremely controversial, either in public or behind the closed doors of diplomatic and monetary negotiations. Legal and other technical debates often act as a kind of shorthand for political disagreement. Competing economic theories frequently play the same role. This was the case long before EMU was set as a priority European Union objective. This does not mean, of course, that all legal aspects of EMU have been or are politically controversial. But, in the future also, political conflicts about EMU are likely often to appear in legal camouflage. This dialectical relationship between politics and law, political discourse and monetary discourse, and political discourse and legal discourse should not be surprising. The driving force in EMU, including its main legal aspects, has always been politics.

6 EMU: MONETARY UNION AND THE ECB

The provisions concerning monetary and economic union are complex. The former will be addressed in this section, the latter in the section which follows. Article 119 TFEU is the lead provision.

> 1. For the purposes set out in Article 3 of the Treaty on European Union, the activities of the Member States and the Union shall include, as provided in the Treaties, the adoption of an economic policy which is based on the close coordination of Member States' economic policies, on the internal market and on the definition of common objectives, and conducted in accordance with the principle of an open market economy with free competition.
> 2. Concurrently with the foregoing, and as provided in the Treaties and in accordance with the procedures set out therein, these activities shall include a single currency, the euro, and the definition and conduct of a single monetary policy and exchange-rate policy the primary objective of both of which shall be to maintain price stability and, without prejudice to this objective, to support the general economic policies in the Union, in accordance with the principle of an open market economy with free competition.
> 3. These activities of the Member States and the Union shall entail compliance with the following guiding principles: stable prices, sound public finances and monetary conditions and a sustainable balance of payments.

p. 767

(a) ECB AND ESCB

The ECB together with the national central banks whose currency is the Euro, have the primary responsibility for monetary policy.[64] The ECB has legal personality.[65] It has an Executive Board and a Governing Council. The Executive Board is composed of a President, Vice-President, and four other members, who must be recognized experts in monetary or banking matters. They serve for eight years and the posts are non-renewable.[66] The Governing Council consists of the Executive Board plus the Governors of the national central banks whose currency is the Euro.[67] The President of the ECB is invited to Council

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meetings for discussion of matters that impact on the ESCB,[68] and for areas falling within its responsibilities the ECB shall be consulted on all proposed Union acts, and all proposals for regulation at national level, and may give an opinion.[69] The President and other members of the Executive Board can be heard before the European Parliament.[70]

The independence of the ECB is enshrined in Article 130 TFEU, which stipulates that the ECB shall not take any instruction from EU institutions, Member States, or any other body, and this is further affirmed by Article 282(3) TFEU. This independence is reflected in the ECB's decision-making structure: the President of the Council and a member of the Commission may participate in meetings of the ECB's Governing Council, but they do not have the right to vote.[71] The ECB has the power to make regulations, take decisions, make recommendations, and deliver opinions.[72] The ECB is entitled, on p. 768 certain conditions, to impose fines or periodic penalty payments on undertakings for failure to comply with obligations contained in its regulations and decisions.[73]

The ESCB is composed of the ECB and the national central banks, although it is the ECB and the national central banks whose currency is the Euro which conduct the EU's monetary policy.[74] The ESCB is governed by the decision-making bodies of the ECB.[75] The Statute of the ESCB and ECB is attached to the Treaties as a Protocol.[76]

The third stage of EMU saw the establishment of the Economic and Financial Committee, composed of no more than two members drawn from the Member States, the Commission, and the ECB. This Committee has a number of tasks, including:[77] delivering opinions to the Council or Commission; keeping under review the economic and financial situation of the Member States and the EU; examining the situation regarding free movement of capital; and contributing to the preparation of Council work.

(b) MONETARY POLICY

The objectives of EU monetary policy are set out in Article 127 TFEU. The primary objective of the ESCB is to maintain price stability. Without prejudice to this objective, the ESCB must support the general economic policies of the EU with a view to attaining the objectives set out in Article 3 TEU. The ESCB is to act in accordance with the principle of an open market economy with free competition, and in compliance with the principles in Article 119 TFEU.

The basic tasks of the ESCB are to define and implement the EU's monetary policy; to conduct foreign-exchange operations; to hold and manage the official foreign reserves of the Member States; and to promote the smooth operation of the payment system.[78] The ECB must be consulted on any EU act in its fields of competence and, subject to certain conditions, by national authorities regarding any draft legislative provision in its fields of competence.[79] The ECB has the exclusive right to authorize the issue of banknotes within the EU, although the actual issue of the notes may also be undertaken by national central banks.[80]

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The ESCB is to 'contribute' to the smooth conduct of policies pursued by other competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system.[81] It is in addition open to the Council, acting unanimously after consulting the European Parliament and the ECB, to confer specific tasks on the ECB concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings.[82]

p. 769

(c) POLICY ISSUES: CENTRAL BANK INDEPENDENCE

The Treaty places particular emphasis on the independence of the ECB.[83] The degree of independence possessed by national central banks varies.[84] Gormley and de Haan[85] identified five criteria that shape the division of responsibilities between national governments and their central banks.[86]

The first is the ultimate objective of monetary policy, which in many countries is price stability. The second feature is the specification of inflation targets. In some countries this is agreed by the central bank with the government, in others, such as Germany, there is no obligation as such on the Bundesbank to announce or agree to any such targets. The third criterion is the bank's degree of independence and its juridical basis. There will, for example, often be a statute, which stipulates the extent to which the government can give any instructions to its central bank. The fourth criterion is the extent to which the government can override the central bank's view. The final factor is the appointment of bank officials, and the extent to which the government has any real discretion over this matter.

When judged by these criteria the ECB has a high degree of independence. Its independence is enshrined in Articles 130 and 282(3) TFEU. The Treaty establishes the primary and secondary objectives of the ESCB. There is no formal requirement for the ECB to agree with other Union institutions on the specification of price stability in particular economic circumstances, or on inflation targets. Nor is there any formal provision allowing the other EU institutions to override the choices made by the ECB.[87] It should, however, be noted by way of contrast to the position prior to the Lisbon Treaty that many of the provisions of the Statute of the ESCB and ECB can now be amended through the ordinary legislative procedure, and do not require Treaty amendment.[88]

The Treaty has nonetheless accorded a constitutional status to the ESCB and ECB. This degree of independence was influenced by German desires to have an ECB that mirrored closely the powers and status of the Bundesbank. This sentiment was further strengthened because the ECB would be considering price stability for the EU as a whole. It was therefore important that the short-term interests of certain Member States, or the EU institutions, could not sway the ECB. While political considerations, therefore, played a role in shaping the ESCB, there are also sound economic arguments for central bank independence. ↵

p. 770

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L Gormley and J de Haan, The Democratic Deficit of the European Central Bank[89]

> It is widely believed that the success of monetary policy in achieving a stable and low rate of inflation depends very much on the credibility of the monetary authorities. It makes quite a difference whether economic agents believe policy announcements and behave accordingly, or not. If a central bank with a high level of credibility indicates, for instance, that inflation is too high and that it will strive for a reduction, trade unions will take this announcement seriously in bargaining about wage levels. If the credibility of the central bank is low, trade unions may not believe that inflation will come down and demand higher wages, thereby fuelling the inflationary process.
>
> By delegating monetary policy to an independent Central Bank with a clear mandate for price stability the credibility of the monetary authorities can be enhanced. A Central Bank which is independent will not be exposed to the same incentives to create unexpected inflation. The public can assume that the Central Bank will strive for a low level of inflation. Trade unions will lower their wage demands and investors will ask for lower interest rates as their inflationary expectations are reduced. Due to lower inflationary expectations, actual inflation will also decline.

There is not, however, only one way to structure a central bank, even given acceptance of independence as an ideal. Numerous factors influence the degree of independence accorded to it. In economic terms, it has been argued that the relationship between a central bank and government should be conceived in terms of a principal/agent contract, whereby the principal, the government, would establish inflation targets and make the agent, the central bank, responsible for attaining them.[90] In political terms, a fully independent central bank, with little provision for policy override by the government may well attain price stability, but at the expense of democratic control. Monetary policy is, in this sense, taken off the normal political agenda, with a corresponding diminution in democratic control.[91] ↵

p. 771

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L Gormley and J de Haan, The Democratic Deficit of the European Central Bank[92]

> By now it is well-known that Central Bank independence may improve upon monetary policy. In that sense, the independence of the ESCB and its mandate to strive for price stability are to be applauded, given the virtues of a low and stable rate of inflation. An important problem is how Central Bank independence is related to democratic accountability. Some authors argue that monetary policy should be treated like other instruments of economic policy, like fiscal policy, and should be fully decided upon by democratically elected representatives. Such an approach implies, however, too much a direct involvement of politicians with monetary policy. … Nevertheless, it is respectfully submitted that monetary policy ultimately must be controlled by democratically elected politicians. … Some way or another, the Central bank has to be accountable, and in relation to the ECB, the European Parliament is undoubtedly the appropriate body. National parliaments are, of course, responsible for Central Bank legislation; so too, logically, should the European Parliament be responsible for the legislative framework of the ECB, at least by way of co-decision. In other words, the 'rules of the game' (i. e. the objective of monetary policy) are decided upon according to normal democratic procedures, but the 'game' (monetary policy) is delegated to the Central Bank.

7 EMU: COORDINATION OF ECONOMIC POLICY

Coordination of economic policy is the other limb of EMU. Such coordination has been especially important in the light of monetary union,[93] since the economic health of individual Member States' economies can have a marked impact on the valuation of the Euro, as exemplified by the EU's economic crisis, which is examined below.[94] This is the broad rationale for coordination, two forms of which are embodied in the Treaty.

(a) MULTILATERAL SURVEILLANCE PROCEDURE

The softer version is the multilateral surveillance procedure. Member States are to regard their economic policies as a matter of common concern, and are to coordinate them in the Council.[95] The Council acting on a recommendation from the Commission, formulates a draft for the broad guidelines[96] of the economic policies of the Member States and the EU, and reports this to the European Council. The guidelines are discussed by the European Council, and its conclusion forms the basis for a Council recommendation setting out the broad guidelines.[97] It is then for the Council, on the basis of reports from the Commission, to monitor economic developments in the Member States.[98]

This constitutes the multilateral surveillance. If it becomes apparent that the economic policies of the Member States are not consistent with the broad economic guidelines, or that they risk jeopardizing the proper functioning of EMU, the Commission may address a warning to the relevant Member States. The Council may make the necessary recommendations to the Member State concerned.[99] The Council acts without taking account of the vote of the Member State concerned.[100]

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p. 772 ↵ The Treaty provisions have been complemented by the Stability and Growth Pact (SGP). The Regulation[101] provides rules covering the content, submission, examination, and monitoring of the stability and convergence programmes, so as to prevent at an early stage the occurrence of excessive government deficit, and to promote the surveillance and coordination of economic policies. The SGP has recently been reformed as will be seen below.

(b) EXCESSIVE DEFICIT PROCEDURE

The harder version of coordination is embodied in the excessive deficit procedure. Member States are under an obligation to avoid excessive deficits.[102] The Commission monitors the budgetary situation and government debt in the Member States to identify 'gross errors'.[103] The Commission must in particular examine compliance with budget discipline based on two criteria.[104]

The first criterion is whether the ratio of the planned or actual government deficit to gross domestic product exceeds a reference value, this being 3 per cent, unless either 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. The second criterion is whether the ratio of government debt to gross domestic product exceeds a reference value, this being 60 per cent, unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace. These reference values are specified in the Protocol on the Excessive Deficit Procedure.[105]

The Commission reports where a Member State does not fulfil these criteria, and may do so if it believes that there is a risk of an excessive deficit in a Member State.[106] The Economic and Financial Committee gives an opinion on this report.[107] Where the Commission considers that there is an excessive deficit, or that it may occur, the Commission must address an opinion to the Member State concerned and inform the Council.[108] It is then for the Council, acting on a proposal from the Commission and having taken account of any observations from the Member State, to decide whether the excessive deficit exists.[109]

Where the Council decides that an excessive deficit does exist, it shall adopt, without undue delay, on a recommendation from the Commission, recommendations addressed to the Member State concerned with a view to bringing that situation to an end within a given period.[110] The general rule is that these recommendations are not made public, but where the Council establishes that the Member State has taken no effective action within the requisite period then the Council may make the recommendations public.[111]

The Treaty then contains provisions specifying what should happen if the Member State fails to put into practice the recommendations of the Council. If this occurs the Council can decide to give notice to the Member State to take, within a specified time limit, measures for the deficit reduction which is

p. 773 ↵ judged necessary by the Council to remedy the situation, and to submit reports to the Council so that it can examine the adjustment efforts of that Member State.[112]

If the Member State fails to comply with such a decision, the Council may then decide to apply or intensify one or more of the following measures:[113] it can require the Member State to publish additional information, specified by the Council, before issuing bonds and securities; it can invite the European

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Investment Bank to reconsider its lending policy towards that Member State; it can require the Member State to make a non-interest-bearing deposit of an appropriate size with the Union until the excessive deficit has, in the Council's view, been corrected; and it can impose fines of an appropriate size. The Council must abrogate the preceding decisions and recommendations to the extent that the excessive deficit in the Member State has, in the Council's view, been corrected.[114]

The Treaty provisions on excessive deficit have, like those on surveillance, been complemented by a regulation concerning excessive deficit,[115] this being the other limb of the SGP.[116]

(c) POLICY ISSUES: ECONOMIC POLICY COORDINATION

The frailty of the surveillance and deficit procedures was revealed in relation to the deficits run by France, Germany, Portugal, and Italy in 2002–2003. They undertook to balance their budgets over the medium term, but departed from their corrective programmes. This led to the Commission taking legal action when Ecofin placed the excessive deficit procedure in abeyance for France and Germany.[117] The flouting of the system by France and Germany led to changes to the Stability and Growth Pact Regulations,[118] the net effect being to soften and render more discretionary the multilateral surveillance and excessive deficit procedures.[119]

The regime for coordination of economic policy was subject to more general strain as a result of the banking and financial crisis that began in 2008.[120] The problem began with the fact that Greece's rating to repay its debt was downgraded.[121] This then led to problems for the Euro, and to concerns about the budgetary health of some other countries that used the currency. The net impact of these developments was downward pressure on the Euro, which was only alleviated when Euro countries provided a support package for Greece that satisfied the financial markets. The sovereign debt crisis was overlaid by, and interacted with, the banking crisis that affected some lending institutions that were heavily committed to economic sectors, such as housing, which were hit badly by the downturn p. 774 ↵ in the economic markets. The deeper causality underlying these events is contestable.[122] The crisis generated a range of responses from the EU.[123]

(i) *Assistance*

The EU put in place a range of measures to give assistance to Member States that were in severe economic problems as a result of the Euro crisis.[124] The most important common element is conditionality, connoting the basic precept that funds are given on strict conditions concerning reforms that must be put in place by the recipient state.

The assistance was initially provided through the European Financial Stabilisation Mechanism (EFSM), which was financed from the EU budget and from bonds.[125] It was then provided by the European Financial Stability Facility (EFSF), a company established by the Euro countries on 9 May 2010.[126]

The main vehicle for assistance is now the European Stability Mechanism (ESM),[127] which entered into force on 8 October 2012.[128] Article 136 TFEU was amended by the simplified revision procedure, the result being a new paragraph 3, which stated that 'the Member States whose currency is the euro may establish a

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stability mechanism to be activated if indispensable to safeguard the stability of the euro-area as a whole'.[129] However, this amendment was not in force when the ESM was established and could not form the legal basis for the ESM, which therefore took effect as an intergovernmental organization based on an international treaty between the Euro-area Member States.

The legality of the ESM was challenged in *Pringle*,[130] where the claimant argued that it was concerned with monetary policy, which fell within the exclusive competence of the EU, with the consequence that the Member States had no competence to enact legally binding measures in this area. The other principal contention was that the ESM was legally inconsistent with the no bail-out clause contained in Article 125 TFEU. The ECJ rejected the arguments and upheld the legality of the ESM.[131]

The ECB also provided some assistance through, for example, Outright Monetary Transactions (OMTs) which concern transactions in secondary sovereign bond markets 'that aim at safeguarding an appropriate monetary policy transmission and the singleness of the monetary policy.'[132] p. 775 ↵ The legality of these measures was challenged by the German Federal Constitutional Court, its first ever reference to the CJEU. The CJEU upheld the legality of the OMT measures in *Gauweiler*.[133] It followed *Pringle* and held that whether a measure fell within monetary policy depended on its objectives,[134] which were to secure the appropriate monetary policy transmission and the singleness of monetary policy.[135] The CJEU rejected the argument that the OMT scheme was economic policy designed to pool debt of certain Member States and thus outside the power of the ECB. The fact that the OMT programme might also preserve stability of the Euro area, which was a matter of economic policy, did not call into question its status as a measure of monetary policy.[136]

The CJEU further concluded that the OMT scheme was proportionate. It held that the framing of programmes such as the OMT required the ESCB to make complex assessments of a technical nature, and it must therefore be allowed a broad discretion, with the consequence that proportionality review would be cast in terms of manifest error of assessment.[137] The CJEU nonetheless emphasized that even where an institution enjoyed broad discretion 'review of compliance with certain procedural guarantees is of fundamental importance', which included 'the obligation for the ESCB to examine carefully and impartially all the relevant elements of the situation in question and to give an adequate statement of the reasons for its decisions'.[138] While the reasons must reveal the institution's reasoning, it was not required to go into every relevant point of fact and law. The CJEU held that these requirements had been met.[139] The CJEU has drawn on the precepts in *Gauweiler* in later challenges to ECB action.[140]

(ii) *Oversight*

The grant of assistance to Member States in serious financial difficulty has been complemented by increased supervision over national financial institutions. Thus, the regulatory apparatus for banking, securities, insurance, and occupational pensions was thoroughly overhauled,[141] and new measures were introduced such as the Single Resolution Mechanism, which has increased EU oversight over national banking facilities.

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There have also been major changes designed to increase oversight over national economic policy, because of the proximate connection between economic and monetary union. The primary objective was to tighten EU control over national economic policy in order to prevent a recurrence of the sovereign debt and banking crises that precipitated the crisis with the Euro. The legislative framework for economic union was amended through the 'six-pack' of measures in 2011,[142] which were enacted p. 776 ↵ pursuant to Articles 121, 126, and 136 TFEU.[143] The measures were designed to render economic union more effective by tightening the two parts of the schema, surveillance and excessive deficit, the details of which were contained in the Stability and Growth Pact.[144] Further measures, the two-pack, were enacted on 21 May 2013.[145] Space precludes detailed elaboration of these complex provisions. Suffice it to say for the present that they included changes to enhance budgetary oversight by focusing on its timing, the format of national budgetary determinations, and the need for these to be independently verified. Further changes to the surveillance mechanism are substantive and require Member States to make significant progress towards medium-term budgetary objectives (MTO) for their budgetary balances. The EU also strengthened the excessive deficit procedure, the other limb of economic union.

The rules on oversight over national economic policy analysis were also affected by the Treaty on Stability, Coordination and Governance,[146] hereafter the TSCG, also known as the Fiscal Compact, which was signed by twenty-five contracting states in March 2012.[147] Article 3(1) TSCG contains the 'balanced budget' rule and is the heart of the new Treaty. The budgets of the contracting parties must be balanced or in surplus. This is deemed to be respected if the annual structural balance of the general government is at its country-specific medium-term objective, as defined in the revised SGP, with a lower limit of a structural deficit of 0.5 per cent of gross domestic product at market prices. The contracting parties must ensure rapid convergence towards their respective medium-term objectives, within a time frame set by the Commission. While the obligation to balance the national budget is the core of the TSCG, it is arguable that almost everything therein might have been done under the Lisbon Treaty provisions.[148] It is also important to recognize that the provisions concerning assistance and those concerning oversight are 'joined at the hip', in the sense that grant of assistance under the ESM is conditional from 1 March 2013 on ratification by the applicant state of the Fiscal Compact.

p. 777

(iii) *Political, Legal, and Economic Concerns*

The financial crisis cast a serious shadow over the EU and led to a plethora of political, legal, and economic concerns, which can only be touched on here.[149]

Thus in political terms, it cast into question the EU's defining credo, which was the promise of peace and prosperity. Politicians and academics might engage in complex argument about the relative degree of responsibility for the current malaise. This, however, matters little from the perspective of ordinary citizens, more especially those living in countries affected most dramatically by the Euro crisis and consequent economic measures imposed under the name of conditionality. For these people it is the EU and the Euro that has failed, and this is so irrespective of political and academic discourse as to the 'real' causes of the crisis. Another political consequence of the crisis has been an increase in EU supervisory power over national economic policy, in order to prevent recurrence of the crisis, with the consequence that national political choice has been constrained. There are in addition political and social problems

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caused by the need for national austerity measures to comply with conditionality requirements from EU assistance, which can have a very marked impact on, for example, the funding of national social welfare programmes.

In legal terms, the range of measures enacted pursuant to the financial crisis has exacerbated problems of transparency and complexity that already beset this area. There were prior to the reforms three layers of complex legal rules pertinent to control over national economic policy: provisions of the Lisbon Treaty, EU legislation, and the broad economic policy guidelines. The ESM and TSCG add a fourth layer to the existing schema through Treaties operating outside the Lisbon Treaty. This exacerbates difficulties of complexity and transparency, more especially because there is significant overlap between obligations incumbent on states through the six-pack and two-pack of EU legislation, and those in the TSCG. There are in addition further legal problems concerning, for example, the application of the Charter of Fundamental Rights in this area,[150] and the ability of EU institutions to participate in treaties outside the framework of EU law, such as the ESM and the Fiscal Compact.[151]

In economic terms, the central issues are funding, who pays for the assistance, and moral hazard, the concern that the recipient state will take excessive risks and free ride on the greater fiscal rectitude practised by others. The numbers involved with financial assistance/bail-outs are significant indeed. They are in the billions. The money has come from other Member States, with Germany bearing the principal burden. This is likely to continue for the foreseeable future, given that financing of the ESM is predicated on state contributions. The economic impact of contributions from smaller countries should nonetheless be kept firmly in mind. The aggregate constraints thereby placed on Member State economic freedom are far-reaching.

p. 778

(iv) *EMU: Further Reform Initiatives*

EU institutional thinking about EMU has continued apace since the initial flurry of political and legal responses to the financial crisis. It is reflected in the high-profile reports that have emanated from the EU,[152] and the concrete proposals that flowed therefrom. The proposals are complex, and thus only the bare outline can be conveyed here.[153]

A prominent strand of the proposals is what may be termed a return to Treaty orthodoxy. This is manifest in Commission proposals for the integration of the ESM and the TSCG into mainstream EU law. This was perceived to foster the unity of EU law, to facilitate democracy, and to foster efficiency. Thus, the proposal is for the ESM to be absorbed into a European Monetary Fund, which would provide assistance to Member States. The core of the TSCG is the balanced budget provision, contained in Article 3 therein, and the proposal is for this to be incorporated into a directive.

A second strand of the reforms is concerned with provision of structural support to Member States, more especially those within the Euro area. The rationale is to strengthen the economic resilience of Member States to render recurrence of a financial crisis less likely. There has been progress in this respect, which has been based on the Structural Reform Support Programme, SRSP. The general objective of the programme is to contribute to institutional, administrative, and growth-sustaining structural reforms in the Member States by providing support to national authorities for measures aimed at reforming and

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strengthening institutions, governance, public administration, and economic and social sectors, with a view to enhancing cohesion, competitiveness, productivity, sustainable growth, job creation, and investment, in particular in the context of economic governance processes.[154]

A third strand of the projected reform is designed to address the collective dimension of macro-economic stabilization. If there is a severe economic crisis, national budgets may be overwhelmed, as happened during the EU financial crisis. If this occurs, 'national fiscal stabilizers might not be enough to absorb the shock and provide the optimal level of economic stabilization, which in turn can harm the whole euro area'.[155] There are, however, considerable difficulties in dealing with this issue at EU level. Thus, there is concern that it could lead to regular fiscal transfers from richer to poorer Member States, and that it might undermine the incentives for sound fiscal management at national level. There are moreover considerable difficulties in the funding of such a scheme. The Commission has, however, proposed a European Stabilization Protection Function to alleviate the problem.[156]

There is moreover a further element to the reform architecture that is concerned with banking union and capital markets union. It attests to the fact that the root cause of the financial crisis was an admixture of problems concerning sovereign debt and problems concerning the stability of banks. A range of measure have been introduced, or have been proposed, to deal with these dimensions of the problem.[157]

p. 779

8 CONCLUSIONS

i. In terms of free movement of capital, there has been a growing body of case law testing the Treaty provisions. This case law should be viewed alongside that dealing with goods, persons, establishment, and services.
ii. In terms of EMU, the financial crisis revealed that the Maastricht architecture, whereby there was an asymmetry between monetary and economic policy, was unsustainable. The controls over national economic policy were not strong enough, even though it is generally recognized that there is an intimate relationship between monetary policy and economic policy, since if countries run long-term budgetary deficits then this will cause the currency markets to take a poor view of the value of the Euro.
iii. It is for this reason that one principal dimension of the EU's response to the financial crisis has been the raft of legislation designed to increase control over banking and national budgets to prevent a recurrence of the banking and sovereign debt crisis, with the other principal dimension being the grant of assistance to those countries in dire economic trouble in order to prevent further 'economic contagion' in the Euro area.
iv. The political, legal, and economic consequences of the crisis have been very significant.

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