European University Institute

DEPARTMENT OF LAW

A LEGAL AND ECONOMIC ASSESSMENT OF THE EMU'S COMMON PRINCIPLES AND ALTERNATIVE ROUTES OF BUDGET CONSTRAINTS

Alessandro Busca

Thesis submitted for assessment with a view to obtaining
the degree of Doctor of Laws of the European University Institute

Florence, 20 July 2018

European University Institute
Department of Law

A LEGAL AND ECONOMIC ASSESSMENT OF THE EMU'S COMMON PRINCIPLES AND ALTERNATIVE ROUTES OF BUDGET CONSTRAINTS

Alessandro Busca

Thesis submitted for assessment with a view to obtaining
the degree of Doctor of Laws of the European University Institute

Examining Board

Professor Stefan Grundmann, European University Institute
Professor Klaus Heine, Erasmus University Rotterdam
Professor Giorgio Monti, European University Institute
Professor Pietro Sirena, Università commerciale Luigi Bocconi

Researcher declaration to accompany the submission of written work
Department of Law – LL.M. and Ph.D. Programmes

I Alessandro Busca certify that I am the author of the work "A legal and economic assessment of the Emu's common principles and alternative routes of budget constraints" I have presented for examination for the Ph.D. at the European University Institute. I also certify that this is solely my own original work, other than where I have clearly indicated, in this declaration and in the thesis, that it is the work of others.

I warrant that I have obtained all the permissions required for using any material from other copyrighted publications.

I certify that this work complies with the Code of Ethics in Academic Research issued by the European University Institute (IUE 332/2/10 (CA 297).

I declare that this work consists of 102.047 words.

Statement of language correction (if applicable):

This thesis has been corrected for linguistic and stylistic errors.

I certify that I have checked and approved all language corrections, and that these have not affected the content of this work.

Signature and date:

28/06/2018

ACKNOWLEDGEMENTS

I have many people to thank for having given me the encouragement and support I needed to undertake this project and to see it to its completion.

First, I would like to thank my supervisor, Prof. Grundmann, who has always believed in my research from the beginning. He has supported me in all these years not only with kind words of encouragement but maily with brilliant ideas and a clear direction who have proven to be invaluable.

I would like also to thank Prof. Klaus Heine, who I met at the Erasmus University in Rotterdam. I would have not undertaken such project without his initial ideas and guidelines, for which I will be always gratefull.

Prof. Micklitz has also been very important in my years at the EUI. He has challenged me more than once in thinking more deeply to my arguments and my analysis. I am now a better academic thinker and writer also because of him.

I am very gratefull to the entire EUI community and to my fellow classmates. I have really enjoyed my time at the EUI and this is mainly due to the extraordinary people I have met: Agnieszka, Fabrizio, Federico, Federica, Grazia, Leonardo, Liam, Mikaela, Rebecca and Veronica.

I would like to thank my best friends: Caterina, Elena, Francesco, Matteo, Nina and Stefano. Each one of them has played an important part for my life during all these years.

Finally, I would like to thank and dedicate this endeauvor to my brother Marco and to my parents Paolo and Marina who have always encouraged and supported me.

THESIS SUMMARY

In the past 20 years, the European integration process has been mostly successful at establishing a single European market. However, no such success can be attributed to the establishment of an economic and monetary union. The recent financial and sovereign debt crisis dramatically exposed all the flaws and weaknesses of this ambitious project, which led the European Union into a deep economic and political crisis. In this context, the task of scholars and academics should be to explore new effective and efficient alternative in order to strengthen and create "a more perfect union". On these premises and considerations, the present research will analyze the current legal framework of the European Monetary Union in order to assess and understand its success, and explore possible alternative institutional designs which could be more effective in achieving its objectives and, at the same time, be potentially more efficient and legittimate.

More in details, after examining in the first chapter, the origin and evolution of the economic and monetary integration from its very foundation, and, in the second chapter, the current legal structure of the economic union; the last and third chapter represents the normative claim of thesis. In an attempt to reconcile both law and economics, this normative part will involve a balancing exercise between the economic concepts of effectiveness and efficiency, and the legal concepts of legitimacy. The analysis will first understand and assess the effectiveness of the present governance structure. We will argue that the fundamental problem of the present governance structure is given by its many internal inconsistencies. On these premises, we will claim that it is possible to design an alternative regime which could potentially solve such issues and thus be more effective. The resulting three different alternative regimes will then be compared and evaluated in terms of their efficiency, according to the new institutional economics approach. The purpose of the efficiency evaluation is not to identify the single most efficient system of governance, but rather to understand the distinctive strenghts and weaknesses of the various alternatives in comparison with the current structure. Ultimately, the chapter will also evaluate the current EMU structure under a legitimacy standpoint. In particular, it will try to assess and understand whether these potentially more effective and efficient alternative arrangements would also improve the EMU under a legitimacy standpoint.

TABLE OF CONTENTS

CHAPTER I

HISTORY OF THE EUROPEAN MONETARY UNION

CHAPTER II

THE COMMON PRINCIPLES OF THE ECONOMIC UNION

CHAPTER III

ALTERNATIVE ROUTES OF BUDGET CONSTRAINTS

CHAPTER I

HISTORY OF THE EUROPEAN MONETARY UNION

TABLE OF CONTENTS

INTRODUCTION AND SUMMARY

The European Economic and Monetary Union (EMU) is a unique and exceptional endeavour which was the result of a long and complex political process. Before we can begin a full evaluation of this structure, it is necessary to understand why the European States chose to create such an unprecedented structure of governance. In other words, why were these institutions and legal rules enacted in the first place? As O. Holmes points out in his famous essay: "If we want to know why a rule of law has taken its particular shape, and more or less if we want to know why it exists at all, we go to tradition"[1]. This is especially true in the context of the European Union, where the study of its foundational period is not only a mere historical exercise but a very functional one since the developments crystalized in this period affected all subsequent phases of the European integration process.[2]

The purpose of this first chapter is thus to examine the origin and evolution of the economic and monetary integration process and its rules from its very foundation, in order to understand how its legal regime has progressively been enacted as well as its underlying economic assumptions. This evolution will be addressed in four key historic periods.

The first period of this integration process dates back to before the establishment of the European Community itself. The European Payment Union (EPU) of the 1950s, for instance, might be considered the first European agreement, which expressly acknowledged the economic interdependence among Member States in connection with trade and economic

[1] O W Holmes Jr, 'The path of the law' 10 *Harvard Law Review* 457 (1897), 469.

[2] J Weiler, 'The Transformation of Europe' 100 *Yale Law Journal* 2403 (1991), 2410.

policies and required, as a result, a system of monetary coordination. The EPU's logic and economic rationale still have an impact on today's rules and it is relevant for our further discussion. Similarly, the founding treaty of the EEC also recognized the economic interdependence among Member States, and, as a function of the common market, required monetary and economic coordination in connection with currency, price stability as well as balance of payments. The Treaty did not, however, establish a real form of supervision or coordination at the community level for economic and political reasons. These two initial legal arrangements had very different rationales but, overall, complemented each other in order to address the monetary side and the common market side of the economic integration process.

The second period coincides with the implementation of the EEC Treaty. This period lasted until the end of the 70s and was characterized by a number of proposals, specifically advanced by the Commission, to enhance coordination in these fields. The Barre Report on the one hand, and more importantly, the Werner Report on the other hand, were the two main plans for increasing the economic and monetary convergence among European States. In particular, the Werner Report proposed, in connection with monetary policies, the locking of exchange rates and the possible adoption of a single currency, while in the area of economic policies, it proposed a strong allocation of power to the Community which could directly influence the national budgets. The EU, after an initial period, did not eventually carry out the implementation by phases set forth by the Werner Report for both political and economic reasons. As a result, the process for a monetary union became *de facto* suspended for a number of years. The process was eventually relaunched with the adoption of the European Monetary System, which, among other things, envisioned a mechanism to link exchange rates among participating currencies (ERM). This second period of integration, although partially ineffective, was able to further push the monetary and economic integration process, and eventually, deeply affected the successive steps in this direction.

The third period of integration began with the realization that, with the adoption of the single market program in 1986, the establishment of the EMU could no longer be postponed. The Council strongly headed into this direction and led to the formation of the Delors Commission. The report of the Delors Commission represents the founding document of today's EMU, as its core ideas were later enshrined in the Maastricht Treaty. The report adopted an approach different than the previous Werner Report concerning its economic policy recommendations. Its proposal was less politically controversial, and somewhat more in line with the early approach of the Commission in the early 60s. With the resulting Treaty of Maastricht, the EU finally launched the process of progressive monetary integration in phases up to the adoption of the single currency, in combination with a system of convergence criteria and a framework of coordination and assessment of short-term and medium-term economic developments.

Nevertheless, the Member States realized that the system in place needed a further addition to complement the monetary requirements with additional and more stringent fiscal requirements. The EU approved in the late 90s the so-called Stability and Growth Pact (SGP) to strengthen the surveillance and coordination of economic policies, but also and more importantly, to extend the Maastricht benchmarks as well as its sanctioning procedure over the initial period. The SGP and its rules-based approach to economic policies was largely criticized for its insufficient flexibility, for its unenforceability, and for a serious lack of leadership of the two core Member States, which was exemplified by the failure of the Council to complete any procedure for excessive deficit as occurred in 2003 against France and Germany. As a result, in 2005, the SGP was subject to a complete reform toward a more flexible, hence a more credible, approach.

The sovereign debt crisis, which began in 2010, represents the fourth key period. The crisis dramatically reshaped the entire economic governance of the Euro area, for it exposed the ineffectiveness of this system to promote fiscal discipline and consolidation. The EMU has been significantly under pressure since the overall crisis has proven to be of a complex nature, for it started as a worldwide financial crisis in 2007–08 and became afterwards a European sovereign debt crisis. During the late stage of the financial crisis (2008-2009), the EU tackled the financial situation by adopting interim measures to restore liquidity in the banking sector, to boost the economy and to create a unitary financial oversight to restore confidence, stability and sustainability in the financial markets. However, with the progressive worsening of the debt crisis, the Council acknowledged the need to revise its system of economic governance and consequently agreed to a long-term commitment to accelerate toward specific structural reforms. As a result, the EU approved, through a number of different legal measures, a reformed structure of economic governance around three main strands: (i) A stricter system of coordination and surveillance of economic policies through a new EU calendar system for budgetary information (The European Semester), a new comprehensive procedure to address macroeconomic imbalances and competitiveness developments (the Macroeconomic Imbalance Procedure), and additional commitments to enhance policy coordination also for non-euro countries with the Euro Plus Pact; (ii) A more stringent regime of budget constraints and more credible enforcement mechanisms provided by part of the so-called "Six Pack", the

“Two Pack” and by the Treaty on Stability, Coordination and Governance (the so-called Fiscal Compact); and (iii) A new framework of financial assistance for Member States in distress through the European Stability Mechanism.

These measures were followed by two important reports to progress towards a genuine Economic and Monetary Union (EMU) within a multi-stage process. The first report, the Four President Report of 2012, outlined four pillars of analysis: financial market union, fiscal union, economic union and political union. With particular regards to the economic and fiscal union, the Four President Report envisioned a series of structural reforms to move gradually towards an integrated budgetary framework and eventually a fiscal union. The report was able to promote the establishment, among other things, of the Banking Union, and to provide legitimacy and strength to the following OMT program by the ECB. The Five Presidents’ Report of 2015 moved along the line of the previous report. It urged to complete both the Banking Union and the Capital Market Union in order to form a more intregrated financial union. With regards to economic and fiscal policies, the report re-launched the idea for an integrated budgetary framework and a fiscal union through a series of measures, which have been partially implemented by the Commission thus far.

1. EARLY PROCESS OF INTEGRATION

The process leading to the creation of a European economic and monetary union formally began in the early 70s, but its foundation lies long before, in the events of the previous decades. The likely predecessors of today's Economic and Monetary Union are in part the monetary framework of the European Payment Union (EPU) in 1950, and the progressive establishment of a European common market, with the creation in 1957 of the European Economic Community (EEC).[3]

After the Second World War, the Bretton Woods system established in 1944 promoted the reconstruction of the international economic and financial system based on a free-trade approach and a system of fixed exchange rate pegged to the U.S. dollar, which was separately linked to gold.[4] However, in the post-war European context, such reconstruction was impractical as many states were nearly bankrupt: industrial production and trade were at an all time low. Additionally, European currencies were not internationally stable and reliable, notwithstanding the fixed exchange rate. The only stable and generally accepted method of payment, the U.S. dollar, was rather limited and expensive. As a result, trade was negatively affected, as were the European countries' current accounts with the U.S., which experienced a large and structural deficit.[5]

Intra-European trade was therefore crucial to restarting the economic engine, but this could not effectively operate without preliminarily restoring the convertibility of European countries. The newly created International Monetary Fund (IMF) was only able to provide limited loans, as

---

[3] For a historic survey of the EMU see H Ungerer, *A Concise History of European Monetary Integration: From EPU to EMU* (Santa Barbara CA., Praeger, 1997); H James, *Making the European Monetary Union* (Cambridge, MA., Harvard University Press, 2012). For a good understanding of the negotiation process behind the establishment of the EMU see K Dyson and K Featherstone, *The Road to Maastricht. Negotiating Economic and Monetary Union* (Oxford, Oxford University Press, 1999); For a legal analysis of the EMU framework see J Louis, *From the European Monetary System to Monetary Union* 2nd edn (Luxembourg, OPEC, 1990). For a law and economic analysis see T Eger, H Schafer, *Research handbook of the economics of European Union Law,* (Northhampton, Edward Elgar, 2014); J Pelkmans, *European Integration: Methods and economics analysis*, 2nd edn (Harlow UK, Prentice Hall, 2001). For a more economic analysis see R Baldwin C Wyplosz, *The Economics of European Integration* (London, McGraw-Hill, 2004); P De Grauwe, *Economics of monetary union*, 6th edn (Oxford, Oxford University Press, 2005); From a political economic standpoint see B Eichengreen, J Frieden, *The Political Economy of European Monetary Integration*, 2nd edn, (Westview Press, 2000).

[4] For a more detailed account of this, see M Gilbert, 'The gold-standard system: conditions of equilibrium and the price of gold in B Eichengreen' in M Flandreu (ed) *The Gold Standard in theory and history* (New York/London, Routledge, 1997).

[5] For an economic history of the European post war context see B Eichengreen and J Braga de Macedo, 'The European Payments Union: History and Implications for the Evolution of the International Financial Architecture' *OECD Development Centre Paris* 25 (2001).

the Bretton Woods architecture did not allow for a clearing system, as an alternative method of payment, where surplus with a country could be financed with deficits with another country.[6] In such a context, bilateral arrangements to offset imports and exports were the only available option of payment for two trading countries. The disadvantage of these mechanisms, however, was that compensation occurred on a strict bilateral basis so that a net position of trade deficit between two countries was required to be bilaterally settled by either quantitative restriction, bargaining, or by selecting import or export.[7] In other words, as pointed out by economist R. Triffin, such bilateral arrangements slowed down the European recovery precisely because they generated significant trade distortions. In practice, each country would naturally tend to trade and establish a bilateral arrangement almost exclusively with partners on the basis of a favorable financial position (i.e. the existence of trade surplus or further loans), rather than on the basis of the maket price[8].

Triffin's ideas and critiques of the present system significantly influenced the draft proposal for a European multilateral clearinghouse in order to facilitate the reliability and convertibility of European currencies.[9] This proposal became the European Payment Union, which was signed on 19 September 1950 by eighteen European member states of the Organization for European Economic Cooperation (OEEC).[10] This agreement legally operated within the framework of the newly created OEEC[11]. More specifically, the Council of the OEEC, who preliminary approved the text, assumed authority over the Payment Union through a managing board, which together

[6] This system reflected the different visions of J M Keynes who advocated for a Clearing Union, precisely for such purposes, and H D White, responsabile for the design of the IMF, who instead pushed, mainly for political reasons, for an institution providing only temporary assistance to debtor countries. See G Carli, 'From the European Payments Union to the European Monetary System', in R Cooper, P Kenen, J Braga de Macedo and Y van Ypersele (eds) *The International Monetary System under Flexible Exchange Rates: Global, Regional, and National* (Cambridge, Mass, Ballinger, 1981) 161.

[7] B Eichengreen and J Braga de Macedo (n. 5), 32.

[8] See R Triffin, 'The Unresolved Problem of Financing European Trade. IMF Memorandum' in R Triffin (ed) *The World Money Maze: National Currencies in International Payments* (New Heaven and London: Yale University Press, 1947) 407-418.

[9] The economist R Triffin is widely considered the architecht of the EPU project. For a recent and detailed discussion on Triffin's contribution see by I Maes and I Pasotti, 'The European Payments Union and the origins of Triffin's regional approach towards international monetary integration', (2016) NBB Working Paper No. 301 available at https://www.nbb.be/doc/ts/publications/wp/wp301en.pdf.

[10] Accord sur l'établissement d'une Union européenne des paiements-Agreement for the establishment of a European payements union. Paris: Organisation européenne de coopération économique, 1950. 50 p. (EPU agreement) The agreement was signed in Paris by 18 countries (Austria, Belgium, Denmark, France, the Federal Republic of Germany (FRG), Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Sweden, Switzerland, Turkey, the United Kingdom and the Commandant of the Anglo-American Zone of the free territory of Trieste).

[11] Article 1 of the EPU's agreement. The Organisation for European Economic Co-operation (OEEC) was established in 1948 to administer the financial aid for the reconstruction of Europe after World War II within the framework of the Marshall Plan.

with the Bank for International Settlements (BIS) as financial agent, ran the daily operation of the EPU[12]. The agreement worked in connection with the European Recovery Programme (the so-called 'Marshall Plan'), under which the U.S. provided the initial allocation of the Fund[13] and allotted the initial credit and debit balances among signature countries.[14]

The function of the Payment Union was quite straightforward. On a monthly basis, each member state would report its trade balance accounts with reference to the other EPU's countries according to a pre-fixed exchange rate.[15] Based on these reports, a net deficit position toward a specific country would be automatically offset with a surplus position toward another country.[16] Ultimately, each member would have an overall deficit or surplus with respect to the Union, with a maximum amount that the account could reach. As a result, settlements were carried out partly in gold and partly via the granting of EPU credits. With such a multilateral system, European states would no longer have the need to discriminate on the basis of the financial positions of the trading partner as occurred under the previous framework of bilateral arrangements. Because credits and debits were financially reliable and guaranteed by the overall payment system as well as the common fund, what mattered for trade purposes was merely the overall EPU balance as a constant deficit with certain countries, which could be offset by a constant surplus with other countries.

The EPU is still very relevant today, for it marks the first European agreement to expressly recognize the economic and monetary interdependency among European countries. Additionally, this agreement reflects several concepts of the present EMU's political and economic debate. First, from a political economy standpoint, the Payment Union addressed early some of the themes we will more deeply develop, such as the use of European arrangements to solve coordination problems, and the role of institutions in forming credible commitments.[17] More specifically, the EPU was able to operate effectively and solve the coordination problem of discriminatory trade carried out under the previous bilateral arrangements. In doing so, it relied on a supranational institution, the Council of the OEEC, to

[12] Article 18 ("Administrative organs") of the EPU agreement.
[13] Article 23 ("The Fund") of the EPU agreement. According to article 23, the U.S. provided an initial fund of 350 million of United States dollars.
[14] Article 10 ("Initial balances") of the EPU agreement.
[15] Article 26 ("Unit of account") of the EPU agreement. In practice, each member would determine a parity between its own currency and the unit of account which was expressed in terms of grammes of gold.
[16] See Article 3 and 4 of the EPU agreement.
[17] For this argument see B Eichengreen, 'European Integration', in B Weingast and D Wittman (Eds) *The Oxford Handbook of Political Economy* (Oxford, Oxford University Press 2006) 801.

take such binding decisions as may be necessary. It also and more importantly relied on a self-enforcing mechanism, where cooperative behavior under the EPU system to safeguard the common commitment, produced welfare gains exceeding the possible gains arising from opportunistic behaviors[18].

Second, from a purely macroeconomic standpoint, the EPU and its underlying monetary discussions still characterize today's debate on the future of the European Monetary and Economic Union. The arguments behind the Payment Union were in fact part of a larger discussion among economists concerning the role of public intervention in monetary matters.

On one side of the spectrum, there were American economists, like the Chicago School of Economics, and particularly Milton Friedman, who opposed the use of compensatory policies (such as the measures under the EPU) to address structural or even temporary pressures on the balance of payments. He saw these instruments as methods to artificially alter cross-border flows of trade and capital, and ultimately to produce an instable system for balance of payments.[19] He alternatively proposed a fiscal and monetary framework where no discretionary action by governmental authorities in the creation or destruction of money was possible, and where market forces were the sole factor affecting and determining the rates of exchange[20]. More specifically, Friedman argued that the aggregate quantity of money in a given country should only be automatically determined by no other means than its balance of payments.[21] As a result, a system of fixed exchange, such as the Bretton Woods system in place, could not be used to achieve equilibrium in international trade, while only a system based on a flexible exchange rate could be the logical counterpart of such a framework.[22] It is interesting to note that Friedman surprisingly considered Keynes as the intellectual precursor of the ideas of a

---

[18] On this point see J Broz and J Frieden, 'The political economy of exchange rates' in in B Weingast and D Wittman (Eds) *The Oxford Handbook of Political Economy* (Oxford, Oxford University Press 2006) 590.

[19] M Friedman, 'The Case for Flexible Exchange Rates' in *Essays in Positive Economics* (Chicago, University of Chicago Press, 1953) 157-203.

[20] M Friedman, 'A Monetary and Fiscal Framework for Economic Stability', 38 *The American Economic Review* 3 (1948), 245.

[21] "Deficits or surpluses in the government budget would be reflected dollar for dollar in changes in the quantity of money; and, conversely, the quantity of money would change only as a consequence of deficits or surpluses". Additionally, the proposed system was based on the elimination of both the private creation of money, by separating the depositary from the lending function of the banking system, and the destruction or discretionary control of the quantity of money by central bank by eliminating rediscounting and existing powers over reserve as well as the existing powers to engage in open market operations and direct controls over stock market and consumer credit. Ibid 251.

[22] Ibid 251.

system based on flexible exchange rates[23]. The truth is that, while Keynes argued against fixed exchange rates (the gold standard) as well as against a broad discretionary power of the state in monetary matters,[24] it is undeniable that Keynes would have supported the Payment Union and its underlying logic, simply because the latter greatly drew from his unsuccessful plan for an international Clearing Union.

On the other side of the spectrum, there were European economists, like Triffin and Hirschman who were deeply involved with such projects from the "American side". Both economists were supporters of the efficiency of the price system with respect to the effect of exchange rate changes on the balance of payments, and distrusted monetary controls, allocations, and plans. Triffin, most notably, was an early vocal critic of the Bretton Woods system and its fixed currency exchange rates, and was eventually the first to identify the unsustainability of such a system, in what is known as the "Triffin dilemma" (see below para. 2.1). Nevertheless, both economists also recognized how market forces could not effectively operate in the European post-war context as argued by Friedman. Triffin's critique emphasized the existence of many structural factors, such as the inconvertibility of currency and political instability, as obstacles and inefficiencies for the correct working of the price system.[25]

As a result, the use of compensatory measures, in case of temporary strains in balance of payments, were the logical conditions for the economic recovery.[26] Hirschman, who was at the time deeply involved in the negotiations and drafting of the plan for the EPU as an outside consultant, likewise strongly supported the EPU.[27] He realized that the Payment Union imposed a temporary discrimination against imports from the U.S. and hence against the dollar, and this also explained the hostility of the U.S. government, for which he was working at the time (as a staff member of the Federal Reserve Board). However, he also saw the Payment Union as an

[23] M Friedman, 'The European Community: Friend or Foe of the Market Economy' *Paper for Mont Pèlerin Society Meeting*, (1982).
[24] J M Keynes, *Tract on Monetary Reform* (London: Macmillan, 1923), 126, in Royal Economic Society ed. *Collected Writings of John Maynard Keynes*, vol. 4 (London, Macmillan for the Royal Economic Society, 1971).
[25] R Triffin, *Europe and the Money Muddle: From Bilateralism to Near-Convertibility, 1947-1956* (New Heaven/London: Yale University Press, 1947) 31-87.
[26] "Whenever balance of payments disequilibria are due, not to international price disparities, but to accidental factors or to cyclical fluctuations in foreign income and demand, compensatory policies should be followed to the fullest possible extent." Ibid 80.
[27] A Hirschman, 'Fifty Years After the Marshall Plan: Two Posthumous Memoirs and Some Personal Recollections' in A Hirschman (ed.) *Crossing boundaries: selected writings* (New York, Zone Books, 1998) 41. In this essay, Hirschman narrates the story of his involvement in the EPU, its relationship with Robert Marjolin and Richard Bissell who were at the time two key actors for the implementation of the Marshall Plan on behalf, respectively of the European side and the American side, as well as the hostility of the U.S. government toward this program.

instrument to remove the obstacles and inefficiencies pointed out by Triffin.[28] In this sense, he generally opposed the prescriptions of orthodox monetary policies in the postwar economies of Western Europe for being "politically naïve, socially explosive, and economically counterproductive from any long run point of view"[29], while generally supported the regional common framework to tackle every cyclical shock that would produce further trade isolation among European countries[30]. His vision for a deeper European integration is also reflected in his alternative and piorenistic proposal for a European Monetary Authority concerning common fiscal, monetary, and foreign exchange policies that might be gradually adopted under the guidance of a future European Central Bank (for futher deails see below chapter 2.1).[31]

These readings of the EPU framework reflect two different visions of how market forces should work in monetary settings, the multilateralism approach supported by Friedman, and the regionalism approach supported by Triffin and Hirschman. Nevertheless, these two apparently irreconcilable visions can be aligned if we consider the second approach in light of the new evolution of economic analysis. First, the Payment Union actually operated under the rule of the Bretton Woods system, thus it was not merely a regional approach but it was more a regionally coordinated attempt within a multilateral system. Second, as we have extensively discussed, intra-European trade in the post-war era was negatively affected by the impracticality of currency conversions, the impossibility of multilateral compensation and, as a consequence, the persistence of trade distortions. The EPU system was meant and able to address and minimize all these market inefficiencies, which we can label as transactions costs. In other words, as it was prominently recognized, the EPU succeeded by minimizing distortions[32], and hence by minimizing transaction costs so as to restore the correct workings of trade and monetary market forces. The Payment Union and its underlying logic therefore beautifully exemplifies the role of institutions in minimizing transactions costs as supported by the so-called Coase theorem and the later approach undertaken by the New Institutional Economics. In this sense, the EPU is widely considered a great success and is credited as one

[28] Ibid 41 and ff.

[29] A Hirschman, *Rival views of market society and other recent essays* (New York, Viking, 1986) 5.

[30] A Hirschman (n. 27) 41.

[31] Hirschman explains (A Hirschman (n. 27) 41) that the "Proposal for a European Monetary Authority" (November 2, 1949) was only a confidential memorandum circulated within the European Cooperation Administration (ECA) in response to an "informal request". It has not been published in English, but only an Italian translation was published under the title A Hirschman, Proposta per una Autorità Monetaria Europea, in L Meldolesi (ed.) A. Hirschman, *Tre continenti. Economia politica e sviluppo della democrazia in Europa, Stati Uniti e America Latina* (Torino, Einaudi, 1990).

[32] B Eichengreen and J Braga de Macedo (n. 5) 42.

the greatest achievement of the Marshall Plan.[33] Many studies show that the EPU was able to expand intra-European trade[34], and secure and restore stability and convertibility of currencies on current accounts by the end of the 50s[35].

With the progressive restoration of currency convertibility, European countries were able to direct their main efforts to pursue free trade and market integration, as a second step toward economic recovery. The EPU is one of the first examples of the notion of neofuntionalist spillover, according to which integration in a specific field naturally led to integration in other related fields.[36] Already after the war, a process of liberalization of trade was promoted under the European Recovery Plan, as European countries were obliged to reduce their reciprocal tariff barriers and quantitative restrictions as a condition for receiving American aid[37]. However, such a process was not fully effective since it strictly occured on an individual basis. According to many sources, the formation of large free trade areas, or even a custom union, on the other side could have produced greater efficiencies and benefits.[38] On this assumption, a project to create a free trade area among France, Italy and the Benelux, called the Fritalux (later changed to Finebel) was negotiated but never completed.[39]

---

[33] Richard Bissell, one of the key figures behind the Marshall Plan is quoted as saying that the EPU is the "The EPU was in some ways the supreme organizational achievement of the Marshall Plan" in A Hirschman (n. 27) 42.

[34] B. Auguste in particular estimated the quantitative effect of the EPU on trade liberalization and found that the level of trade liberalization, which would have taken place in absence of the EPU would have been significantly lower. See B Auguste, *The Economics of International Payments Unions and Clearing Houses - Theory and Measurement* (Oxford and New York, Palgrave Macmillan UK St. Martin's Press in association with St. Antony's College, 1997) 173-179.

[35] It is important to note that only current accounts convertibility was restored. This means that national and foreign currencies were able to inflow and outflow for trade-related related purposes or unilateral transfers without restrictions. Capital account convertibility, which refers to the free inflows and outflows of national and foreign currencies also in connection with non-trade related purposes (for instance investments or loans), on the other hand, were not achieved until the 1980s. For a full account see B Eichengreen, 'The European Payments Union: An Efficient Mechanism for Rebuilding Europe's Trade?', in B Eichengreen (ed.) *Europe's Postwar Recovery* (Cambridge, Cambridge University Press, 1995) 169-195.

[36] See B Eichengreen (n. 17) 802, drawing this concept from E. Haas, *The Uniting of Europe* (Stanford, Stanford University Press, 1958).

[37] Committee for European Economic Co-operation, *General Report*, Paris, September 21 1947 (U.S. Department of State Pubblications 2930).

[38] "The formation of a larger free trade area in Europe could be expected to lead to greater efficiency-in many sectors of production and this would not only increase the wealth of the countries concerned, but would also be of assistance in solving the fundamental problem of the European balance of payments." Ibid 34.

[39] For a discussion on these first projects see R Griffiths and F Lynch, 'The Fritalux/Finebel negotiations: 1949/1950' EUI working paper, no. 84/117 (1984).

It was only with the establishment of the European Coal and Steel Community (ECSC) in 1951 that the European integration process took a resolute step toward market integration[40]. The Treaty established a European common market for coal and steel based on common rules and institutions in order to promote economic expansion, the development of employment and the standard of living, undistorted competition and efficiency. A proper analysis of all the features of the Treaty requires greater attention that falls outside the scope of the present analysis.[41] Nevertheless, two key elements of the ECSC stand out and are worth mentioning for our discussion. First, the Treaty established four supernational institutions: a High Authority, a Common Assembly, a Special Council, and a Court of Justice, which represent the foundation of today's EU institutions. This Community thus represented the first system of European supranational institutions in economic matters, which resembles many features of today's EMU governance. Second, the Treaty implemented for the first time the idea of a European common market, which was later fully developed. Again, the guiding principle for this idea was the concept of "economic interdependence" among European states as expressly acknowledged by the Joint Statement of the ECSC: "All these efforts will be guided by the growing conviction that the countries of free Europe are interdependent and that they share a common destiny"[42].

It is crucial that such a free trade approach was necessary not only for merely economic purposes, but also to set up "common foundations for economic development" as a first step toward a larger political goal, "the federation of Europe". Already, Hirschman pointed out in connection with the Payment Union, that the ultimate goal was not just trading itself, but rather had a more political agenda: "fostering a healthy European society in our struggle for peace".[43] Similarly, this was the manifesto defined by the French Foreign Minister Robert Schuman in 1950 in his famous declaration acknowledging that economic unification was the first step toward the "realisation of the first concrete foundation of a European federation indispensable to the preservation of peace"[44]. More specifically, Schuman maintained that European states should focus on establishing a strong common interest so that any potential war would be

---

[40] The Treaty establishing the Coal and Steel Community was signed on 18 April 1951 by 6 European states (Belgium, the Federal Republic of Germany, France, Italy, Luxembourg and the Netherlands); Treaty Establishing the European Coal and Steel Community, Apr. 18, 1951, 261 U.N.T.S. 140 (ECSC Treaty).
[41] For a comprehensive discussion on the ECSC Treaty see W Diebold, *The Shuman Plan: A Study in Economic Cooperation 1950-1959* (New York, Praeger, 1959).
[42] Joint Declaration of the Ministers signatory to the Treaty establishing the European Coal and Steel Pool (18 April 1951).
[43] A Hirschman, 'The Essential Hirschman', J Adelman (ed) (Princeton, Princeton University Press, 2013) 273.
[44] R. Schuman, *The Schuman Declaration – 9 May 1950*, available at: http://europa.eu/about-eu/basic-information/symbols/europe-day/schuman-declaration/index_en.htm.

"materially impossible". This is similar to the practice of royal intermarriage, where marriage betwen monarchs were often pursued to guarantee peace or to make aggression practically impossible. According to Schuman, such interest should have been economically oriented, and initially directed toward the pooling of coal and steel production as the two crucial elements for industrial and belligerent purposes at the time. The establishment of the European Coal and Steel Community was thus the material implementation of Schumann's declaration as it is particularly evident in its preambles, which mirrors and resembles many passages of the declaration itself.

The ECSC was perceived as a major success already in the immediate years after its entry into force[45]. This led to a significant expansion of its core principles in 1957 with the signing of the Treaties in Rome by the six founding member states (France, Italy, Germany and the Benelux), creating the European Atomic Energy Community (Euratom)[46], and more importantly, the European Economic Community (EEC)[47].

The EEC Treaty gave a decisive and crucial impulse to the European integration process as it represented the natural prosecution and expansion of the very basic ideas carried out by the Coal and Steel Community and the Schuman Declaration.[48] Similarly to the ECSC, the EEC Treaty was based on common rules and institutions, and particularly on two newly established executive branches, the Commission and the Council of Ministers, and two shared institutions with the other communities: the Common Assembly, renamed European Parliamentary Assembly, and the Court of Justice.[49] However, differently from the ECSC, The Treaty of Rome was not merely an international agreement "providing a detailed specifications of objectives and policy instruments", but truly a "framework treaty".[50] This was of critical importance as it allowed the six founding members, on the one hand, to avoid a long process of negotiation over

[45] For a full account of the successes and failures of the activities of the ECSC see M Gilbert, 'Dans l'histoire de la CECA, du rose et du gris', Le Monde. 09.05.1970, available at http://www.cvce.eu/obj/the_history_of_the_ecsc_good_times_and_bad_from_le_monde_9_may_1970-en 54f09b32-1b0c-4060-afb3-5e475dcafda8.html.

[46] Treaty Establishing the European Atomic Energy Community, Mar. 25, 1957, 298 U.N.T.S. 167 (Euratom Treaty).

[47] Treaty Establishing the European Economic Community, Mar. 25, 1957, art. 30, 298 U.N.T.S. 11, (EEC Treaty).

[48] The preamble of the Treaty solemnly declares that the objective of the Treaty is "to lay the foundations of an ever closer union among the peoples of Europe […] to preserve and strengthen peace and liberty, and calling upon the other peoples of Europe who share their ideal to join in their efforts".

[49] Such system changed when the executive authorities presiding over the three different Communities were merged with the Treaty of Brussels in 1965 (The Merger Treaty). More specifically, the three Councils of Ministers (EEC, ECSC and Euratom) were merged to form a single Council and the two Commissions (EEC, Euratom) and the High Authority (ECSC) were merged to form a single Commission.

[50] G Majone, *Regulating Europe* (New York, Routledge, 1996), 71; A Moravcsik, *The Choice for Europe: Social Purpose and State Power from Messina to Maastricht* (Ithaca, NY, Cornell University Press, 1998) 152-157.

a number of elements to be specified, and on the other hand, to adapt its content over time since it essentially allowed changes without Treaty amendment.[51] Furthermore, the EEC Treaty was not limited toward a free trade area for coal and steel, but established a larger community based on the notion of a common market. It encompassed a customs union on the one hand, where tariff barriers and quotas among member states were abolished leading to the free circulation of goods, and a common tariff on imports was imposed on goods from non-member states. On the other hand, three crucial sectors, including agriculture, transportation and competition, became subject to common policies and implementation at the supranational level. These three sectors were critical for the establishment of the common market, and the mere removal of tariffs and quotas was not sufficient given their high national regulation and protection. Thus, negative steps needed to be coupled with positive steps to coordinate and merge six different regulatory systems.[52]

The economic logic behind the EEC was based on the traditional economic assumption that the creation of a customs union is done to ease and intensify trade among its members, so as to generate a positive sum game.[53] More specifically, when border inspections and customs fees are dismantled, the market for goods and services naturally increases in size, and this, in turn, leads to stronger overall economic growth. Furthermore, the existence of a customs union is able to generate also an indirect effect of an efficiency-type nature. In particular, market integration is traditionally able to produce two types of efficiencies, defined as static efficiency and dynamic efficiency.[54] As for the static efficiency, with the establishment of a common market, each member would naturally tend to specialize in producing particular goods and services. By expanding the economy's diversity of products, knowledge and skills, free trade encourages a comparative advantage and the division of labor as early recognized by D. Ricardo.[55] This would then lead to a more efficient allocation of resources and production, mainly because of economy of scale.[56] A common market can also generate a more competitive market per se, which could potentially lead to greater benefits for European citizens, where

[51] J Weiler (n. 2) 2437.
[52] K Dam, 'The European Common Market in Agriculture' 67 *Columbia Law Review* 209 (1967) 209.
[53] Traditional literature on theory of international trade and free trade dates back to the arguments advanced by A Smith and D Ricardo.
[54] D Balaam and M Veseth, *Introduction to International Political Economy*, 4th edition (Upper Saddle River, New Jersey, Prentice Hall, 2008) 244. For a general survey see also R Baldwin and C Wyplosz (n. 3).
[55] D Ricardo, *The Principles of Political Economy and Taxation* (London, J.M. Dent & Sons., 1912).
[56] D Balaam and M Veseth (n. 54) 245.

firms compete with one another without discrimination and unfair restrictions based on nationality. This generates innovation, hence dynamic efficiency.[57]

However, there is also the other side of the coin. As noted by Jacob Viner in his pioneering study of international trade, customs unions may be positive or negative depending on whether they generate a trade-creating effect as outlined in the traditional literature, or trade-diverting effects.[58] A system of free customs necessarily implies discrimination against nations that import from outside the customs union. Therefore, whereas some countries benefit from the custom union in terms of comparative advantages and economic growth, others will be subject to tariffs and barriers, and thus economically harmed, leading to an overall zero sum game. Viner noted that such tariff discrimination might operate as a deterrent instead of as an incentive to the optimum allocation of resources in production.[59] In a system based on pure competition, with constant costs and zero transportation costs so that the price of a commodity would be equal to its production costs, commodities would naturally be imported by the lowest-cost source. Where regional customs unions are present, however, trade creation would be enhanced only in cases where the lowest-cost country of production belongs to the union. On the contrary, if the lowest producing country falls outside the union, trade might be eventually diverted, by such an artificial price system, to the more expensive producing country that belongs to the union, leading to an inefficient allocation of resources in production.[60]

The argument advanced by Viner was empirically tested in the aftermath of the Common Market's establishment, and the first results were somewhat mixed.[61] Some authors suggested that the EEC had a more trade diverting effect, especially versus the U.S. market, rather than a trade creating effect.[62] On this basis, Friedman most notably concluded that "a common market in Europe was more likely to be a foe than a friend of free markets", and that free trade on a multilateral basis would have been preferable to the establishment of a European common

[57] D Balaam and M Veseth (n. 54), 245.

[58] J Viner, *The customs union issue* (New York, Carnegie Endowment for International Peace, 1950). For a recent survey on this argument see P Oslington, 'Contextual History, Practitioner History, and Classic Status: Reading Jacob Viner's The Customs Union Issue' 35 *Journal of the History of Economic Thought* 4 (2013) 491-515.

[59] J. Viner, 'The Most-Favored-Nation Clause' 61 *Journal of Political Economy* 2-17 (1931) 5.

[60] J. Viner (n. 58), 10.

[61] For a large economic survey on this issue see R Baldwin and Venables, 'Regional Economic Integration', in G Grossman and K Rogoff (eds) *Handbook of International Economics: Vol. III* (Amsterdam, North-Holland, 1995) 1625-1628.

[62] L H Janssen, *Free Trade, Protection and Customs Union* (Leiden, H. E. Stenfert Kroese, 1961); and L B Krause, 'European Economic Integration and the United States', American Economic Review, Papers and Proceedings, (1963) 185-96.

market.[63] Other economists did not find clear evidence for a trade-creating nor a trade-diverting effect of the Common Market.[64] Ultimately, other economists found empirical evidence supporting the opposite view, that is that the Common Market had a more trade-creative effect. The main argument in this sense was advanced by Balassa, who argued that the trade-diverting effects of the Common Market were actually lower than previously shown, and potentially compensated for by other factors, such as the expansion of imports associated with the acceleration of economic growth resulting from the EEC's establishment.[65]

Balassa, in particular, having in mind the European integration process, also advanced a well-known unified theory of economic integration.[66] In particular, he distinguished between multiple layers of economic integration according to their degree of political development and economic sovereignty. He thus classified integration on a scale from a simple free trade area to a fully developed economic union. According to this idea, the EEC was clearly more complex than a simple customs union, which is by definition only composed of a tariff free-trade area and a common set of external tariffs[67]. It was a common market but less complex than a fully developed economic union as a number of elements were still lacking. Among many, one element very minimally defined under the Treaty, but which is key for our present research, is integration of monetary and economic policies.[68]

The six Member States clearly understood the critical importance of economic and monetary policies for their national economies as well as for the European integration process. The lack of economic and monetary integration was indeed a political choice. A full economic union was not possible at the time because it required a higher degree of integration than simply the creation of a common market. According to many authors, the six Member States were not ready or willing to renounce part of their autonomy in either fiscal nor monetary matters.[69] This political unwillingness also had a strong economic rationale. With regards to fiscal and economic policies, any transfer of sovereignty in these fields would plainly conflict with the

[63] M Friedman (n. 23) 7.
[64] A Lamfalussy, 'Intra-European Trade, and the Competitive Position of the E.E.C' *Transactions of The Manchester Statistical Society*, (Manchester, Manchester University Press, 1963).
[65] B Balassa, 'Trade Creation and Trade Diversion in the European Common Market' 77 The Economic Journal (1967) 1-21. For a following appraisal see B Balassa, 'Trade Creation and Trade Diversion in the European Common Market: An Appraisal of the Evidence,' 42 *Manchester School of Economic & Social Studies* 2 (1974) 93-135.
[66] B Balassa, 'Towards a theory of economic integration' 1 *Kyklos* (1961) 1–17.
[67] See A Dictionary of Economics, Oxford University Press (2009) (4 ed.).
[68] A Szász, 'The Monetary Union Debate' 7 *Common Market Law Review* 4 (1970) 407.
[69] Ibid 408.

Keynesian economic thinking, which was mainstream in many European countries, and which stressed the need for national control of macroeconomic policy instruments, especially in the event of an economic downturn.[70] With regards to monetary policies, Member States observed that exchange rates were already stabilized under the rules of the international monetary system and the European Payment Union, and, therefore, there was no need, at the time, for a specific arrangement at the Community level.[71] As a result, Member States decided not to specify *ex ante* all the details related to economic and monetary matters. In this context, they embraced even more strongly the above-mentioned concept of a "framework treaty".

The Treaty emphatically affirmed, as one of the goals of the Treaty, the progressive approximation of economic policies of Member States, and provided for a list of four major economic matters where such approximation needed to be achieved: (i) equilibrium of balance of payments (ii) currency stability, (iii) a high level of employment and (iv) price stability.[72] Furthermore, the Treaty affirmed in a number of mirroring provisions, that policies relating to economic trends (equilibrium in the balance of payments and level of employment) and exchange rates, "should be treated as a matter of common interest".[73] Nevertheless, there were no specific obligations under the Treaty, nor any form of sanctions or economic benchmarks for enforcement or compliance. Certainly, all these provisions concerning the coordination and supervision of monetary and economic policies were much more advanced than similar arrangements under the EFTA Treaty.[74] However, they required, in large part, an extensive *ex post* implementation by the Council as the official responsible institution.[75]

All the provisions related to monetary and economic trends were not only very general, but also very difficult to enforce. Conjunctural policies, for instance, were defined as a matter of

---

[70] D Hodson, 'Policy-Making under Economic and Monetary Union, Crisis, Change, and Continuity' in H Wallace, M Pollack, A Young (eds) *Policy-making in the European Union* (Oxford, Oxford University Press, 2015) 168.

[71] R Lastra, and J Louis, 'European Economic and Monetary Union: History, Trends, and Prospects - Yearbook of European Law' 136 Queen Mary School of Law Legal Studies Research (2013) 7, available at SSRN: https://ssrn.com/abstract=2244764.

[72] Article 104 provides that "each Member State shall pursue the economic policy necessary to ensure the equilibrium of its overall balance of payments and to maintain confidence in its currency, while ensuring a high level of employment and the stability of the level of prices."

[73] See Article 104 and 106 of the EEC Treaty.

[74] For this argument see H Audretsch, 'The E.E.C. and E.F.T.A. Two Solutions Regarding Balance of Payments Difficulties' 4 *Common Market Law Review* 4 (1967) 420. The European Free Trade Association Convention (EFTA Convention) was signed at Stockholm on January 4 1960 by seven European countries (Austria, Denmark, Norway, Portugal, Sweden, the Swiss Confederation and the United Kingdom).

[75] The Council being the official responsible institution according to article 145 of the EEC Treaty: "the Council shall ensure the co-ordination of the general economic policies of the Member States, and dispose of a power of decision."

common concern and consultation, and subject to a specific adjustment procedure empowering the Council to take the appropriate measures.[76] However, by requiring a unanimous decision, thus including also the country under scrutiny, the Treaty significantly weakened any possible action and deterrent arising from this procedure. The rules concerning the balance of payments[77] were slightly more precise and developed.[78] In fact, the equilibrium in the balance of payments was a key issue for the common market. A common market would enhance trade among member states as explained above, but this might also imply larger regional disequilibria. This means that some States would be able to gain a larger trade surplus and some states would suffer from a larger deficit.

Traditionally, to fix the country's balance of payments in fundamental disequilibrium, that country could change its exchange rate, i.e to depreciate or devaluate its currency, either by directly buying foreign currency or by decreasing its nominal interest rate. The traditional view, assuming that price of exports and imports are fully elastic[79], is that exports will be stimulated and imports will consequently decrease. According to this view, the overall tendency restores the equilibrium of the balance of payments. However, within the context of a common market, any devaluation is crucial for it might be carried out with the sole aim of extracting competitive advantages. The drafters therefore sought to avoid such opportunistic behaviors that could potentially lead to a vicious cycle of devaluation that would ultimately threaten the same existence of the common market.

---

[76] Article 103 of the EEC Treaty.

[77] A balance of payment is a statistical record of all the international monetary transactions undertaken by residents of one nation with those of other nations in a given year. In other words, the inflows and outflows of money from one nations to other nations. The balance of payment is made by two components: the current account and the capital and financial account. The former represents on one side (i) the money received for exports of goods and services abroad (ii) profit and interests received form foreign assets owned, (iii) unilateral transfer of money from other persons or nations; and on the other side (i) the money paid for import of goods and services abroad, (ii) profit and interest paid to the foreign owners of the country's assets (iii) unilateral transfer to foreign persons or nations. The latter represents on one side the money received from foreign buyers for sale of the country's bonds, stocks, real estate, patents and other assets; and on the other side, the money paid to foreign sellers for purchase of foreign bonds, stocks, real estate, patents, or other assets. R Mundell, Balance of Payments, in D L Sills (ed.), *International Encyclopedia of the Social Sciences*, Vol. 8. (USA, Crowell Collier and Macmillan, 1968) 1-11.

[78] EEC Treaty Title II Economic Policy - Chapter 2 - Balance of payments.

[79] This is the so-called Marshall–Lerner condition, which represents a fundamental doctrine of international economics. According to this theory, currency devaluation generates a positive impact on trade balance only if the country's imports and exports are elastic to prices. In other words, the revenue arising out of exports will increase only if the quantity demanded increases proportionately more than the decrease in price. Similarly, total import expenditure will decrease only if the quantity demanded decreases proportionately more than the increase in price. Empirical studies show, however, that currency devaluation, even in the long term, is not always an effective solution for trade balance. For a survey M Bahmani, H Harvey, S W Hegerty, 'Empirical tests of the Marshall-Lerner condition: a literature review', 40 *Journal of Economic Studies* 3 (2013) 411-443.

For this reason, they elaborated three procedure to tackle the issue: a coordination procedure, an authorization to the right to safeguard, and a mechanism of financial assistance. Article 105 affirmed that Member States, with particular reference to their central banks, shall coordinate their fiscal and monetary policies. Thus, a Monetary Committee was set up under the Treaty with two basic tasks: (i) to review the monetary and financial situation of Member States and of the Community, as well as the general payment system of Member States and (ii) to formulate opinions.[80] In case, however, such coordination failed and any Member State decided to carry out its currency devaluation so as to seriously distort the conditions of competition, the Commission may authorize the other Member States the right to safeguard. In other words, it may authorize the other member states to take for a limited period the necessary measures, such as quantitative restriction, in order to deal with the consequences of such alteration.[81] Ultimately, Article 108 provides for a system of mutual assistance in order to avoid the possibility of a Member State being in such difficulty with regard to its overall balance of payments or currency. The Commission may, if such difficulties might prejudice the functioning of the Common Market or the progressive establishment of the common commercial policy, indicate the necessary measures to adopt. If these measures are not sufficient, however, the Council, on the basis of a recommendation of the Commission, could grant mutual assistance under multiple forms and mechanisms, such as those of the EPU and the IMF, or complementary forms as the common market develops. [82]

As explained above, all these rules concerning exchange rates and balance of payments were limited in scope also because the international monetary system and the payment union already stabilized, by the late 50s, the exchange rates among European countries. For these reasons, and parallel to the entry into force of the Economic Community, the EPU was replaced by a

[80] Article 105 of the EEC Treaty.

[81] Article 107 of the EEC Treaty. More specifically, according to article 109 of the EEC Treaty "the measures of safeguard has shall cause the least possible disturbance in the functioning of the Common Market and shall not exceed the minimum strictly necessary to remedy the sudden difficulties which have arisen. The Commission and the other Member States shall be informed of such measures of safeguard not later than at the time of their entry into force. The Commission may recommend to the Council mutual assistance under the terms of Article 108. 3. On the basis of an opinion of the Commission and after consulting the Monetary Committee, the Council, acting by means of a qualified majority vote, may decide that the State concerned shall amend, suspend or abolish the measures of safeguard referred to above."

[82] "(a) concerted action in regard to any other international organisations to which Member States may have recourse; (b) any measures necessary to avoid diversions of commercial traffic where the State in difficulties maintains or re-establishes quantitative restrictions with regard to third countries; or (c) the granting of limited credits by other Member States, subject to the agreement of the latter. Furthermore, during the transitional period, mutual assistance may also take the form of special reductions in customs duties or enlargements of quotas, for the purpose of facilitating the increase of imports from the State in difficulties, subject to the agreement of the States by which such measures would have to be taken." Article 108 of the EEC Treaty.

more market-oriented mechanism, the European Monetary Agreement (EMA).[83] The EMA was a new system to work in coordination with the IMF, comprising a European fund and a multilateral settlement of payment. The former would grant repayable credits to help member states "to withstand temporary overall balance of payments difficulties" that would "[endanger] the maintainence of Intra-European trade"[84]. The latter would "facilitate the settlement of transactions in the currencies of and between the monetary areas of the Member Countries" with short-term loans and monthly settlements.[85] Similarly to the previous Payment Union, the EMA legally operated within the framework of the OEEC, under the authority of its Council, as well as the Bank for International Settlements (BIS) as financial agent. The main difference between the EMA and the EPU was that the former relied more on market mechanism than the latter. Free floating of exchange rates was again restored, although within marginal and limited exchange rate guarantees, and compensatory credits were not automatically allowed, but only granted in case of temporary balance of payments difficulties subject to rigid economic policy conditions.[86] In other words, the EMA moved from a regional approach to monetary coordination towards a multilateral and international approach in connection with the growing importance of the IMF functions and roles.

We affirmed, at the beginning of the analysis, that the EPU and the EEC are the predecessors of today's Economic and Monetary Union. After this overview, it is clear why these instruments are particularly important for the EMU's future development. Both instruments early addressed and defined the two dimensions of today's economic integration: the monetary side and the common market side. In the early stages of integration, these two dimensions ran in parallel through these intertwined instruments. As we have explained, the EPU was a monetary instrument to enhance trade liberalization, and in the same way the EEC included some provisions toward integration of monetary and economic policies. In other words, the

[83] The EMA was signed on 5 August 1955 (but entered into force upon the condition of the termination of the EPU) by 16 European countries, basically all the signatory countries of the previous EPU except Iceland, Norway and the Commandant of the Anglo-American Zone of the free territory of Trieste, whose territory was given as civil administration to Italy. Accord monétaire européen et protocoles additionnels (5 août 1955-27 juin 1958) (EMA agreement).

[84] Article 2 of the EMA agreement.

[85] Article 8 of the EMA agreement. For a more detailed analysis of the EMA operation see J Furth, 'The European Monetary Agreement', *Board of Governors of the Federal Reserve System Division of International Finance, Review of Foreign Developments* (September 6 1955).

[86] See on this point H Ungerer (n. 3), 29.

instruments complemented each other, for as early recognized by Friedman, "domestic and international monetary and trade arrangements are part of one whole".[87]

Despite this link, however, they pursued a different economic approach.[88] With the EEC Treaty, European states adopted a regional approach to integration of the goods markets, whereas with the EPU, European states adopted a more international approach to monetary integration. This is mainly because they had different underlying objectives. The EEC was predominantly a political instrument with a deep economic rationale. The creation of the common market was not an end in itself but was a pre-requisite for a larger political goal. In this sense, for instance, the EEC was conceptually different than its counterpart, the EFTA, which was mainly economically driven.[89] On the contrary, the EPU was mainly drafted and conceived in purely economic terms.

If we narrow the scope of our analysis to the rules concerning coordination of economic and monetary policies, we see that these different objectives had significant consequences for the respective legal frameworks. The EEC Treaty pursued these policies as a function of the common market and in accordance with a Keynesian rationale, which strongly relied on the national control of macroeconomic policy instruments. Because of this economic philosophy and its underlying political objectives, all the rules concerning coordination of economic and monetary policies under the EEC were essentially general principles, with no binding obligations, institutions for supervision, nor economic benchmarks for possible compliance and enforcement. In other words, as will develop in the second chapter, it was a system of soft monetary and economic policy coordination. On the other hand, the EPU addressed the coordination of monetary (and to a minor extent economic) policies with the main purpose of restoring the convertibility of European currency within the framework of the Bretton Woods system. These monetary reasonings largely prevailed over political interests, and this in turn led the drafters to rely on self-enforcing mechanisms based on high incentives and binding rules.

[87] M Friedman (n. 20) 252.

[88] For this argument see I Maes, 'The ascent of the European Commission as an actor in the monetary integration process in the 1960s' 53 *Scottish Journal of Political Economy* 2 (2006) 222-241.

[89] According to some authors, this is proven, for instance, by the fact that the EEC created one single free market with one common external tariff towards non-Members, while EFTA, in line with its exclusively free trade approach, left its members free to set up tariffs toward third parties. H Audretsch (n. 74) 420.

2. THE INITIAL PROPOSALS FOR A MONETARY AND ECONOMIC UNION

After the entry into force of the Treaty of Rome and for most of the 60s, European countries experienced a golden age of economic growth, with a stable inflation and an expansion of trade within the common market.[90] However, as mentioned before, economic integration was far from being fully completed, as two main issues remained unresolved. On the one hand, the internal market was still largely fragmented, mainly due to the persistence of non-tariff barriers in intra-EU trade.[91] On the other hand, integration of economic trends and monetary policies was missing, as a number of implementing measures were required.

This last issue, in particular, could have seriously affected the success of the common market. As we have previously discussed, in fact, with the establishment of a common market, the stability of price and exchange rates, as well as the stability of economic trends, became functional conditions for its operation. In such context, the devaluation of a currency could be used to restore the fundamental equilibrium of a balance of payments, but also to extract competitive advantages. Monetary stability was additionally crucial for both firms and consumers within the Common Market. In a context of currency instability, firms would face difficulties in terms of long-term business planning and in terms of fair competition.[92] Similarly, consumers would not be able to buy products at equal prices and opportunities within the single market. This situation would also, in turn, have serious consequences on free capital mobility, which again could hamper competition among firms and equal opportunities among citizens as a vicious cycle.[93] Ultimately, monetary stability was also vital for the common price system of the common agricultural policy (CAP). The newly introduced CAP was based on a system of price support, composed by a single target price and a single intervention price, in order to realize the objectives under Article 39 of the EEC Treaty. For purposes of uniformity, the common prices were denominated in a common unit of account, and national currencies

---

[90] For a survey see G Toniolo, 'Europe's Golden Age, 1950-1973: Speculations from a Long-Run Perspective', 51 *The Economic History Review* 2 (1998) 252-267.

[91] The Commission, in a wide research project, identified the persistency of non-tariff barriers as the main cause for market fragmentation. See EC Commission, Research on the Cost of Non-Europe. Office for Official Publications of the European Communities (Luxembourg, 1988). However, some authors, most notably, presented an alternative explanation by arguing that consumers might have exhibited a bias towards domestic goods. See K Head and T Mayer, 'Non-Europe: The Magnitude and Causes of Market Fragmentation in the EU' 136 *Review of World Economics* 2 (2000) 284-314.

[92] For instance, If company of State A sells cars to State B and the currency of State A greatly appreciate (10 %) in relation to the currency of State B it is also easier for corporation to realisticly plan their budget.

[93] See Commission Communication, the impact of currency fluctuations on the internal market, Brussels, 31.10.1995 COM (9S) 503 final.

were fixed to such unit.[94] As a result, any currency fluctuation could severely conflict with and eventually jeopardize this fixed exchange system and, as a result, the support price-system itself.[95]

The Commission, in order to immediately address this complex issue, in the aftermath of the introduction of the Treaty, periodically analyzed the monetary and economic situation of the six Member States in cooperation with the respective national institutions.[96] However, this procedure was informal and did not provide any concrete follow up. Some critical events, such as the French economic imbalances in 1958, raised concerns over the need for a more stable and developed coordination mechanism between the economies of the Member States.[97]

For this reason, an initial phase of Treaty implementation began in the early 60s, with the first related to the consultation procedure under Article 103. The Council, based on the Commission's proposal, decided to establish a Short-Term Economic Policy Committee in order to provide recommendations on the coordination of conjunctural policies of the Member States[98]. Under this proposal, Member States were required to inform and discuss within the committee any broad guidelines of economic policy that could have repercussions over the conjunctural situation of the other Member States.[99] The discussion was, however, limited to short-term policies, and similarly to the monetary counterpart, this committee had no binding power, but only a consultive status. In parallel, the Council also decided to implement Article 67 of the EEC Treaty on free movement of capital by enacting the First Capital Directive and a Second Capital Directive (which amended the first one).[100] These first two directives were limited as they only covered financial-related movement of capital, such as direct investments, short or medium-term lending for commercial transactions, and purchases of securities traded on the stock exchange.

---

[94] J Usher, *EC Agricultural Law*, 2nd edn (Oxford, Oxford University Press, 2001) 111-130.

[95] For a more detailed analysis on this see also G Braakman, 'Monetary Evolutions and the Common Agricultural Policy' 15 *Common Market Law Review* 2 (1978) 157–186.

[96] G Weil (Ed), *A Handbook on the European Economic Community* (New York, Praeger, 1965) 163.

[97] To correct such imbalances, a European Reserve Fund was proposed, but not implemented, as French President De Gaulle opted for an internal solution with the adoption of rigid economic policies. See I Maes, (n. 88) 13.

[98] EEC Council Decision of 9 March 1960 on Coordination of the Conjunctural Policies of the Member States, OJ 9.5.1960 L31/764.

[99] Ibid Article 2.

[100] First Capital Directive Council OJ 12.7.60 L921/60; Second Capital Directive Council Directive OJ 22.1.63 L62/63.

After these two rather moderate attempts, in 1962 the Commission launched the Commission's Action Programmme for the second stage of the EEC (also known as the Marjolin Memorandum).[101] With the Marjolin Memorandum, the Commission drew "a guiding line for its own action over the coming years and a pattern for the continued growth of the Community".[102] Among the many sectors involved, the Commission largely extended its interpretation of monetary and economic policies under the EEC Treaty, and for the first time launched the discussion about creating a common currency. The Commission prompted several measures in the field of economic and monetary cooperation, largely inspired by a previous joint study carried out by the national monetary authorities and the Commission Directorate-General for Monetary and Financial Affairs.[103] With reference to the economic policies, the Commission distinguished between policy concerning economic development, and structural policy.[104] Within the notion of economic development, a further distinction was made between short-term and long-term objectives. In both cases, the Commission aimed to gradually create, through annual surveys, forecasts, programmes and long-term plans, a single coordinated short-term policy into which national policies would merge and accordingly adjust to, and a consolidated long-term Community program.[105] With reference to the structural policies, the Commission maintained the need to reduce the differences between various European regions, mainly through appropriate regional policies.[106] In connection with monetary policies, the Commission first recognized their vital importance to the Common Market since the "Economic union will involve fixed rates of exchange between Member States with very narrow limits on the variations allowed. Any major modification would so much upset the trade of countries no longer protected by any customs barrier."[107] The Commission acknowledged that the proposed merging of economic policies would support the monetary adjustments, but also that specific actions in the monetary field were still required.

As a result, it proposed to strengthen the monetary cooperation with the institutionalization of a Council of Governors of Central Banks and with the establishment of a procedure of prior consultation before any major decision concerning monetary policies and before any recourse

[101] Memorandum of the Commission on the Action Programme of the Community for the Second Stage. (Marjolin Memorandum) COM (62) 300 final, 24 October 1962.
[102] Ibid 9.
[103] Monetary policy instruments in the countries of the EEC, published by the EC Official Publications Office under No 8051/1/VII/1962/5.
[104] Ibid 50.
[105] Ibid 53-55.
[106] Ibid 58-62.
[107] Ibid 63.

to the facilities offered by the International Monetary Fund. Additionally, the Commission maintained the need to harmonize the policies of the Central Banks on reserve currencies, and to adopt a common position regarding the international monetary system and its possible reforms[108]. The ultimate objective of the Commission was to evolve the Community into a full economic union with irrevocably fixed exchange rates between European currencies and the possible creation of a single currency. The Commission clarified this position with a second memorandum to the Council entitled "Initiative 1964". The Commission, in particular, affirmed that, "The aim of the Community is not merely to expand trade between the Member States, it implies merging the six markets in a single internal market and the establishment of an economic union." For this reason, the Commission concluded that integration of monetary policy was "indispensable", and that it would have submitted "without delay to the Council proposals for the progressive introduction of a monetary union".[109]

The Marjolin Memorandum was vital for the development of the monetary union, as it was only with its launch in 1962 that "a single market and a single money were linked and that a serious discussion on European monetary integration began."[110] Its novelty and relevance is also given by the fact that it was the first document to lay down many elements for the EMU's future development. For instance, it was the first to address both short-term policies and medium-term objectives, the first to highlight the importance of structural policies for a fully harmonized economic union, and to combine coordination in monetary and economic policies. Furthermore, as pointed out by other authors, this memorandum had a profound impact because it "contributed to establishing the Commission as an actor in the monetary area".[111]

The concrete measures stemming from the memorandum were, however, modest. The Council, through a series of parallel decisions, adopted only a small number of its recommendations, and added limited innovations to the previous practices of coordination, especially in terms of economic policies. In this sector, the Council created a Medium-Term Economic Policy Committee and a Budgetary Policy Committee.[112] The former committee, after gathering the

[108] Ibid 63.
[109] Commission Communication, Brussels, 30.9.1964 COM (64)400 (1964 Initiative). A third proposal was the "Dichgans Report" on Monetary Union (Rapport sur l'activité de la Communauté dans le domaine de la politique monétaire et la création d'une union monétaire européenne) - EP, 1966-67 Doc.138, Par. 3, 'L'Union Monétaire'.
[110] How central banks meet the challenge of low inflation Marjolin lecture delivered by M Draghi, speech at the SUERF conference (Frankfurt, 4 February 2016).
[111] I Maes (n. 88) 23.
[112] Council Decision of 15 April 1964 establishing a Medium-term Economic Policy Committee OJ 22.4.1964 L64/1029; Council Decision of 8 May 1964 on Cooperation between the Competent Government Departments of Member States in the Field of Budgetary Policy, OJ 21.5.1964 L77/1205.

relevant information, was in charge of drafting a five-year program of broad economic policy guidelines of the Member States for coordination purposes. The program had to be eventually adopted by the Council as well as by the governments of the Member States, and carried out under the supervision of the Committee. The latter committee would instead analyze and confront the broad budgetary policy guidelines of the Member States in coordination with the Short-Term Policy Committee and the Monetary Committee. Most of these procedures were rather ineffective as they resulted in a mere exchange of information within the Committees about economic policies already adopted at the national level.[113] In terms of monetary policies, the Council was more effective, as it institutionalized the Council of Governors of Central Banks with the purpose of establishing a seat for a stable exchange of information and a procedure for prior consultation concerning major monetary decisions of the Central Banks.[114] The Council, as the memorandum suggested, was also in charge of discussing any recourse by one of the Member States to the facilities offered by international monetary arrangements (the IMF) and for any participation by one of the Member States in the monetary assistance of a third country. Overall, the Council did not, however, embrace the more advanced approach for the development of a full monetary union and for a possible single currency. The idea encountered heavy resistance, both internally and externally (from central banks), as it would have resulted in an excessive transfer of sovereignty to the Community.[115]

After this initial period of implementation and by the end of the 60s, the economic community substantially accomplished major goals with the removal of all quotas and monetary tariffs among Member States. At the same time, significant tensions started to build in the international monetary system with the increasing deficit of the U.S. balance of payments. As a result, many European states experienced a sharp rise of inflation and currency instability.[116] This financial tension put the Bretton Woods system under pressure, and this began to hamper the success of the Community economic policy, especially the CAP. This new international context suddenly changed the perception of the need for futher integration in the monetary and economic fields.

[113] J Mortensen, *Federalism vs. Co-ordination: Macroeconomic Policy in the European Community* (Brussels, Centre for European Policy Studies, 1990) 20.

[114] Council Decision of 8 May 1964 on Co-operation between the Central Banks of the Member States of the EEC, OJ 21.5.1964 L77/1206; Council Decision of 8 May 1964 on Co-operation between Member States in the Field of International Monetary Relations, OJ 21.51964 L77/1207. See also the Declaration of 8 May 1964 of the representatives of the Governments of the Member States of the European Economic Community, meeting within the Council, on the prior consultations between Member States in the event of changes in the exchange-rate parities of their currencies, OJ 22.5.1964 L78/1226.

[115] For a more detailed political reconstruction, see K. Dyson and K. Featherstone (n. 3) 100 and ff.

[116] For an overview see Organisation for Economic-Cooperation and Development, Main Economic Indicators: Historical Statistics, 1959-1969 (Paris: OECD, 1970).

The implementation of the Treaty became seen as necessary for the survival of the same common market.

For this reason, the Commission, on 12 February 1969, through its vice-president R. Barre (responsable for economic and financial affairs) presented to the Council a memorandum on "the coordination of economic policies and on monetary cooperation within the Community".[117] This so-called First Barre Plan was designed to enhance coordination of monetary and economic policies as a function of the common market. The proposal preliminarily recognized that the common market had increased Member States' mutual interdependence, specifically in terms of balance of payment. As a result, currency-related national measures (such as devaluation) could no longer be carried out without negatively affecting the economies of the European partners.[118] The proposals insisted on the "prime importance" of the coordination of short-term policies and on the convergence of medium-term policy objectives as generally required under Article 105 of the EEC Treaty.[119] In other words, each country had to take into account, when carrying out short-term policies and setting up own medium-term objectives (i.e. production and employment growth rates, prices, current accounts and the equilibrium of the overall balance of payments), their own potential and that of its partners to ensure no excessive disparities or incompatibilities existed. To complete the picture, the Commission proposed the implementation of article 108 of the EEC Treaty with the establishment of a short-term monetary support and a medium-term financial assistance.[120]

This proposal was clearly much more modest and pragmatic than the previous Marjolin Memorandum,[121] but, at the same time, it was the "first attempt to formulate a systemic, coherent approach to monetary integration".[122] In connection with economic policies, the Commission rejected the Marjolin idea of a solution based on a single short-term policy and a consolidated long-term Community plan, citing the lack of the necessary political and economic conditions. At the same time, it also rejected the present coordination procedure for the existence of "gaps and inconsistencies" in the exchange of information within the Committees.[123] It advocated instead for a more consensus-based approach grounded on a closer

[117] EEC Commission, memorandum to the Council on the co-ordination of economic policies and monetary co-operation within the Community. COM (69) 150 final, (12 February 1969) (First Barre Plan).
[118] Ibid 5.
[119] Ibid 9-10.
[120] Ibid 11-12.
[121] I Maes (n. 88) 20.
[122] D Kruse, *Monetary Integration in Western Europe* (London, Butterworths, 1980) 23.
[123] First Barre Report (n. 117) 6.

system of coordination and consultation among Member States. More explicitly, to improve the regular exchange of information concerning the medium-term objectives, it proposed an annual review of the conditions governing their achievement. In connection with short-term policies, it suggested that national budgets (limited to general aspects, such as the trend of the large expenditure and revenue items, and the impact of this on economic growth and stability) be discussed not only in the committee but also at a meeting between economic ministers.[124] Additionally, it recommended the formalization of a system, already set up on an experimental basis, of early warning indicators to detect possible deviations from the basic short-term policies.[125]

The Barre Report went through intense discussion within the Council.[126] This resulted in the approval of a more advanced system of prior consultation within the committees to address "important short-term economic policy measures" or decisions which substantially affect "the economies of the other Member States", their "internal or external equilibrium", or which "might cause a substantial divergence between the trend of country's economy and the medium-term economic objectives determined jointly".[127] However, the Council did not specifically mentioned in its decision any reference to the sharing of information concerning national budgets or to a system of early warning indicators in connection with disequilibria in the balance of payments.[128] The Council additionally approved a resolution to establish the community system for short-term monetary support while the six Central Banks implemented it by providing a certain amount of funds according to a particular quota system and limited to a fixed ceiling.[129]

With the increased financial tensions in the second part of the year,[130] at the meeting on 1-2 December 1969, the European Heads of State or Government ultimately acknowledged that an

---

[124] First Barre Report (n. 117) 10.
[125] First Barre Report (n. 117) 11.
[126] For an overview of the debate surrounding the Barre report see F. Snyder, 'EMU Revisited Are we Making a Constitution? What Constitution are we Making?' EUI Working Paper Law No. 98/6 (1998) 13-14 available at http://cadmus.eui.eu/bitstream/id/942/BS-EMUWOR-FS.pdf/.
[127] Council Decision of 17 July 1969 on co-ordination of the short-term economic policies of the Member States (69/227/EEC) - OJ L 183, 25.7.1969. See also Council Decision of 16 February 1970 concerning the appropriate procedures for the prior consultations provided for in the Council Decision of 17 July 1969 (Member States' short-term economic policies).
[128] For a comprehensive critical analysis of the Report see A Rugina, 'Critical analysis of the Barre-Plan' 8 Intereconomics 1 (1978) 17-20.
[129] E Apel, *European Monetary Integration 1958 – 2000* (London and New York, Routledge, 2005) 31. See the Agreement of 9 February 1970 among the EEC central banks on the establishment of a short-term monetary support mechanism.
[130] Ibid 31-32.

even more advanced monetary coordination was required, in light of the new challenges.[131] The European Council proposed, for the first time at the highest Community level, the "gradual realization of monetary union and a common economic policy". The Commission laid down the technical details in its "Second Barre Plan" on 4 March 1970. The new report, which followed the guidelines of the former, expressly required that the "convergence of monetary policies" had to be coupled with "concerted action in the field of economic policy".[132] More importantly, the Plan proposed a three-stage approach in order to achieve in ten years the realization of a full economic and monetary union, the last stage being the elimination of margins of fluctuation of the member countries' currency as well as the irrevocable fixing of parities. Based on this memorandum, the Council formally requested that a committee of experts led by Pierre Werner, the Luxembourg Prime Minister and Minister for Finance, study the implementation of this three-stage timeline.[133]

The resulting document was the "Werner Report", which defined the possible framework and the progressive steps to achieve a fully developed economic and monetary union.[134] The Second Barre memorandum represented its starting point, as the Werner Report adopted the same three-step approach within a transitional period of ten years in order for the States to surrender some of their sovereignty, and for the community to acquire the corresponding powers.[135] More specifically, with regards to economic policies, the report highlighted the need, in connection with the first stage, for a deeper exchange of information based on at least three annual surveys of the economic situation in the Community. On the basis of these progressive reports, national economic budgets would be coordinated and drawn up to be compatible with one another.[136] As the transition moved from the first to the following stages, it recommended a revision of the

[131] "Recent monetary developments and the repercussions and consequences of these for the common agricultural policy in particular have proved that any common policy is likely to become precarious at a moments notice until such time as the Member States take a decisive step towards monetary co-operation and thealignment of financial policies." The "Summit Conference" at the Hague Statements made by the Heads of State or Government on 2 December 1969, OJ C 136, 11.11.1970.

[132] EEC Commission memorandum to the Council on the preparation of a plan for the phased establishment of an economic and monetary union. (Second Barre Plan) COM (70) 300 final, 4.03.1970.

[133] Decision of the Council of 6 march 1970 regarding the procedure in the matter of economic and monetary cooperation, OJ L 59, 14.3.1970.

[134] P Werner, (1970) Report to the Council and the Commission on the realization by stages of Economic and Monetary Union in the Community (Werner Report) OJ C 136, 11.11.1970.

[135] Ibid 14.

[136] "The first survey in the spring will provide an opportunity for drawing up a balance sheet for economic policy in the previous year and possibly for adapting that relating to the current year to the requirements of economic development […] The second survey, a little before the middle of the year will make an initial selection of the guidelines for the policy to be implemented in the following year and will review the policy to be followed during the current year […] Finally, a survey carried out in the autumn will make it possible to lay down in greater detail the guidelines arrived at in the course of the year". Ibid 16.

Treaty in order to create a proper "centre of decision for economic policy", that would be accountable toward a European Parliament. One of the primary duties of such centre of decision would be "to influence the national budgets, especially as regards the level and the direction of the balances and the methods for financing the deficits or utilizing the surpluses".[137]

With regards to monetary policies, the report advocated for, in the first stage, the progressive narrowing of exchange rate fluctuations and the establishment of a European Fund to provide monetary cooperation and support for currency adjustments. As the transition moved to the following stages, the fund would be replaced by a newly created Community system for central banks. This institution would be modelled on "organisms of the type of the Federal Reserve System". It would be able to take decisions in the matter of internal monetary policy as "regards liquidity, interest rates, and the granting of loans to public and private sectors"; whereas, in the field of external monetary policy, it would intervene "in the foreign exchange market and the management of the monetary reserves of the Community".[138] Additionally, in the final stage, the Report maintained the full liberalization of the movements of capital, the irrevocable fixing of exchange rates, and finally the adoption of a single currency, as the natural progression of the previous stages.[139]

The Werner Report was thus the first Community report to provide a complete framework for the establishment of a European economic and monetary union. The Report did not elaborate on the concrete institutional structure of the EMU or the difference between a single currency and a system of irrevocably fixed exchange rates as recognized by similar future reports,[140] but it presented many novel and significant elements, which still have a profound influence on the ongoing debate. First, this report significantly increased the concept of economic coordination with respect to the previous plan, as it introduced a third level of integration in the form of supervision of budgetary policy of the Member States, a field which will eventually be a major source of conflict.[141] Second, the Werner Report was crucial in establishing the future "practice" of treating economic coordination and monetary solidarity as inseparable from each other. In this regard, it tried to reach a delicate balance between the two schools of thinking

[137] Ibid 13.
[138] Ibid 13.
[139] Ibid 26.
[140] G Baer and T Padoa-Schioppa, 'The Werner Report revisited' in Committee for the Study of Economic and Monetary Union EC Publications Office 1989 (Delors Report) 54.
[141] H. Siekmann, 'Monetary institutions and monetary policies', in (ed.) (n. 3) 357.

known as the 'economists' and the 'monetarists'.[142] More explicitly, countries, like Germany and the Netherlands, who saw coordination of economic policy as the priority, supported the economists approach. According to this approach, the full convergence of economic fundamentals was essentially a pre-requisite for the monetary union, with the purpose of decreasing the recourse to monetary solidarity and thus inflationary tendencies.[143] Countries like France and Belgium instead supported the monetary approach in particular, who saw monetary integration and solidarity as the priority. They agreed with the economist view on the need for a coordination of economic policy but also believed that full convergence of the economies was not a pre-condition, but rather an eventual consequence of the monetary union. In other words, the fixing of exchange rates would eventually complete the degree of economic convergence resulting from the common market and the absence of important economic disequilibria.[144] Indeed, the need to maintain fixed exchange rates would naturally lead the member states to make their own domestic economic policies as compatible as possible with the policies at the Community level.

These two views were certainly the result of a different history, culture and economic thinking. France, for instance, had a long-standing tradition of central state and economic planning. Within the central state, the mainstream school of economic thought was Keynesian-oriented. According to this view, the objective of economic policy was mainly to stimulate economic growth, even at the cost of a higher rate of inflation.[145] As a result, in France, economic growth was widely considered more important than monetary stability and, in line with the central-state tradition, the transfer of any sovereignty to the Community was negatively perceived in this field. In Germany, on the other hand, the post-war economic and political system was based on "decentralization" and the notion of "social market economy". The concept of the social market economy was based, as the name suggests, on a mix of liberalist and socialist ideals. Among many key issues, a vital element of the social market economy was a secure and stable legal framework for monetary stability, as inflation could damage both the price mechanism, its liberalist component, and the redistribution of income, its social component.[146] As a result, in Germany, priority was given to the fight against inflation and to a solution based on federal

[142] For a more detailed analysis see I Maes, 'On the origins of the Franco-German EMU Controversies', 17 *European Journal of Law and Economics* 1 (2007) 21-39.
[143] E Apel (n. 129) 32.
[144] R Lastra and J Louis (n. 71) 64.
[145] I Maes (n. 142) 2-5.
[146] I Maes (n. 142) 5-8.

structure so that a partial transfer of sovereignty over the Community was positively perceived in this field.

The Werner Report is widely mentioned as adopting a "parallel approach" to these two elements. The economist and monetarist approaches were in fact "mutually exclusive", meaning that "pieces of one could not be combined with parts of the others because the elements of each strategies formed interconnected, indeed indivisible, wholes".[147] As a result, the Werner Committee could only agree on pursuing both strategies in parallel, so that any progress in economic policy coordination would go hand in hand with any progress in exchange rate coordination over the different stages. In other words, parallelism was not a combination of the two views but was more a "temporary expedient" to reach a compromise formula.[148] It became a key strategy to reach an agreement for the progressive development of the union but, at the same time, was also one of the Achille's heel of the project from its beginning. Because the formula was so vague, it left many questions open concerning the ultimate priority between monetary and economic policies, which will have strong influence in the Maastricht Treaty as well as in the debate of today's measures.[149]

Despite this parallel trend, the Werner Report, in connection with the third stage of economic integration, took a resolute and rather political stand. As we discussed, it proposed, by the end of the last stage, to provide a greater allocation of power in favor of the Community than previous or even future proposals. In this sense, the Report strongly affirmed in its conclusions that "Economic and monetary union means that the principal decisions of economic policy will be taken at Community level and therefore that the necessary powers will be transferred from the national plane to the Community plane."[150] As a result, the development of a political union was ultimately perceived as a pre-condition for the establishment of both an economic and a monetary union. This proposal is key in our context because, as we will develop in the last chapter, it did anticipate some of the more recent developments of the EMU.

The Council formally adopted the Werner report in 1971,[151] and its first-stage implementation began in April 1972 with the narrowing of currency fluctuations. This system (eventually

[147] D. Kruse (n. 122) 72.
[148] Ibid 73.
[149] K Dyson and K Featherstone (n. 3) 29.
[150] Werner Report (n. 134) 26.
[151] Formal adoption by the Council of the Resolution and the three decisions on 22 March 1971: Resolution of the Council and of the Representatives of the Governments of the Member States of 22 March 1971 on the attainment by stages of economic and monetary union in the Community (OJ C 28, 27.3.1971, p. 1). Council

known as the "snake in the tunnel") allowed a margin of fluctuation within a commonly set narrow band.[152] In particular, the snake allowed central banks to adjust the currency value by buying and selling European currencies provided that a specific exchange rate fluctuation margin was maintained.

During this first implementation stage, the economic conditions in Europe turned out to be significantly worse. In particular, the rise of financial and currency instability significantly hampered the Bretton woods system[153] until its collapse in August 1971 when the U.S. President Richard Nixon announced the "temporary" suspension of the dollar's convertibility into gold.[154] As a result, European countries experienced a regime of floating exchange rates.

To adjust the European currency regime to this new free-floating system, the European Monetary Agreement was terminated, and largely replaced with the functions of the IMF. In this context, the European Council in the 1972 reaffirmed its integration stands by affirming that "Serious monetary and trade problems require a search for lasting solutions that will favour growth with stability […] Member States are determined to strengthen the Community by establishing an Economic and Monetary Union".[155] However, in its progress report the Commission was more pragmatic and noted that the results of the first stage were not very successful as monetary and economic policy coordination remained very limited.[156] It was clear

---

Decision of 22 March 1971 on the strengthening of the coordination of short-term economic policies of the Member States of the European Economic Community (71/141/EEC) - OJ L 73, 27.3.1971. Council Decision of 22 March 1971 on the strengthening of cooperation between the central banks of the Member States of the European Economic Community (71/142/EEC) - OJ L 73, 27.3.1971. Council Decision of 22 March 1971 setting up machinery for medium-term financial assistance (71/143/EEC) - OJ L 73, 27.3.1971.

[152] The snake was built on the so-called "currency tunnel", set up on 18 December 1971, which was a system of exchange rate fluctuation margins of the main European currencies to 2.25 % around a central rate. The snake reduced the width of the tunnel to half its size.

[153] This collapse was due to the issue raised by the notable "Triffin Dilemma", according to which, the Bretton Woods system and its gold exchange standard, would eventually become unsustainable because of the tension between national monetary policies and international financial need for reserve currencies. Triffin was the first to formalize in 1960 this issue: the U.S. had to supply extra dollars to meet the growing demand for currency reserve, but in doing so, it would automatically run on a persistent current account deficit to provide liquidity for the conversion of gold into U.S. dollars. This deficit would slowly result in the loss of confidence in the dollar as reserve currency until the breaking point. On the contrary, if the U.S. decided to stop providing extra dollar to avoid such vicious cycle, international liquidity would suffer so as to significantly restrict world trade expansion and produce widespread deflation. See R Triffin, *Gold and the Dollar Crisis* (New Heaven CT, Yale University Press 1960).

[154] This announcement formally marked the initial breakdown of the system established with the Bretton Woods conference, although the U.S. dollar's fixed value against gold was already under pressure for a number of years.

[155] Final communiqué of the Conference of the Heads of State or Government of the Member States of the enlarged Community, and in particular the reaffirmation of "the resolve [...] to move irrevocably towards the Economic and Monetary Union" - EC Bulletin, No 10-1972.

[156] For a survey of the progress in this period see the Commission communication to the Council on the progress achieved in the first stage of economic and monetary union, COM(73)570 final, 19.4.1973.

that, among the Member States, there was no common view for a transition to the second stage. On the monetary side, Member States decided to maintain the snake in the tunnel, and established a new European Monetary Cooperation Fund (EMCF), and a system of short-term monetary support.[157] On the economic side, on 18 February 1974 the Council of Ministers merged, for efficiency purposes, the activities of the Short-term Economic Policy, the Budgetary Policy and the Medium-term Economic Policy Committees into a single Economic Policy Committee. [158] This marked in substance a return to the previous form of economic coordination by committees. Economic coordination was addressed with a second decision on the attainment of a high degree of convergence of economic policies, which repealed the previous methods of convergence.[159] This provided for a specific and fairly detailed procedure within the council where three regular yearly meetings would take place to discuss the economic and monetary situation of the community. As a result of these assessments, the Council would then adopt the necessary economic policy guidelines "in order to achieve harmonious economic development".

However, all these decisions were attempts to maintain the status quo rather than concrete actions to implement the recommendations of the Werner Report for the second stage. For instance, the Committee of Governors was not given the necessary powers for monetary coordination. Additionally, the procedures for coordination and supervision on economic policies were rarely used, and the interaction between the Community and the Member States on the guidelines remained rather limited.[160] The recommendations of the Werner Report were perhaps too advanced at that time as also recognized by the Delors Report[161] but ultimately, the development of the monetary union lost its momentum mainly due to the effect of the 1973 oil crisis, which critically endangered the already weak stability of exchange rates. Member States

[157] Decision of the Representatives of the Governments of the Member States on the provisional location of the European Monetary Cooperation Fund (EMCF) in Luxembourg (Decision 73/208/EEC) - OJ L 207, 28.7.73. Council Resolution of 18 February 1974 on short-term monetary support. OJ C 20, 5.3.1974.
[158] Council Decision of 18 February 1974 setting up an Economic Policy Committee (74/120/EEC) OJ L 63, 5.3.1974, p. 21–22.
[159] Council Decision 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 (74/120/EEC) - OJ L 63, 5.3.1974. The decision repealed: Council Decision of 17 July 1969 on the coordination of short-term economic policies of the member states; Council Decision of 16 February 1970 on the appropriate procedures for the consultation arrangements provided for in the council decision of 17 July 1969; Council Decision of 22 march 1971 on the strengthening of the coordination of short-term economic policies of the member states of the european economic community.
[160] See all the comments in G Baer and T Padoa-Schioppa (n. 140) 56.
[161] See J. Delors, Report on economic and monetary union in the European Community - Committee for the Study of Economic and Monetary Union EC Publications Office 1989 (Delors Report) 15.

were reluctant to transfer the amount of sovereignty implied by the monetary union in this economic context.[162] This led to a paradoxical situation, as the stability reached under the Bretton Woods system essentially prevented for a long time the need for a Community monetary arrangement. The collapse of this system, instead of being seized as the opportunity for more resolute action on the monetary and economic side, pushed the Member States to react nationally.

The plan by stages for the monetary union was *de facto* suspended after the 1974 Decision, and was only relaunched several years later, once the financial instability began to slowly decline. In 1977, the European Commission requested a group of independent economists to examine the future role of public finance at the Community level in the general context of European economic integration (MacDougall Report).[163] The report was a detailed and quantitative study of public finance (covering the existing major western federations and European unitary states) and of the theoretical literature on fiscal federalism. In its conclusion, it provided for a possible set of options under different set of developments in the public finance of the European Community. Overall, in light of the future development of a fully integrated economic union, the report argued for an increase in the Community budgets in order to overtake certain functions on the one hand, and in order to provide a transfer of funds for redistribution effects and economic convergence.[164]

The following year, after some of years of negotiation, the Council meeting in Brussels formally adopted the European Monetary System (EMS).[165] The EMS was the replacement of the snake in the tunnel which turned out to be highly unstable.[166] This, notwithstanding the fact that the finance ministers and the central bankers of the countries involved repeatedly praised the need to preserve the "snake", and decided to assist one another "in a virtually unlimited manner", [167] evoking a message that would be used many years later by Draghi in his famous London speech

[162] R Lastra and J Louis (n. 71) 65. Also on this G Baer and T Padoa-Schioppa (n. 140) 56.
[163] Report of the Study Group on the Role of Public Finance in European Integration Studies: Economic and Fiscal Series A13 (vol. I), Brussels (1977) EC Commission, doc. II/10/77. (MacDougall Report).
[164] Ibid 66-72.
[165] Resolution of the European Council on the establishment of the European Monetary System (EMS) and related matters of 5 December 1978. The EMS was principally implemented with: (i) the Council Decision 78/1041/EEC of 21 December 1978 - OJ L 379, 30.12.1979; and the (ii) Central Banks Agreement laying down the operating procedures for the European Monetary System (EMS).
[166] The tunnel collapsed in 1973 when the U.S. dollar floated freely. The snake proved unsustainable and was subjected to major speculative attacks. As a result many countries were forced to leave the exchange-rate mechanism (and in some cases to re-enter). For a more detailed survey see K McNamara, *The Currency of Ideas: Monetary Politics in the European Union* (Ithaca NY, Cornell University Press, 1988).
[167] Reuters Agency - Echo de la Bourse, 8/9/10 March 1974.

in 2012. The EMS essentially consisted of three pillars, each building on already existing Community structures. The first pillar, the European Exchange Rate Mechanism (ERM), was the most relevant for purposes of monetary stability. It was a mechanism where exchange rates among participating currencies were defined and linked, within a narrow band, to a newly created European Currency Unit (ECU). The ECU was equal to the weighted average of all the participating currencies. It was defined as a system of "fixed but adjustable exchange rates" since participating central banks were supposed to actively intervene in the financial market for adjustment purposes in case the exchange rate fell outside the fixed band.[168] As a result, floating of currency was rather limited and confined in the narrow margin. The second and third pillars were a projected European Monetary Fund, and a system of credit facilities for mutual payments support. The former was meant to supervise all Community credit facilities related to exchange rates and balance-of-payments financing. The latter was a mechanism for swapping existing reserves for ECUs in connection with loans made directly by one member country to another.[169]

There are many interesting aspects of the EMS to be discussed.[170] We will focus on the binding nature of the ERM obligations in particular, which will prove useful for our discussion in the following chapters. On this point, we can recognize, at first, that the EMS had a more political than legal nature as it was mainly established through political instruments, such as a European Council Resolution. The question is, however, more complex than this because the European Community relied on a mixed of legally binding procedures, Council regulations and decisions, and central banks agreements to implement the Resolution.[171] Therefore, from a general standpoint, the exchange-rate commitments were not strictly subject to binding procedural constraints, and "the ultimate responsibility for the management and strengthening of the EMS lies with the Council", which was thus subject to certain obligations.[172] The political nature of the Resolution and generally of the EMS also allowed each Member State to decide whether or not to join this Community system. The EMS turned out to be a non-binding agreement between Member States within the framework and the institutions created under Community law. In this sense, it can be seen as an early example of future enhanced cooperation.[173]

---

[168] For this definition see for instance B Higgins, 'Was the ERM Crisis Inevitable?' 78 *Federal Reserve Bank of Kansas City Economic Review* 4 (1993) 30.
[169] B. Cohen, 'The European Monetary System: An Outsider's View', *Princeton Essays in International Finance* n. 142 (1981).
[170] For legal consideration see J Rey, 'The European Monetary System', 17 *Common Market Law Review* 7 (1980).
[171] Ibid 10.
[172] Ibid 30.
[173] F Snyder (n. 126) 20.

The EMS represented an innovative and unprecedented coordination system of monetary policies between the Member States, and was able to operate successfully for over a decade. The system was able, in this economically complex period, to promote monetary stability both internally, among European countries, and externally, with reference to the dollar.[174] In particular, the stability of exchange rates was reached thanks to the constant intervention of alignment carried out by the central banks to compensate for differences in inflation rates of the participating countries.

The entry into force of the EMS partially determined the end of the implementation stage of the Treaty of Rome with regards to monetary and economic policies. From a broad overview of this transitional period, one distinctive feature is certainly the end of the debate between the regional and multilateral approaches to integration, which characterized the initial period leading to the EEC Treaty. With the adoption of the EEC, the regional approach became dominant, and it was pursued principally in its monetary side. However, there was no widespread consensus over the purpose of such monetary policies coordination. For the Commission, monetary integration was clearly functional to the integration of the goods markets, with primary importance given to the agriculture sector. The central bankers of the Community viewed monetary coordination in terms of price and financial stability within the context of the international monetary system.[175] The debate was also part of a larger and general tension between the community method embraced by the Commission, and the intergovernmental method embraced by the Committee of Central Bank Governors and by the Council, who often assumed a dominant position in this historical phase.[176]

As a result, this period was not able to produce a clear and more stringent set of rules concerning the coordination of both economic and monetary policies under the EEC, especially in light of the breakdown of the Bretton Woods system and the economic turmoils of the last decade. This lack of consensus was also deeply influenced by another internal dispute in the Community, between the monetarist and the economist schools. In this regard, we saw that the different implementing proposals, from the Marjolin report up to the Werner report, did not take a resolute position between the two, although some authors have argued that the creation of the ESM was a sign of prevalence of the monetarist view over the economist view.[177] In order to

---

[174] See on this point the Delors Report (n. 161) 7.
[175] I Maes (n. 88) 26.
[176] J Weiler (n. 2) 2423.
[177] For this argument see K McNamara (n. 166).

find a viable political solution, the choice was to follow a parallel approach, meaning that both approaches had been pursued at the same time.

Nevertheless, the constant tension of this period had a serious impact on the future establishment of the EMU. Similarly, many of the legal proposals and instruments of this period had very interesting reflections and implications on the future monetary union. On the monetary side, the Council of Governors of Central Banks gradually increased in importance over time, and eventually prepared the first draft of the Statute of the ECB in 1990.[178] Additionally, many authors pointed out that the single financial market and the single currency became possible by the operation of the ERM code of conduct.[179] On the economic side, the proposal under the Barre Report for the approval of national budgets at the community level, as well as the 1974 Council decision on the attainment of a high degree of convergence of the economic policies, set the foundation for the procedure of macroeconomic coordination which would be developed under the Treaty of Maastricht and the Stability and Growth Pact.

[178] See D Andrews, 'The Committee of Central Bank Governors as a source of rules' 10 *Journal of European Public Policy* 6 (2003) 956-973.
[179] B Eichengreen and J Braga de Macedo (n. 5) 40.

3. THE ESTABLISHMENT OF THE EMU

The financial and monetary turmoils of the 80s and, more significantly, the adoption of the Single European Act (SEA) in 1986[180] were major factors that encouraged the European countries to relaunch the monetary union project. This was anticipated by the Padoa-Schioppa Report of 1987, which argued that the 1992 program created the need for complementary measures to foster monetary stability through a strengthened monetary coordination.[181] It was then formally recognized by the European Council meeting in Hanover in 1988 by affirming that, "in adopting the Single Act, the Member States of the Community confirmed the objective of progressive realization of economic and monetary union"[182].

From both a legal and a political perspective, a number of scholars emphasized the connection between the Single Act and the Monetary Union project as another example of neofuncionalist spillover throughout the European integration process.[183] In the 50s, integration of monetary policies under the Payment Union led to the establishment of the Coal and Steel Community. In the 90s, the spillover ran backward, as integration of the goods market led to monetary integration. From an economic standpoint, this connection was principally caused by three components. First, as explained before, the stability of exchange rates and economic trends was generally considered a necessary precondition for the Common Market because currency instability or disequilibria in the balance of payments could seriously distort fair competition.[184] All the commissions' proposals, from the Marjolin up to the Werner report, began from this premise. Most notably, the former Italian President L. Einaudi affirmed long before that "Unifying the [currency] issuing institutions and making them subject to a State authority that

[180] Single European Act, 1987 O.J. L 169/1, (SEA) amending Treaty Establishing the European Economic Community, Mar. 25, 1957, 298 U.N.T.S. 11. The Single European Act represented one of the most important and significant amendments to the EEC architecture for the completion of a single integrated market. It was the result of the 1984 European Parliament Draft Treaty of European Union and the 1985 Commission White Paper (completing the Internal Market).

[181] Publication of the Padoa-Schioppa report on "Efficiency, stability and equity: A strategy for the evolution of the economic system of the European Community" which had been requested by the Commission following the enlargement to twelve Member States and inview of the objective of creating a market without internal frontiers by 1992 - EC Bulletin, No 4-1987, p. 7 ("Padoa-Schioppa Report").

[182] European Council in Hannover, Conclusion of the Precidency, EC Bulletin, No 6-1988, p. 22. The European Council adopted the same expression of the preambles of the Single Act, which mentioned the Paris meeting of 1972.

[183] For a more legal analysis see J Weiler (n. 2) 2455; For a more political analysis see T Sadeh and A Verdun 'Explaining Europe's Monetary Union: A Survey of the Literature', 11 *International Studies Review* 2 (2009) 277-301.

[184] For this argument see also J Vinal, 'European Monetary Integration: A narrow or a wide EU' 40 *European Economic Review* 1103 (1996).

is separate from and superior to that of the two Contracting States is therefore, on full consideration, the only necessary and sufficient prerequisite for abolishing the customs line between two States".[185]

With the expansion of the common market into a single internal market, the need for a monetary union became even more urgent. This was even truer with regards to the need for stable exchange rates in light of the CAP price system. Currency instability, as stated, could severely distort the agricultural price-system based on fixed exchange rate, and eventually jeopardize the entire agricultural policy. The third factor, and perhaps the most important one for the final decision to pursue a monetary union, was the removal of capital controls pursuant to the Single European Act. This was implemented with the Third Capital Directive of 1988, which directed Member States to abolish all remaining restrictions on capital movements between residents of the Member States.[186] The combination of full capital mobility and the "fixed but adjustable exchange rates" system led to a situation where Member States had very limited ability to conduct an independent monetary policy. This is conceptualized by the so-called theory of the "impossible trilogy", which holds that fixed exchange rates, independent monetary policy, and full mobility of capital are cumulatively incompatible, and that only two of the three can be mutually consistent.[187]

In accordance with this theorem, after the approval of the Third Capital Directive, carrying out an independent monetary policy was not possible within the European context. Capitals were in fact able to flow freely in and out of the Member States. In case of decreasing foreign investments into a particular country, the demand for domestic currency and its relative value would therefore fall based on the market's demand and supply. However, the fixed exchange rate under the ERM would not allow the currency to decrease in value, and the central bank would have to intervene in the open market by acquiring foreign currencies to keep the

[185] L Einaudi, *Lo scrittoio del presidente (1948-1955)* (Torino, Einaudi Editore, 1956) 157-160.
[186] Council Directive 88/361, OJ 8.7.88 L178/5 - EC Bulletin, No 6/1988, p. 24. The directive in particular extended the free capital movement to all monetary or quasi-monetary transactions, while allowing limited exemptions, the so-called safeguard clause, in the form of protective measures with respect of certain capital movements of exceptional size, which could serious create instabilities for monetary and exchange rate policies.
[187] The "trilemma" originally arised from the Mundell-Fleming model. See R Mundell, 'Capital mobility and stabilization policy under fixed and flexible exchange rates' 29 *Canadian Journal of Economic and Political Science* 4 (1963) 475–485; and J Fleming, 'Domestic financial policies under fixed and floating exchange rates' 9 *IMF Staff Papers* (1962) 369–379. For a general overview see M Obstfeld, J Shambaugh and A Taylor, 'The Trilemma in History: Tradeoffs among Exchange Rates, Monetary Policies, and Capital Mobility' 87 *Review of Economics and Statistics* 2 (2005) 423–438. In the writing of Padoa-Schioppa the trilemma became a quadrilemma with respect to European monetary integration as the free movement of goods was added as a fourth element. See T Padoa-Schioppa et al, *Efficiency, Stability and Equity* (Oxford: Oxford University Press, 1987).

exchange rate within the established margin. This would, however, prevent monetary policy from being used to target domestic needs and would result in the impossibility for the central bank to independently regulate money supply in the market by adjusting the interest rate.[188]

Based on these different considerations and the overall benefits of the currency area in terms of transactions costs and trade efficiencies and growth[189], the Heads of State decided to entrust a second Committee with "the task of studying and proposing concrete stages leading towards this union". The Committee was chaired by the president of the European Commission J. Delors, and was predominantly composed of Governors of national central banks[190]. The result of this study was the Delors Report, which was presented in April 1989.[191]

The Delors Report resembled in many ways the previous Werner report.[192] Similar to its predecessor, it broadly defined the possible framework as well as the three stages required to achieve an economic and monetary union, while it left to a Treaty revision the full definition of the concrete legal and economic arrangements. The Delors Committee thus opted for a gradual approach to the monetary union so that national economies would progressively adapt to it and to that of each other. In this sense, the Committee followed the arguments expressed by the Werner Committee.[193]

The three steps envisioned in the report involved, in the first stage, the completion of the internal market, through the introduction of the free movement of capital. The second stage included the preparatory work for the European Central Bank (ECB) and the European System of Central Banks (ESCB), and for achieving the necessary macroeconomic convergence. In the third and final stage, it provided for the fixing of exchange rates and the launching of the euro.

---

188 R Baldwin and C Wyplosz (n. 3) 310-316. For empirical research on the trinity A Rose, 'Explaining Exchange Rate Volatility: An Empirical Analysis of "The Holy Trinity" of Monetary Independence, Fixed Exchange Rates, and Capital Mobility' 15 *Journal of International Money and Finance* 6 (1996) 925-945.

189 For a survey on the benefits of the currency area see R Baldwin and C Wyplosz (n. 3) 353-356.

190 The Committee was composed of the twelve central bank governors, serving "in a personal capacity", two members of the European Commission and three independent experts (N. Thygesen, Professor of Economics, Copenhagen, A. Lamfalussy, General Manager of the Bank for International Settlements in Basle, M. Boyer, President of Banco Exterior de Espana).

191 Delors Report (n. 161). The report was accompanied by a collection of papers submitted by members of the Committee who provided good insight into the negotiation and the different stances.

192 On the differences between the two see a good analysis in J Louis, 'A monetary Union for tomorrow?' 26 *Common Market Law Review* 2 (1989) 301-326.

193 "The Group in no way wishes to suggest that economic and monetary union are realizable without transition. The union must, on the contrary, be developed progressively by the prolongation of the measures already taken for the reinforcement of the coordination of economic policies and monetary cooperation." Werner Report (n. 134) 14. In his proposal, Hirshman wrote: "While it may be impossible to tear down the economic and fiscal attributes of national sovereignty by direct assault, it may be possible to coordinate these attributes and to build […] new institutions in the 'interstices' of the national prerogatives". A Hirschman (n. 31).

Also like the Werner Report, it embraced a parallel approach between monetary and economic policies precisely because "economic union and monetary union form two integral parts of a single whole".[194] Parallelism was particularly emphasized as a core principle for balancing the economist and the monetarist standpoints,[195] as the principle of subsidiarity was an essential element for balancing the powers within the Community".[196]

However, there was one crucial and far-reaching difference between the two reports. The Werner report provided for a greater allocation of power in favor of Community concerning economic policies, while allowing a more differentiated approach in the field of monetary policy. In contrast, the Delors report suggested a greater allocation of power in favor of the Community concerning monetary policies while allowing a more differentiated approach in the field of economic policy.[197] This difference was important for achieving a concrete and a politically viable proposal in light of the failure of the previous Werner Report. More specifically, for its success, the Delors Committee had to reach a uninanimous approach and solution, and this required a delicate balancing act between the economists and monetarists, the former represented in the negotiation by the German and the majority of central banks, with the latter represented by the French and the Commission.[198] The composition as well as the political actors directly and indirectly involved in the negotiation were crucial.[199]

The proposal was conceptually divided between economic and monetary policy recommendations. With regards to monetary policies, the Report recognized that two of the three conditions for a monetary union, namely the total and irreversible convertibility of currencies and the complete liberalization of capitals and full integration of banking and other financial markets, were already completed or at least addressed by the internal market program. The last and most important condition, the irrevocably fixing of exchange rates, would instead require additional steps. An effective coordination of monetary and non-monetary policies, such as the one substantially carried out until that moment, was seen as a viable option in order

[194] Delors Report (n. 161) 14.
[195] Parallelism was maintained "in order to avoid imbalances which could cause economic strains and loss of political support for developing the Community further into an economic and monetary union" Ibid 32.
[196] Ibid 14.
[197] See for this argument J Louis (n. 192) 304-306.
[198] . For a larger discussion on the negotiation process of the Delors Report and the different standpoints see K Dyson and K Featherstone (n. 3).
[199] For this argument see H Ungerer (n. 3) 199. On the importance of the Delors Committee and its composition see A Verdun, 'The Role of the Delors Committee in the Creation of EMU: An Epistemic Community?' EUI Working Paper RSC No 98/44 (1998) available at http://cadmus.eui.eu/bitstream/handle/1814/1596/98_44t.htm?sequence=1&isAllowed=y.

to increasingly make national currencies close substitutes and to converge interest rates, up to the locking of exchange rates. The creation of a single currency would then complete the process by marking the irreversibility of the monetary union and avoid the transactions costs of converting currencies.[200] The Delors Committee more clearly indicated its preference for a single currency than it had before, by expressly citing the need to avoid "transaction costs of converting currencies".[201] As a result, the monetary union would also result in the creation of a new community institution, responsible for the formulation and implementation of a common monetary policy. The Bundesbank was its model, as the main characteristic of this new institution was its independence from national governments and Community authorities, and its commitment to price stability.[202]

With regards to economic policies, as anticipated before, the Delors Report departed from the Werner Report and returned to an approach based on wide coordination and supervision.[203] The Werner Report regarded economic policy integration solely in terms of increasing procedural efficiency, and, as a result, put forward a progressive transfer of the decision-making power to the Community. The Delors Committee, on the other hand, given the failure of the previous plan, was more concerned with reaching a viable solution. As a result, it agreed on clear and simple objectives of convergence and precise budgetary limits, which would gather stronger political consensus than an extensive transfer of power.[204] The Committee perceived with urgency the need for a stronger framework for macroeconomic policies in light of the completion of the single market.[205] Additionally, with the adoption of the single currency, exchange rate adjustments could no longer correct economic imbalances within the Community since monetary policy would eventually be delegated to a unitary central institution.

[200] Delors Report (n. 161) 15.
[201] J Louis (n. 192) 306.
[202] Among many pointing out this comparison, see O Issing, V Gaspar, I Angeloni and O Tristani, *Monetary policy in the euro area: strategy and decision-making at the European Central Bank*, (Cambridge, Cambridge University Press, 2001).
[203] Delors Report (n. 161) 10.
[204] For this argument see J Mortensen, 'Economic Policy Coordination in the Economic and Monetary Union: from Maastricht via the SGP to the Fiscal Pact' CEPS Working Documents No. 381 (2013) 4. Available at http://aei.pitt.edu/43184/1/WD381_JM_Economic_Policy_Coordination.pdf.
[205] The Committee recognized in particular that "The pressure for mutually consistent macroeconomic policies [...] has hitherto been lessened to some extent by the existence of capital controls in some countries and by the segmentation of markets through various types of non-tariff barriers, but as capital movements are liberalized and as the internal market programme is implemented, each country will be less and less shielded from developments elsewhere in the Community". Delors Report (n. 161) 11.

The Report, in order to avoid these potential imbalances, proposed to carry out actions in three specific areas: competition policies, regional policies, and macroeconomic coordination.[206] With respect to the latter, the Community would oversee its macroeconomic condition, by assessing the consistency between developments in individual countries and mutual objectives and by formulating policy guidelines.[207] The Report envisioned the Commission as the responsible institution for the monitoring process, as well as for eventually reporting and proposing possible actions; the Council (Ecofin) would retain the last word on this matter.[208]

Additionally, the Report suggested strengthening and extending the convergence of national economic policies. During the first stage of the EMU process, the report proposed the creation of "a process of multilateral surveillance of economic developments and policies based on agreed indicators" and "a new procedure for budgetary policy coordination, with precise quantitative guidelines and medium-term orientations".[209] During the second stage, it proposed to "set a medium-term framework for key economic objectives" as well as "precise, although not yet binding, rules relating to the size of annual budget deficits and their financing".[210] The report suggested to repeal and replace the process of multilateral surveillance of economic policies established under with the Council Decision 120/74 in order to strengthen both economic and fiscal policy coordination, as well as to provide a more comprehensive framework for assessment of the consequences and consistency of the overall policies of Member States.

Furthermore, the focus on fiscal and budgetary policies represented a particularly significant shift from previous approaches. We saw that the Barre Report was the first community proposal to suggest a discussion of national budgets, within the Council, as well as the establishment of early warning indicators to detect possible deviations from the basic short-term policies. However, this suggestion was only limited to general aspects of national budgets, and remained only in papers. The Delors Report took a more resolute stand on this point. It was pointed out that neither in the theoretical literature nor in past practical discussions in the Community, had budgetary coordination had such a role of prime importance, as under the Delors proposal.[211] However, it is also true that the report only focused on the size and financing of budget deficits

[206] Ibid 17.
[207] Ibid 18.
[208] Ibid 30-34.
[209] Ibid 30.
[210] Ibid 34.
[211] N Thygesen, 'The Delors Report and European Economic and Monetary Union' 65 *International Affairs* 4 (1989) 639.

and debt, while it failed to mention, as the Werner Report for instance did mention, the variations in the volume of public budgets.[212]

In its suggestions concerning economic policies coordination and supervision, the Delors Committee expressly excluded two controversial elements. First, it rejected the idea for a mechanism of fiscal transfers for balancing regional disequilibria, citing the lack of an appropriate Community budget to carry out cyclical adjustments.[213] As a result, in order to tackle potential regional disequilibria, the Delors report relied exclusively on a combination of fiscal discipline and limited structural policies. This was in sharp contrast to previous proposals, such as the MacDougall Report,[214] as well as the main economic literature on currency unions, most notably the OCA theory, which, as we will explain below, considers automatic fiscal transfer a crucial component for an optimal monetary union. Second, the report expressly denied relying on market pressure in order to achieve fiscal discipline, while it entirely relied on a rule-based approach.[215] This was in contrast, however, with the consideration of the Padoa-Schioppa Report, which maintained that capital market restraints on state finance would result in a more effective instrument in the long-run than would wide fiscal arrangements.[216]

Many authors generally praised the Delors Report for being more specific and concrete than previous plans[217], but, at the same time, there was also significant skepticism about its practical consequences given the historical experience of the Werner Report. The doubts particularly concerned its possible approval, as there was not a widespread consensus on the monetary union.[218] However, the eventual urgency of the monetary union, resulting from the single act, in combination with a proposed framework based on the international monetary system, and a central bank modeled after the Bundsbank, was able to overcome both internal and external opposition.[219] European leaders accepted its policy recommendations and formally approved

[212] J Louis (n. 192) 310.
[213] See on this point the analysis in D Gros and N Thygesen, *European Monetary Integration: From the European Monetary System to European Monetary Union* (London, Longman, 1992) 480.
[214] The Report maintained that, unless the Community significantly extended its budget in order to equalize productivity and living standards across different regions, "the monetary union would be unattainable". MacDougall Report (n. 163) 20.
[215] "With parities irrevocably fixed, foreign exchange markets would cease to be a source of pressure for national policy corrections when national economic disequilibria developed and persisted." Delors Report (n. 161) 17.
[216] Padoa-Schioppa Report (n. 181) 10.
[217] See for instance J Louis (n. 192) 325.
[218] See the reconstructions made by H James (n. 3) 210-215.
[219] For a comprehensive analysis on the success of the Delors Report see among many A. Verdun (n. 199).

the plan, at the European Council in Madrid, as the basis for future work and process towards the monetary union.[220]

The approval immediately resulted in two subsequent Council Decisions, one of which adopted a series of amendments to the structure and functions of the Committee of Governors of the Central Banks by extending and reinforcing the Committee's task and role.[221] The accompanying decision repealed, as suggested by the Delors Commettee, Council Decision 120/74, and established a more stringent system of multilateral surveillance of economic developments and policies for the first stage of the monetary union process.[222] This new system of multilateral surveillance was more developed than the previous arrangement. Analyzing the difference between the two, we immediately recognize two things in particular. First, the former procedure of coordination and surveillance was fairly detailed in terms of timetable as well as in its concrete process of examination.[223] Second, the latter decision was overall much more comprehensive and advanced. In particular, it empowerd the Council to monitor, at least twice a year, both the short and the medium-term economic prospects and policies in the Community and its Member States, the compatibility of these policies within Member States and in the Community at large, as well as the external economic environment and its interaction with the economy of the Community. The scope of the monitoring procedure as well as the aim and scope of the national budgetary planning was also much more defined, as it was the power for the Council to set forth general economic policy suggestions and issue country-specific policy recommendations.

The approval of the Delors Report and of these initial measures were, however, not sufficient for the establishment of the EMU. The Single European Act only provided limited legal basis for some of the necessary stages envisioned under the plan.[224] Both Article 102a of the EEC Treaty and the Delors Report confirmed this view and anticipated the need for a Treaty amendment if further development concerning economic and monetary policy required institutional changes.[225] As a result, the European Council in Strasbourg decided to convoke an

[220] European Council in Madrid, Conclusion of the Precidency, EC Bulletin, No 6-1989, p. 11.
[221] Council Decision 90/142 on the Committee of Central Bank Governors of the Member States, OJ 24.3.1990 L78/25.
[222] Council Decision 90/141 on the progressive convergence of economic policies and performance during stage one of economic and monetary union, OJ 24.3.1990 L78/23.
[223] Stressing such procedural side of Decision 120/74 were also G Baer and T Padoa-Schioppa (n. 140) 56.
[224] Delors Report (n. 161) 13.
[225] The Single European Act added a new Chapter 1 to the monetary and economic parts of the EEC Treaty concerning the "co-operation in economic and monetary policy (economic and monetary union)". The new chapter comprised only Article 102a which reads: "In order to ensure the convergence of economic and

intergovernmental conference to draft the necessary Treaty amendments.[226] This was also the second revision of the existing Community Treaties that occurred only a few years after the Single European Act.

The Treaty on the European Community (EC Treaty) was agreed at the European Council held in Maastricht in December 1991 and came legally into effect on 1 November 1993.[227] The Treaty of Maastricht was a major change for the European Community for many reasons, but above all, for establishing the European Economic and Monetary Union. Similar to the EEC Treaty, the EC Treaty still represented a "framework treaty" in connection with economic and monetary policies, but it was certainly much more precise and detailed than its predecessor as it provided the necessary legal foundation for all the institutions, procedures and stages necessary for the development of the monetary union.[228] The Treaty provided on the one hand, for a partial transfer of authority in the fields of economic and budgetary policy by creating a revised decision-making process at the EU level. On the other hand, it provided for a complete transfer of sovereignty over monetary matters by creating an independent European Central Bank that would be in charge of issuing a single currency and carry out a common monetary policy.

The EMU was the result of the intergovernmental negotiation in light of the policy recommendations of the Delors Committee. With regards to the necessary steps to implement the Monetary Union, the Treaty strictly followed the suggestions of the report by setting the three stages outlined above. In the first stage, until 1994, the Community was to remove all of the remaining barriers to the free movement of capital, and grant political independence to the central bank. In this regard, the Maastricht Treaty further advanced the free capital development

---

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. In so doing, they shall take account of the experience acquired in cooperation within the framework of the European Monetary System (EMS) and in developing the ECU, and shall respect existing powers in this field. 2. In so far as further development in the field of economic and monetary policy necessitates institutional changes, the provisions of Article 236 shall be applicable. The Monetary Committee and the Committee of Governors of the Central Banks shall also be consulted regarding institutional changes in the monetary area".

226 The Strasbourg European Council EC Bulletin, No 12-1989.

227 Treaty on European Union (Maastricht text), July 29, 1992, 1992 O.J. C 191/1 (Treaty of Maastricht or EC Treaty).

228 For major surveys on these provisions see J Louis, 'L'Union Europeenne et sa Monnaie', Commentaire J Megret, chapter III (Brussels, Editions de l'Universite´ de Bruxelles Collection: Institut d'Etudes Europe´ennes, 2009).

by introducing the free movement of capital as a Treaty freedom.[229] The second stage of EMU provided for the establishment of a European Monetary Institute (EMI) responsible for strengthening monetary policy coordination with the aim of safeguarding price stability, carrying out the preparations for the European System of Central Banks (ESCB), and monitoring the development of the ECU. The third stage only included the Member States that complied with the so-called "Maastricht convergence criteria". These criteria, agreed upon at the last minute of the negotiation[230], refer to economic indicators specified in the Protocol of the Treaty, which included standard measures concerning price stability, public finance, participation in the EMS exchange-rate mechanism and long-term interest rates.[231]

In reference to governmental budgets, the Treaty indirectly required the respect of the two values provided under the excessive deficit Protocol 5, the 3% government deficit to GDP ratio, and the 60% government debt to GDP ratio.[232] These criteria of economic convergence were also coupled with other, less known, criteria of legal convergence concerning the compatibility of national legislation with a number of Treaty provisions.[233] In case a majority of the members satisfied both these economic and legal criteria, the European Council would decide by a qualified majority to initiate the third stage of the EMU. This would then result in the irrevocable fixing of exchange rates, the creation of the ECB, and ultimately the launch of the single currency. The Treaty provided for the necessary legal foundation for the irrevocable adoption of the euro as it still stands today.[234] It was not, however, precise with regards to a certain timetable or the method for adopting the single currency, as it was impossible to foresee when the conditions would have been met.[235] These details were left to a future evaluation by

[229] Article 63 TFEU prohibits all restrictions on the movement of capital and payments between Member States, as well as between Member States and third countries. This constitutes a unique third-country dimension of this particular Treaty freedom. It prohibits all obstacles, not just discriminatory ones.
[230] A Verdun (n. 199) 24.
[231] Art. 109j EC. These criteria and the relevant periods for assessing whether they have been met are explicated in Protocol 6 annexed to the Treaty.
[232] Article 2 of the Protocol recites that "The criterion on the government budgetary position referred to in the second indent of Article 109j(l) of this Treaty shall mean that at the time of the examination the Member State is not the subject of a Council decision under Article 104c(6) of this Treaty that an excessive deficit exists".
[233] For a more detailed analysis of these legal convergence criteria see R Lastra and J Louis (n. 71) 19.
[234] See article 4(2) and article 123(4).
[235] See Delors Report (n. 161) 28.

the Commission as well as by the EMI,[236] and ultimately approved by the European Council, at the summit held in Madrid in 1995.[237]

With regards to economic policies, the Treaty implemented a more developed system of macroeconomic coordination and supervision, and rejected for the purpose of fiscal discipline a mechanism of fiscal transfers to rely on market pressure as suggested by the Delors Report. As we will further explain in chapter 2.1, coordination and supervision of economic policies had to be strengthened to address the collective action problem of having a common and independent central bank in a decentralized fiscal setting. The EC Treaty added to the vague and rather unenforceable procedure concerning conjunctural policies under the Treaty of Rome,[238] with new and more detailed measures. In particular, the Treaty provided for a set of non-binding economic policy guidelines, the so-called Broad Economic Policy Guidelines (BEPGs), drafted and recommended to the Member States by a qualified majority of the Council.[239] The BEPG would provide the economic guidance for the new system of multilateral surveillance, already introduced with Council Decision 90/14 and now enshrined in the Treaty. Under this system, the Council would, based on the report of the Commission, "monitor economic developments in each of the Member States and in the Community as well as the consistency of economic policies with the broad guidelines and regularly carry out an overall assessment".[240] Based on this overall surveillance, the Treaty empowered the Council to issue, by a qualified majority, possible non-binding recommendations to those Member State whose economic policies "are not consistent with the broad guidelines" or that "they risk jeopardizing the proper functioning of economic and monetary union".[241]

More importantly, the Treaty added to this system an additional complex corrective procedure to evaluate possible excessive debt or deficit. The reference value were defined in terms of government deficit to gross domestic product ratio exceeding 3%, or government debt to gross domestic product ratio exceeding 60%.[242] This procedure authorized the Commission to carry out such evaluation as well as the preparatory work, and the Council to decide, by a qualified

---

[236] See the Commission Green Paper on the practical arrangements for the introduction of the single currency, EU Bulletin, No 5-1995, point 1.3.7, p. 12.
[237] The Madrid European Council decides on the official name of the single currency ("euro") and the technical scenario for embarking on the third stage of EMU (15/16 December 1995).
[238] See Article 103a EC.
[239] Article 103 (2) EC.
[240] Article 103 (3) EC.
[241] Article 103 (4) EC.
[242] The reference values are speficied under Protocol 5 on the Excessive Deficit Procedure annexed to the EC Treaty.

majority, whether an excessive deficit existed. If an excessive deficit was confirmed, a process of recommendation and evaluation could lead, in case of persisting violations, to possible economic sanctions.[243]

This framework of macroeconomic coordination was complemented with three explicit prohibitions under the Treaty. The so-called "no bailout" clause under article 104b (now Art. 125 TEU) provides that, "without prejudice to mutual financial guarantees for the joint execution of a specific project", both the Community and each single Member State "shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of any Member State". The provision was thus designed to make sure that any future financial problem would be strictly contained to the single country involved and, as a result, that the monetary union would not involve a full risk-sharing regime. This second prohibition concerns possible monetary financing by the common ECB. More specifically, Article 104 states that "overdraft facilities or any other type of credit facility with the ECB or with the central banks of the Member States in favor 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 clause also expressly "applies for the purchase directly from these public organizations by the ECB or national central banks of debt instruments". In substance, the provision prevents the ECB from taking actions that would directly finance Member States and their spending ability. The provision was meant, in other words, to represent the monetary counterpart of the "no bailout clause" by avoiding any redistribution of wealth through the common central bank, as well as to avoid the so-called "fiscal dominance", meaning that the ECB could be forced to finance the deficit of the single Member States to the prejudice of its price stability objective.[244]

The last prohibition relates to "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". These three prohibitions are

[243] In particular, the Council could recommend by a majority of two-thirds of the weighted votes "to invite the European Investment Bank to reconsider its lending policy towards the Member State concerned" and/or "to require the Member State concemed 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/or "to impose fines of an appropriate size" Article 104c (11).

[244] Y Mersch, 'Monetary policy in the euro area: scope, principles and limits' Keynote speech at the Natixis Meeting of Chief Economists (Paris, 23 June 2016).

commonly linked together as an additional legal protection to induce fiscal discipline and avoid excessive deficits.[245] More specifically, these prohibitions were traditionally interpreted as a signal to financial markets that each Member State, in case of economic difficulties, could not be financially supported from the Community or from other Member States.[246] This would induce market discipline, with higher risk premiums, against fiscally irresponsible Member States. Some of its definitions were later specificed by a Council Regulation.[247]

The well-known "optimal currency theory" (OCA) originally elaborated by Mundel[248] served as an important tool to assess the EMU project, and particularly the convergence criteria.[249] The OCA theory offers a cost and benefit analysis in connection with the creation of a monetary union. Moreover, this theory maintains that a single currency is largely beneficial and able to stimulate internal trade, economic and financial integration and business cycle synchronization provided that several criteria are met.[250] These criteria have been developed over time and can be summarized as follows: (i) full labor mobility across the region; (ii) production diversification; (iii) full capital mobility and price and wage flexibility across the region; (iv) homogeneity of preferences; (v) automatic fiscal transfer to redistribute to less developed regions; (vi) similar business cycles. These parameters, in other words, are helpful to identify the existence of an optimal currency area, i.e. an area that is less likely to be hit by asymmetric shocks as well as to face and limit in a coordinated manner any major economic downturns.[251]

It was clear, however, that the Eurozone was not at the time, and is still not today, an optimal currency area. Labor mobility on the one hand and similar business cycle on the other are not present.[252] Additionally, as explained before, any mechanism of automatic fiscal transfer was missing from the EMU discussion and framework, except for the existence of limited structural

---

[245] For a more detailed analysis see Guest Editorial, 'The no-bailout clause and rescue package' 47 *Common Market Law Review* 4 (2010) 971-986.

[246] R Lastra and J Louis (n. 71) 43.

[247] See Council Regulation (EC)No 3603/93 of 13 Dec. 1993 specifying definitions for the application of the prohibitions referred to in Articles 104 and 104b(l) of the Treaty, O.J. 1993, L 332/1.

[248] R Mundell, 'A Theory of Optimum Currency Areas', 51 *American Economic Review* 4 (1961) 657–665. For an overview of this theory in connection with the EMU project see F Mongelli, 'European Economic and Monetary Integration, and the Optimum Currency Area Theory', Economic Papers n. 302 (2008). See also R Baldwin and C Wyplosz (n. 3) 361-384.

[249] The plan for a single currency was hypothesized at the time by Mundell: "Supposing that the Common Market countries proceed with their plans for economic union, should these countries allow each national currency to fluctuate, or would a single currency area be preferable?"

[250] For a more detailed analysis see F. Mongelli (n. 248).

[251] For an explanation of each single criteria and their criticism see R Baldwin and C Wyplosz (n. 3) 361-369.

[252] R Baldwin and C Wyplosz (n. 3) 369-376. For empirical analysis in the European context, see T Bayoumi and B Eichengreen, 'Ever Closer to Heaven? An Optimum-Currency-Area Index for European Countries' in P De Grauwe (ed.) *The Political Economy of Monetary Union* (London, Elgar, 2001).

funds. Therefore, the hope at the time of the Delors report was, and still is today, that the countries could "converge", so as to become eventually an optimal currency area.[253] Nevertheless, the Delors Report made no reference to the OCA reasoning, except when it briefly recognized the problem posed by asymmetric shocks.[254] Similarly, the Commission in its assessment for the monetary union named "One Market, One Money" made only reference to OCA by affirming that, "The optimum currency area approach provides useful insights but cannot be considered a comprehensive framework in which the costs and benefits of EMU can be analyzed"[255]. In other words, the "plans for EMU went ahead also as a follow-up of the Single Market Programme (SMP) with only limited direct input from the OCA theory".[256]

Indeed, the main concern of the EU at the time was not to achieve an optimal currency area, but mainly to advance, in a timely manner, the monetary project so as to remove the risks of destabilizing exchange rate volatilities and misalignments that had disrupted the European Monetary System (EMS) on previous and present occasions.[257] Indeed, in the autumn of 1992, during the ratification process of the Maastricht Treaty, the EU was affected by the outbreak of the ERM crisis. In particular, following a series of speculative attacks in the financial markets, based on the perceived unsustainability of the ERM, the UK and Italy had to initially devaluate their currencies, and were then forced to withdraw from the ERM. Some of the literature on the subject points out that the reasons for the crisis were found in the inadequate convergence of national policies within the monetary system.[258] Others blamed the speculative attacks for creating a vicious cycle of currency and economic downturns, which eventually led to such macroeconomic imbalances.[259] Overall, however, the common ground among the different views was that the crisis flourished in a context where capital controls were removed and a timetable for the monetary union was already underway.[260] This crisis demonstrated to the EU institutions and Member States, more than before, the urgency to create a monetary union and

---

[253] J Stiglitz, 'Can the Euro Be Saved? An Analysis of the Future of the Currency Union', *Rivista di Politica Economica* 3 (2014) 12.
[254] Delors Report (n. 161) 15.
[255] EEC Commission (1990) "One Market, One Money" 44 European Economy. p. 46.
[256] F. Mongelli, (n. 248) 51.
[257] Ibid 52.
[258] Among many see J Williamson, 'EMS and EMU After the Fall: A Comment' *The World Economy* 16 (1993) 377-380.
[259] Among many see R Portes, 'EMS and EMU After the Fall' *The World Economy* 19 (1993) 1-16; B Eichengreen and C Wyplosz 'The Unstable EMS', *Brookings Papers on Economic Activity* 1, (1993) 51-143.
[260] B Higgins, (n. 3) 30. For a general overview of the reasons of the currency crisis in 1992 see D Gross and N Thygesen (n. 213) 191-236.

the consequences of the failure to address monetary issues and disequilibria through monetary cooperation alone in the new Single Market context.[261]

This transitional period was not only affected by the major monetary crisis, but also by a relevant constitutional litigation in Germany[262], and a national referendum in Denmark concerning the adoption of the single currency. Overall, this complex period was able to shape and stimulate the political debate on EMU, and to clarify different, competing conceptions of European monetary integration.[263]

On 1 January 1994, the EU completed the first stage under the Maastricht Treaty and entered into its second stage.[264] In connection with monetary policies, the second stage saw the creation of the EMI for the transition to the third stage of the EMU, to strengthen monetary coordination and to oversee the development of the ECU.[265] The EMI's role as successor of the Committee of Governors for monetary coordination and for the development of the ECU was considered very "modest", while its work in preparation for the third stage was considered "impressive".[266] Through a number of legal acts, the EMI was able to promote the legal convergence among Member States; the establishment of the ESCB, most notably with the formulation of the strategies as well as the definition of the monetary policy instruments for the conduct of the single monetary policy; and ultimately the concrete adoption and introduction of the Euro.[267] The institute was eventually dissolved on 1 June 1998 with the creation of the ECB and of the European System of Central Banks (ESCB).

As for macroeconomic policies, the Council approved a number of recommendations on the coordination of economic policies and on the conduct of the multilateral surveillance procedures. It also endorsed a code of conduct for the content and format of convergence programs. More importantly, Member States decided to complement the Treaty with additional fiscal requirements. This was done with the conviction that sound government finances and

---

[261] Along this line of argument see the Committee of Governors of the Central Banks of the Member States of the European Economic Community "The Implications and Lessons to be Drawn from the Recent Exchange Rate Crisis: Report of the Committee of Governors," processed, 21 April (1993).
[262] BVerfGE 89, 155 (202 f.).
[263] F Snyder (n. 126) 29.
[264] European Council in Bruxelles, Conclusion of the Precidency, EC Bulletin No 10-1993, p. 8.
[265] See Article 109F(2) of the EC Treaty; Articles 2 and 4 of the EMI Statute. For a comment on the role of the EMI see J Louis, 'A legal and institutional approach for building a Monetary union', 35 *Common Market Law Review* 33 (1998).
[266] Ibid 35-37.
[267] Council Regulation (EC) No 1103/97 of 17 June 1997 on certain provisions relating to the introduction of the euro, O. J. 1997 L 162/1.

convergence of economic fundamentals are necessary conditions or prerequisite for sustainable exchange rate stability and price stability and for strong sustainable growth conducive to employment creation.[268]

At the European Council in Amsterdam in June 1997, the EU launched the so-called Stability and Growth Pact (SGP).[269] The SGP was designed as a comprehensive set of legal measures to complement and implement the Treaty provisions in order to impose a wide and permanent system of fiscal discipline and consolidation. From an economic standpoint, the arguments in favor of the SGP are many, and were already summarized in connection with the coordination of economic policies (see chapter 2). From a legal standpoint, the reason for this new instrument rested on the evidence that the provisions under Article 104C of the EC Treaty were not considered precise enough with respect to budgetary discipline after the entry into force of stage three.

In this regard, a first proposal was advanced by by the German Federal Ministry of Finance on 10 November 1995.[270] This proposal, known as the Waigel Plan, provided for a significant reinforcement of the budgetary criteria.[271] Crucially, it set forth a procedure of "quasi-automatic" sanctions, in case of breach of the deficit threshold, not being imposed by the Council via the Treaty, but to take immediate effect by law.[272] The German proposal had critical reception outside Germany, but was still able to fuel the discussion, which formally began at the European Council meetings in Madrid in 1995 and Florence in June 1996.[273] In the initial stage, the European Council also considered a possible renegotiation of the Treaty or the

[268] See the recitals of Council Regulation (EC) 1466/97 and of Council Regulation (EC) 1467/97.
[269] For a deeper analysis of the SGP see M Heipertz and A Verdun*, Ruling Europe: The Politics of the Stability and Growth Pact* (Cambridge, Cambridge University Press, 2010). For the constitutional implication of the SGP see M Herdegen, 'Price stability and budgetary restraints in the Economic and Monetary Union: The law as guardian of economic wisdom', 35 *Common Market Law Review* 1 (1998) 9-32; For an economic analysis of the Pact see among many B Eichengreen and C Wyplosz "The Stability Pact: more than a minor nuisance?" 13 *Economic Policy* 26 (1998) 65-113.
[270] Stabilitatspakt fur Europa: Finanzpolitik in der dritten Stufe der WWU, Pressemitteilung des Bundesministeriums der Finanzen, Bonn, 10 Nov. 1995; Deutsche Bundesbank/Ausz¨uge aus Presseartikeln No. 77, 13 Nov. 1995, 6–9.
[271] According to the proposal, the deficit could not exceed the 3% limit even in the case of adverse economic developments and the compliance had to be monitored by the European Commission twice each year. What constitutes extremely exceptional conditions had to be agreed by a qualified majority of EMU Member States. In normal economic conditions Member States should aim at a deficit of 1% of GDP, and the overall indebtedness had to continue below the 60% Maastricht limit. For a more advanced analysis of this proposal see H Hahn, 'The stability pact for european monetary union: Compliance with deficit limit as a constant legal duty', 35 *Common Market Law Review* 1 (1998) 80.
[272] Ibid 81.
[273] Ibid 86.

adoption of an intergovernmental agreement as provided under the German proposal. However, in light of a strong opposition of many states, a compromise was reached so that the SGP was adopted via secondary EU legislation based on the framework of the Treaty.[274] In particular, the Pact consisted of the European Council resolution issue at the Amsterdam meeting[275], two implementing regulations: Council Regulation 1466/97,[276] and Council Regulation 1467/97,[277] and a code of conduct.[278]

With the resolution, the European Council set forth some of the main elements of the Pact, particularly the safeguarding of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation, and the adherence to the objective of sound budgetary positions close to balance or in surplus. Under the Pact, Member States were required to respect a ceiling on general government budget deficits of 3 per cent of GDP as laid down in the Maastricht Treaty (Article 104 and the corresponding Protocol), and to aim for a balanced budget or have budgetary surpluses over the medium term.

With Regulation 1466/97, the Council strengthened the surveillance of budgetary positions and the surveillance and coordination of economic policies. Its legal basis was Article 103(5) of the EC Treaty, which allowed the Council to adopt detailed rules for the multilateral surveillance procedure. This first regulation of the SGP thus rested on and amended the multilateral surveillance procedure provided under the Treaty to prevent, at an early stage, the occurrence of excessive general government deficits. For this reason, this part of the SGP was named the "preventive arm".[279] The "preventive arm" added to the multilateral surveillance procedure a more precise, transparent, and informed procedure of information and control with a clearer timetable. Two documents were introduced in the procedure: the Stability Program (SP) and the Convergence Program (CP). This was done to supply the Community with an updated analysis of the current year, and a projection for the following three years, of the MTO for the

[274] M Heipertz and A Verdun (n. 269) 5.
[275] The European Council in Amsterdam approved three resolutions. Among the three, the European Council reached an agreement on the main elements of the Stability and Growth Pact. European Council in Amsterdam, Conclusion of the Precidency, EU Bulletin 6-1997, point I.27. OJ C 236, 2.8.1997.
[276] Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, OJ L 209/1.
[277] Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure, OJ L 209/6.
[278] "Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of Stability and Convergence Programmes", Opinion of the Economic and Financial Committee.
[279] Article 1 of Council Regulation (EC) 1466/97 (n. 276). See also F Amtenbrink, J De Haan, C.H.M. Sleijben, 'Stability and Growth Pact: Placebo or Panacea?' 8 *European Business Law Review* 9 (1997) 202-210.

budgetary positions of close to balance or in surplus of each country and the adjustment path towards this objective, and the expected path of the general government debt ratio. These two documents would then form the basis for the early warning system envisioned in the regulation.

Under this new system, both the SP and the CP programs were to be preliminarily assessed by the Commission and the Economic and Financial Committee[280] in order to determine whether the programs were in line with the MTO, as well as with the BEPG. Based on this analysis, the Ecofin would then render a formal opinion, within two months from the submission of the program, as to whether (i) the MTO provided for a safety margin to ensure the avoidance of an excessive deficit; (ii) the economic assumptions were realistic; (iii) the measures being taken and/or proposed were sufficient to achieve the targeted adjustment path towards the MTO and, for the non-euro Member states, to achieve a sustained convergence; and (iv) the economic policies of the Member State concerned were consistent with the BEPG.[281] In case the Ecofin considered the program in need of strengthening, the Council would invite the Member State to adjust its program.[282] Ultimately, the Ecofin was responsible for monitoring the implementation of stability and convergence programs and for eventually alerting a Member State at an early stage, if it detected any persistent budgetary divergency from the program, and recommend the necessary corrective action in order to prevent a government deficit from becoming excessive.[283]

With Regulation 1467/97, the Council decided to accelerate and clarify the implementation of the excessive deficit procedure in order to correct the occurrence of excessive government deficits. This part of the SGP was thus called "corrective arm", and its legal basis was Article 104c(14) of the EC Treaty, as well as Protocol 5. More precisely, this second regulation preliminarily clarified that an excess deficit is considered only exceptional and temporary when it results from an unusual event outside the control of the Member State and which has a major impact on its financial position, or when it results from a severe economic downturn, provided that the deficit returns within the reference value at the end of the unusual event or the severe economic downturn. The reference value provided for in this scenario is an annual fall of real

[280] As required by Art 109c(2) EC stating that the Committee shall contribute to the preparations of the work of the Council - among others - in the framework of Art 103(3) - (5) EC.
[281] Article 9 of Council Regulation (EC) 1466/97 (n. 276).
[282] Article 10 of Council Regulation (EC) 1466/97 (n. 276).
[283] Article 1 of Council Regulation (EC) 1466/97 (n. 276).

GDP of at least 2% or less if nevertheless evidence is presented by the Member State to support the abruptness of the downturn.[284]

The Regulation additionally laid out a clear timetable for the EDP with more specific deadlines and a sanctioning procedure at the end of the process. This sanctioning procedure represented the main controversial element of the SGP at the time. The final version of the Regulation on the excessive deficit procedure was different from previous proposals, with a more rigorous process and limited discretion concerning the nature of the sanction to be imposed.[285] However, the possibility of quasi-automatic sanctions, as requested by Germany, was eventually ruled out as it encountered heavy resistance. The council decided to adopt a solution that was based, as some authors have noted, on the mere appearance of "automaticity" through a solemn resolution by all Member States to commit to apply the EDP in a strict and timely manner.[286] Nevertheless, the sanctioning procedure under the Regulation remained unenforceable because of the unwillingness of the majority of the Member States in the Council to impose fiscal discipline.

As a result, the EDP was essentially more a political instrument than a legal one. The Regulation would pressure Community institutions and Member States, in the shadow of the deficit procedure, to negotiate structural reforms and fiscal adjustments toward fiscal discipline. Precisely for this reason, in the aftermath of the SGP approval, the European Council agreed to set up a permanent and informal forum (the Eurogroup) to carry out these negotiations among the finance ministers of euro area members and the representatives of the ECB and the Economic and Monetary Committee.

The following year, the EMU proceeded in its third and final stage, with the irrevocable fixing of the exchange rate and the adoption of the Euro (alongside the creation of the ERM II) into eleven Member States that satisfied the convergence criteria under the Treaty.[287] Not all the eligible countries decided to participate. The UK and Denmark refrained from entering the third

[284] Article 2 of Council Regulation (EC) 1467/97 (n. 276).
[285] M Herdegen (n. 268) 30.
[286] M Heipertz and A Verdun (n.269) 6.
[287] Decision of the Council of the European Union meeting in the composition of the Head of States and Government of 3 May 1998, O.L J 139, 11 May 1998, p. 30. Member States included Belgium, Germany, Spain, France, Ireland, Italy, Luxembourg, The Netherlands, Austria, Portugal, and Finland. Greece adopted the euro in a later stage, on 1 January 2001.

stage of the EMU even though they complied with the convergence criteria, while Sweden was excluded only for failing to meet (voluntarily) one of the convergence criteria.[288]

It is understood that the discourse leading up to the final adoption of the single currency was principally shaped by the French and the German governments. Italy and the UK, as the two other major EU Member States, had a weak influence over the negotiation process and the eventual content of the EMU because of the political turmoil of the former and the persistent opposition to the EMU of the latter.[289] The two engine countries essentially determined the framework of the EMU governance, and, more importantly, whether or not the monetary union was going to occur at all. All of the other countries were only able to decide whether to join the union or not.[290] The EMU governance system was thus a compromise between the German economists, influenced by the Ordoliberal school, and the French monetarists, influence by the new Keynesians. With regards to monetary policies, the compromise was reached so that the French could obtain a complete transfer of sovereignty over monetary matters with a single currency and a common monetary policy, while the Germans could obtain an independent European Central Bank and a clear price stability objective. These considerations were raised by the President of the Bundesbank, K. Pöhl, within the Delors Committee, and were successfully included in the report as a condition for the decision to complete the single currency.[291] They were later preserved in the Treaty to become the principles of price stability as the primary objective of monetary policy, and institutional independence of the European central bank.[292] As for economic policy, the Germans, who perceived the full convergence of

---

[288] The Treaty specifically provided for a special status to certain Member States. Under Protocol 15 the UK could decide, without obligation, when and whether to adopt the euro and allow it "to retain its powers in the field of monetary policy according to national laws." The same special status was extended to Denmark, after an internal referendum rejected the adoption of the single currency. Similarly, the Swedish government decided not to join the euro in 1999 by failing to comply with convergence criteria and as a result, Sweden was not being subjected to most of the rules of the monetary union.

[289] For an ample discussion see K Dyson and K Featherstone (n. 3) 452 and ff. (concerning the Italian position), and 534 and ff. (for the British position).

[290] M Feldstein, 'The political economy of the European Economic and Monetary Union: Political Source of an Economic Liability', 11 *The Journal of Economic Perspectives*, 4 (1997) 28.

[291] K Pöhl, 'The Further Development of the European Monetary System' Collection of Papers. Committee for the Study of Economic and Monetary Union (Luxembourg, 1989) 129-156.

[292] Art. 127 of the Treaty on the Functioning of the European provides a clear mandate: "The primary objective of the ESCB shall be to maintain price stability." The ECB Governing Council provided a formal definition of price stability as "a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the euro area of below 2% […] over the medium term" ECB Press Release, "A stability-oriented monetary policy strategy for the ESCB", (13 October 1998), available at https://www.ecb.europa.eu/press/pr/date/1998/html/pr981013_1.en.html. Art 127 of the Treaty also provides that the ECB objective also includes the support to the general economic policies of the Community, but this must be carried out "without prejudice to the objective of price stability". This definition and the general objective have been recently under discussion and in such connection the ECB Vice President affirmed that: "It

economic fundamentals as a pre-requisite for the monetary union, maintained the convergence criteria as a requirement to participate at the monetary union, as well as the other rules to impose fiscal discipline and consolidation, in combination with the express exclusion of monetary financing or bail-outs. The French maintained that only partial authority in the fields of economic and budgetary policy would be transferred to the Community level, and that no automatic or quasi-automatic sanction would be imposed on Member States in breach of the fiscal discipline rules.

The overall EMU governance received mixed reviews. Some praised it for its novelty and for the economic benefits that it would be able to generate.[293] Others argued instead that the net economic effects of the European Monetary Union would have been negative.[294] The main criticism concerned its asymmetric structure for being subject to pure political considerations rather than for mapping the process that would lead to the adoption of the single currency and on designing the corresponding institutions.[295] In particular, as we will develop in the second chapter, much criticism was directed toward the rules on fiscal discipline and economic policies coordination and the resulting asymmetry of the system. As recognized by A. Lamfalussy, one of the founding fathers of the EMU: "The greatest 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."[296]

It was mainly for this reason that, during the first decade, Member States operated under a widespread lack of fiscal discipline. Government debt and deficit as a percentage of GDP remained high in Belgium, Italy, and Greece. More significantly, France and Germany, the two engines and main actors involved in the adoption of the EMU and its fiscal discipline approach, posted excessive deficits. As a result, in 2003, based on the evidence and a report from the Commission, the Council decided that an excessive deficit existed in both countries, and

---

is worth noting that, in the Treaty, our primary mandate is defined in terms of price stability in the market of goods and services and not in terms of asset prices. Furthermore, we have a strictly hierarchical mandate with price stability as our primary goal and without prejudice to this goal, we have to support the objectives of the European Union, notably, output and unemployment stabilisation, as well as financial stability. Maintaining price stability in the euro area." V Constâncio, Speech at the 18th Annual Central Bank and Investment Authority Seminar organised by Commerzbank (Berlin, 16 October 2014) available at https://www.ecb.europa.eu/press/key/date/2014/html/sp141016.en.html.

[293] See for instance A Brunila, M Buti, D Franco, *The Stability and Growth Pact: the architecture of fiscal policy in EMU* (New York, Palgrave Macmillan, 2001).

[294] Most notably M Feldstein (n. 290) 24.

[295] Among many see C Wyplosz, 'European Monetary Union: the dark sides of a major success', 46 *Economic Policy* 21 (2006) 207-261.

[296] A Lamfalussy, Interview in The Guardian, 16 Aug. 2003.

according to Article 104(7), set a deadline for correction. Because no progress or correction was observed, the Commission in accordance with the provisions of Article 104(8) of the Treaty, ultimately suggested that the Council decide that no effective action had been taken in response to its recommendation under Article 104(7).[297]

After a tense and heated debate at the Ecofin meeting in November 2003, only a simple majority of the Member States voted to uphold the recommendation of the Commission, thus lacking the necessary qualified majority.[298] The Council unanimously issued a separate conclusion reaffirming its commitment to fiscal discipline as well as to the SGP, but ultimately "agreed to hold in abeyance" the excessive deficit procedure against France and Germany and "decided not to act, at this point in time, on the basis of the Commission Recommendation".[299] This controversial decision had no immediate impact on financial markets,[300] but led to a significant legal dispute concerning the interpretation of the EDP. The Commission entered a statement in the Council minutes noting that such rejection had no adequate explanation and that the Council recommendations based on Article 104(7) remained in force. The Commission decided to raise the question before the European Court of Justice (ECJ) to ask for the annulment of the conclusions as well as of the decision for failing to act according to Article 104(8) and (9) EC. The ECJ issued a speedy and very pragmatic decision.[301] The Court annulled the Council's conclusions insofar as they contained a decision to hold the excessive deficit procedure in abeyance as well as a decision modifying its previous recommendations. At the same time, it confirmed the absolute discretion of the Council in declining to adopt the Commission recommendation, by declaring the action of the Commission inadmissible insofar as it seeked annulment of the failure of the Council of the European Union to adopt the formal instruments contained in the Commission's recommendations.

---

[297] See Commission Recommendation to the Council on an Excessive Deficit Procedure for Germany Commission Press Room IP/03/1560 Brussels, 18 November 2003; Commission Recommendation to the Council on an Excessive Deficit Procedure for France Commission Press Room, IP/30/1420 Brussels, 21 October 2003.

[298] For a reconstruction of the events, see D Gros, T Mayer, A Ubide, 'The Nine Lives of the Stability Pact' Special report by the CEPS Macroeconomic Policy Group (2004) available at http://library.coleurop.be/pdf/9%20Lives%20of%20SGP%20standard1.pdf.

[299] Council Conclusions at the Ecofin Council meeting - Brussels, 25 November 2003.

[300] D Gros, T Mayer, A Ubide (n. 298) 17.

[301] Judgment of the Court of 13 July 2004, Commission of the European Communities v Council of the European Union. ECLI:EU:C:2004: 436. On this decision, among many see F Chaltiel, 'Le Pacte de stabilite, entre exigences juridiques et pragmatisme politique', 481 Revue du marche commun et de l'Union Européenne (2004) 509-514.

This crisis was a sign that the rules concerning fiscal discipline prescribed by the Treaty and the SGP had lost credibility and needed a significant reform.[302] As a result of a Commission reform blueprint,[303] the SGP was amended in 2005 toward a softer approach with the hope of creating a more credible and enforceable arrangement.[304] From a practical standpoint, the reform specifically changed the definition and calculation of the MTO by taking into account specific economic and budgetary circumstances, such as the budgetary adjustment implications for the structural balance. The MTO became country-specific and their calculation was conditioned to the level of debt and potential-growth of the country so as to allow a safety margin with respect to the reference value of 3% of GDP. This was meant to allow flexibility during negative economic cycles discouraging pro-cyclical policies, but to ensure at the same time a cap on the levels of debt.[305] Additionally, a greater emphasis was granted to structural reforms in connection with the so-called Lisbon Strategy.[306] As a result, Member States had to provide a supplementary document, the National Reform Programs (NRP), which would outline the ongoing or future national programs of structural reforms toward a sustainable and inclusive growth in light of Broad Economic Policy Guidelines.

As we will discuss more in the second chapter, the 2005 reform was essentially a significant step towards the so-called Open Method of Coordination (OMC), which is based on the idea that a flexible approach to coordination is more appropriate in areas where the case for centralization is weak. This term was coined at the Lisbon Summit in 2000, and preserved in the Lisbon Strategy.[307] It also reflected the previous Cardiff agenda, which aimed at achieving

[302] Editorial comments (2004) cit. p. 1194. For an economic appraisal see also C Allsopp and M Artis, 'The assessment: EMU four years on' 19 *Oxford Review of Economic Policy* 1 (2003) 1-29.

[303] Commission Communication on strengthening economic governance and clarifying the implementation of the Stability and Growth Pact, Brussels, 3.9.2004 COM (2004) 581 Final.

[304] On 20 March 2005 the Council adopted a report entitled "Improving the implementation of the Stability and Growth Pact" which endorsed most of the Commission's recommendations. The report was endorsed by the European Council in its conclusions of 22 March 2005, which stated that the report updates and complements the Stability and Growth Pact, of which it is now an integral part. Two additional regulations were approved to amend the Pact. Council Regulation (EC) No. 1055/2005 of 27 June 2005 amending Regulation (EC) No. 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, O.J. 2005, L 174/1; Council Regulation (EC) No. 1056 of 27 June 2005 amending Regulation (EC) No. 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure, O.J. 2005, L 174/5. For an overview of the reform process see J Louis, 'The review of the Stability and Growth Pact' 43 *Common Market Law Review* 1 (2006) 85–106.

[305] F Amtenbrink and J De Haan, 'Reforming the stability and growth pact', 31 *European Law Review* 3 (2006) 402-413.

[306] In March 2000, at the Lisbon European Council, the Union set forth the strategy for the next decade, the so-called Lisbon Strategy for Growth and Jobs. The aim was to make the EU "the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion".

[307] J. Louis (n. 304) 86.

coherence between reforms of different markets (labor markets, capital markets and public finances), as well as the Cologne process which aimed at establishing a regular macroeconomic dialogue between the Ecofin Council, the Commission, the European Central Bank and the social partners. The open method which relaunched in March 2005 with the new Lisbon Strategy, was a wide program of economic, social and environmental reforms covering policies at both the national and the EU level.[308]

[308] The European Council relaunched the Lisbon strategy in March 2005 with greater emphasis on four main priority areas: Promoting knowledge and innovation, making the EU an attractive area to invest and work in, fostering growth and employment based on social cohesion, and promoting sustainable development.

4. THE SOVEREIGN DEBT CRISIS AND THE EU RESPONSES

In terms of statistical data, during its first years of existence, the Monetary Union was widely successful in promoting price stability, and gained some popularity with the entrance of four new Member States.[309] On the contrary, as we will explain in the last chapter, economic growth on the one hand and fiscal discipline and consolidation on the other hand have been quite disappointing. In this context, the outbreak of the sovereign debt crisis represented the first major test for this new system of governance. The debt crisis was the result of the financial crisis, which evolved into a debt crisis only weeks after the Lisbon Treaty entered into force.[310] Because of the institutional context and its economic magnitude, the crisis had, and still has, a profound impact on the overall European integration process with a diminished acceptance in the general public, a strengthening of "euro-skeptical" positions, tendencies of re-nationalization, and a wide lack of political leadership.[311]

The EU tackled the financial crisis through a dual approach. First, it addressed the primary need for a common response to stimulate the short-term economic recovery and for a sustainable long-term economic growth by dealing with the credit shortages of the banks as well as the economic recovery of the Member States. Second, the EU tried to tackle the underlying factors of the financial crisis by creating unitary financial oversight to restore confidence, stability and sustainability in the financial markets.

As a first step, in 2008, the Member States, in a coordinated attempt, agreed to rescue Europe's distressed banks thorugh several bail-out measures which would total up to 2 trillion Euro. At the same time, the Commission proposed, and later the Council adopted, a European Economic Recovery Plan[312]. The Plan suggested a series of actions (particularly in terms of research, innovation and green energy) to support both the short-term and the long-term European economy in line with the Lisbon Strategy. The implementation of these actions was to be carried out by using both structural funds and national expansionary policies with an overall amount of 200 billion Euro. [313] The stimulus package was mainly left to the discretionary public

---

[309] In January 2007, Slovenia became the first member state of the eastern block to join the euro, followed by Cyprus and Malta in 2008, and Slovakia in 2009.

[310] P Lane, 'The European Sovereign Debt Crisis' 26 *Journal of Economic Perspectives* 3 (2012) 49-68.

[311] For this analysis see M Ruffert, 'The European debt crisis and European Union law', 48 *Common Market Law Review* 6 (2011) 1777–1806.

[312] Commission Communication on "A European Economic Recovery Plan" – 26 November 2008 COM (2008) 800.

[313] The overall package covered 170 billion Euro of national expansionary measures, and 30 billion Euro of EU funding.

spending of Member States, but the Commission suggested that national measures would be carried through a mix of expenditures and/or reductions in taxation within a "timely, temporary, targeted, and coordinated manner". More importantly, the Commission highlighted the need of such budgetary policies being conducted within the margin set forth by the SGP. In particular, the 2005 revision of the SGP was key, because it was cited as the instrument allowing some flexibility, i.e. a potential breach of the 3% GDP deficit reference value, during bad times. The Plan insisted that the package be coupled with structural reforms in terms of curbing the rise in age-related expenditure, improving competitiveness and reducing regulatory and administrative burdens on businesses. In sum, the initiative was the result of a mix of Keynesian policies aimed at providing a significant internal demand boost, as well as economic liberalism policies aimed at providing a strong support for market forces, trade and deregulation.

As a second step, the EU addressed the other important issue arising out of the financial crisis: the need for more effective macro-prudential and micro-prudential financial supervision. To achieve this, the Commission proposed a set of reforms in terms of common European financial supervision in order to 'restore confidence, stability and sustainability in the financial markets'[314]. In particular, the Commission recommended, on the basis of the working group on financial supervision headed by De Larosière[315], the creation of one supervisory institution, the European Systemic Risk Board (ESRB), and one framework for financial supervision the European System of Financial Supervisors (ESFS) with the overall purpose of avoiding collective action problems in connection with capital markets oversight. The main function of the ESRB was to prevent "systemic risks"[316] by monitoring and assessing potential threats to financial stability arising from macro-economic concerns (the so-called "macro-prudential supervision").

Based on these assessments, the ESRB would provide, without legally binding powers, early warnings as well as recommendations, for action in general, and to specific Member States in particular. The ESFS, on the other side, was conceived as a framework consisting of national supervisory authorities, the ESRB, and the new European Supervisory Authorities (ESA), which would safeguard the financial stability of individual firms (the so-called 'micro-

[314] Commission Communication on "European financial supervision" – 27 May 2009 COM (2009) 252.

[315] J De Larosière, 'The High Level Group on financial supervision in the EU' (the De Larosière Report) published on 25 February 2009.

[316] For a survey of the legal and economic issues associated with systemic risks in capital markets see S Schwarcz, 'Systemic Risk', 97 *Georgetown Law Journal* 193 (2008).

prudential oversight'). Within the ESFS, the ESRB would work in tandem with the three new European supervisory authorities (ESAs), namely the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA), and the European Securities and Markets Authority (ESMA), and with supervisory authorities of the Member States, with the overall purpose to acquire better and more reliable information on cross-border risks.[317] This initiative had, however, significant weaknesses. The competence limitations of the ESAs and the strictly macroprudential focus of the ESRB and its 'soft law' status described above, required a stronger mechanism to complement supervision and crisis prevention also on the micro-prudential level, which was still missing at the time.[318]

The European Central Bank also joined these two common responses as the financial crisis severely damaged financial stability as well as price stability, especially in the Eurozone[319]. The regular transmission of monetary policy, i.e. the ability of the ECB to affect price stability by interest rate decisions, had been significantly limited by disfunctional money and security markets[320]. The money market was hampered by mistrust, liquidity and bank solvency problems. In order to overcome such issues and restore liquidity in the banking sector, the ECB underwent a number of non-standard measures – so-called 'enhanced credit support' - through two types of programs: the LTRO[321] and the covered bond purchase program.[322] Like their American counterparts (TARP), both measures were able to partially restore liquidity in the banking sector, and a phasing-out of the program began in late 2009.[323]

[317] Commission Proposal on "Regulation of the European Parliament and of The Council on Community macro prudential oversight of the financial system and establishing a European Systemic Risk Board", 23 September, COM(2009) 499; The Regulations n. 1092 /1093 /1094 /1095 /1096 of 24 November 2010 [2010] OJ L 331/1-84; See also the so-called Omnibus Directive which amended the legislation in the matter of financial services to ensure effective operation of the European System of Financial Supervisors: Directive 2010/78/EU of 24 November 2010, [2010] OJ L 331/120.
[318] B Haar, 'Financial Regulation in the EU – Cross-Border Capital Flows, Systemic Risk and the European Banking Union as Reference Points for EU Financial Market Integration', SAFE Working Paper No. 57 (2014) 33, Available at SSRN: https://ssrn.com/abstract=2459361.
[319] See especially, J Trichet, 'State of the Union: The Financial Crisis and the ECB's Response between 2007 and 2009' 48 *Journal of Common Market Studies* 7 (2010).
[320] See ECB, 'The ECB's Monetary Policy Stance during the Financial Crisis' (2010) *Monthly Bulletin*, 63.
[321] These longer-term refinancing operations (LTROs) provided liquidity to the banking sector for longer periods than short-term refinancing operations. In particular, they extended the maximum maturity of refinancing operations to one year, thus reducing the short-term need for refinancing requirements by banks.
[322] These covered bonds are long-term debt securities issued by banks to refinance loans to the public and private sectors, often in relation to real estate transactions. This importance of this operation was underlined by the former President of the ECB: "The covered bond market is the largest and most active segment of the fixed income market in the euro area – even exceeding the corporate bond market – with the exception of the public sector bond market […] This market nearly collapsed when the financial crisis intensified' J Trichet (n. 319) 13.
[323] ECB, 'Governing Council decisions on the phasing-out of some non standard measures' *Monthly Bulletin* (2009), 9.

However, around the same time as the ECB phasing-out process, the situation dramatically changed. The financial crisis, and particularly the banking liquidity crisis, gradually began to hit the balance sheet of sovereign states, especially in Europe. Some of the major European banks were in fact highly exposed to losses in the US market in asset-backed securities and money markets.[324] The costs of bailing out and recapitalizing the banks ultimately led to a sharp increase of the government budget deficits and public debts. The link between banks and government is widely credited as one of the major reasons for the debt crisis and the increase in government bond yields. Additionally, two other factors were key in turning the financial crisis into a European debt crisis. On the one hand, the collapse of tax revenues, especially in Ireland and Spain, resulting from the economic downturn, significantly contributed to the deterioration of the already weak Member States' economic fundamentals.[325] On the other hand, the revelation, in late 2009, by the newly elected Greek Government of budget manipulation (specifically the amount of the budget deficit) performed by past governments significantly worsened the economic context and raised concerns over the solvability of the Greek State.[326]

By early 2010, the sovereign credit risk, as the government's probability of default, started to intensify for many European States, especially peripheral nations (Greece, Ireland, Portugal, Spain, and Italy), which was reflected in higher yields of government securities. This was in sharp contrast to the government bond market prior to the crisis, which saw the spread, as the difference among bond yields, of European Member States almost close to zero from 2002 to 2010. In other words, before the crisis, financial markets did not express any sovereign credit risk for European Member States and treated all the Member States as equal from a financial standpoint, notwithstanding the apparent different economic fundamentals between them.

Because of this radical shift in the crisis, the first two common EU initiatives essentially became obsolete and ineffective. In particular, the recovery plan correctly urged Member States to put in place counter-cyclical measures to recover from the financial crisis, but at the same time, it recognized that the SGP could not be equally superseded. Through bailouts and economic depression the government budget of a number of Member States significantly deteriorated for

[324] V Acharya, I Drechsler, and P Schnabl, 'A Pyrrhic Victory? - Bank bailouts and sovereign credit risk' NBER Working Paper, 17136 (2012) available at http://pages.stern.nyu.edu/~sternfin/vacharya/public_html/pdfs/ADS_4april2013.pdf.

[325] C Reinhart and K Rogoff, 'The Aftermath of Financial Crises' 99 *American Economic Review* 2 (2009) 466-470.

[326] See Report of the Commission of 8 Jan. 2010 on Greek Government deficit and debt statistics, COM(2010) 1 final.

the kind of flexibility that the SGP allowed, even after the 2005 reform.[327] Ironically, the countries that needed the stimulus package the most, i.e. those whose balance sheet were hit the most by the financial crisis, could not effectively put in place the economic recovery plan envisioned in the proposal.[328] Ultimately, the rise in yields on ten-year sovereign bonds for peripheral nations became critical for their limited ability to finance additional budget deficits and even repay or refinance existing government debt.

For this reason, the EU responded in May 2010, through a number of measures to financially assist Member States in economic distress, with Greece being the first recipient. By April 2010, the Greek borrowing rates rose sharply after a significant downgrade by the major credit agency. Greece became unable to borrow at a sustainable interest rate from the markets and the Greek government officially requested external financial assistance.[329] The instrument of financial assistance provided by the Treaty and the current EU legislations, more specifically the balance-of-payments assistance as well as the medium-term financial assistance, were limited and could not be used in the case of Greece.[330]

As a result, the EU, in combination with the IMF, provided a rescue package through a bilateral loan.[331] This package was part of the so-called "Economic Adjustment Programme", the purpose of which was to financially assist Member States in financial distress during the sovereign crisis.[332] The program was based on a memorandum of understanding agreed by the Greek government, the European Commission, the ECB and the IMF (commonly referred as the "Troika"), which directly conditioned the granting of the loans on strict requirements with

[327] "The budgetary stimulus should take account of the starting positions of each Member State. It is clear that not all Member States are in the same position. Those that took advantage of the good times to achieve more sustainable public finance positions and improve their competitive positions have more room for manoeuvre now. For those Member States, in particular outside the euro area, which are facing significant external and internal imbalances, budgetary policy should essentially aim at correcting such imbalances."

[328] See European Commission, Progress report on the implementation of the European Economic Recovery Plan, Dicember 2009.

[329] see Joint statement by European Commission, European Central Bank and Presidency of the Eurogroup on Greece, IP/10/446, 23 April 2010.

[330] See on this point A Casale, A Giovannini et al., 'The Implications for the EU and National Budgets of the Use of EU Instruments for Macro-Financial Stability', CEPS Working Documents 64 (2012) available at http://aei.pitt.edu/36439/1/Instruments_for_Macro-Financial_Stability.pdf.

[331] The first bailout package for a three year period comprised 110 billion Euro spread over three years, with 80 bilion provided by the EU and the remaining 30 billion from the IMF.

[332] This program was initially set up for Greece, but later also for other Member States, such as Portugal, Ireland and Cyprus.

regard to budget consolidation.[333] The Council later endorsed the agreement with "a view to reinforcing and deepening fiscal surveillance and giving notice to Greece to take measures for the deficit reduction judged necessary to remedy the situation of excessive deficit".[334] The main characteristic of this financial package was that the interest rate charged for this loan was inferior to the one of the markets, and close to the one charged before the debt crisis. Additionally, and more dramatically, all these programs were conditional on the implementation of "austerity measures", i.e. measures that required a significant fiscal consolidation in terms of a rapid decrease of public expenditures and debt restructure agreements.[335]

The approval of the first rescue package for Greece occurred within an extraordinary meeting of the Ecofin held on 9 and 10 of May 2010. During the meeting, the Council also approved, on the basis of a proposal by the Commission, the establishment of two financial instruments: the European Financial Stabilisation Mechanism (EFSM) and the European Financial Stability Facility (EFSF). The general function of these instruments was raising capital by issuing debt instruments in the financial markets in order to finance loans and other forms of financial assistance to Members States in case of need, as had occurred with Greece.[336] The main difference between the two was that the EFSM was placed within the scope of Article 122(2) TFEU, and was thus considered a temporary mechanism of assistance in compliance with the Treaty.

This had two major consequences. First, financial assistance was expressly limited to the Community's own resources (up to 60 billion Euro) since the Commission would guarantee the

[333] The resulting arrangement consisted of two agreements: the Loan Facility Agreement between the states of the euro area and Greece, providng the loan conditions, and the Intercreditor Agreement, an agreement between the Member States of the euro area providing the reciprocal rights and duties.

[334] See Council Decision (2010/320/EU) of 10 May 2010, O.J. 2010, L 145/6, amended by Council Decision (2010/486/EU) of 14 Sept. 2010, O.J. 2010, L 241/12.

[335] The First Economic Adjustment Programme for Greece was later replaced by a second bailout package for the period 2012-2016. The new program had a size of Euro 172 billion Euro (of which 28 billion from IMF and 144 billion from the EFSF) including the remaining committed amounts of 37 billion, which had not been yet disbursed from the first bailout package. In total, Greece received two bailouts for a total amount of 245 billion Euro. Additionally, the private sector, banks and insurance companies, was also "invited" to restructure their debt by voluntarily swapping their Greek government bonds for longer maturity paper at lower interest rates. The restructuring of the Greek public debt was successfully completed in 2012 with a cut of around 53.5 percent of the face value of Greek bonds. For a good survey on these measures see A De Gregorio Merino, 'Legal developments in the economic and monetary union during the debt crisis: the mechanism of financial assistance', 49 *Common Market Law Review* 5 (2012) 1615-1618.

[336] In relation to the EFSM, see Regulation 407/2010, O. J. 2010, L 189/1 (EFSM Regulation); in relation to the EFSF, see Council conclusions at document 9602/10 and Decision of the representatives of the governments of the Euro area Member States meeting within the Council of the EU, at document 9614/10.

loan by using the EU's budget as collateral.[337] Second, the fund would operate under the supervision of the Council who could decide by a qualified majority, on a proposal by the Commission, whether to grant assistance to Member States. The EFSF was created to expand the assistance beyond the Community resources and was thus placed outside the Treaties and designed as an intergovernmental mechanism, and more specifically a "special purpose vehicle".[338] The EFSF could raise a larger amount, up to 440 billion Euro, which would be guaranteed by the participating Member States on a pro rata basis according to their capital contribution to the ECB. The EFSF could also intervene in the secondary markets and finance recapitalization of financial institutions.[339] In any case, both instruments were construed as temporary measures for a three-year period in order to tackle the immediate financial needs of the Member States in distress. They were to be substituted by a permanent instrument, the future European Stability Mechanism (ESM), to be adopted over the course of 2012. At the same time, the sovereign debt situation became subject to a prompt intervention of the ECB, as a well-functioning market for government bonds is considered indispensable for performing monetary policy as well.[340]

In order to restore an appropriate monetary policy transmission mechanism, the ECB adopted the securities market program (SMP).[341] Through the SMP, Central Banks of the Eurosystem could purchase on the secondary market eligible marketable debt instruments issued by the central governments or public entities of the Eurozone. This acquisition, however, also served the other important and underlying purpose of easing market pressure from the European government securities.

All these measures were fundamental to providing the necessary liquidity in the government bond markets, but they clearly did not address any of the underlying reasons for the debt crisis. Among the many important lessons of the crisis was that a setting where fiscal discipline is treated as a matter of common responsibility and fiscal policies are demanded to the sovereign

[337] According to Article 2(2) of the EFSM Regulation: "The outstanding amount of loans or credit lines to be granted to Member States under this Regulation shall be limited to the margin available under the own resources ceiling for payment appropriations".
[338] For a good survey on these instruments see A De Gregorio Merino, (n. 335) 1618-1621.
[339] European Council, Statement by the heads of State or Government of the euro area and EU institutions of 21 July 2011, available at www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/123978.pdf
[340] J. González-Páramo, 'The European Central Bank and the policy of enhanced credit support', Speech at the Conference organised by Cámara de Comercio de Málaga and University of Málaga, Málaga, 18 June 2010. Available at https://www.ecb.europa.eu/press/key/date/2010/html/sp100618_2.en.html.
[341] ECB Decision of 14 May 2010 on establishing a securities markets programme, (2010) OJ L 124/8.

state, is indeed extremely vulnerable to economic shocks and requires a more robust system of governance. In other words, the economic governance in place showed its shortcomings to foster economic coordination and discipline, especially during economic crisis.[342] As anticipated by the Commission before the crisis[343], and reaffirmed by the 2009 report of the European Parliament (so-called Feio Report) "the surveillance framework was too weak and the rules of the Stability and Growth Pact were not sufficiently respected, in particular as regards the preventive arm."[344]

As a result, at the same extraordinary meeting of Ecofin in May 2010, in what has been defined as "the most dramatic week-end in EU history"[345], the Council acknowledged the need for a stronger system of governance and consequently agreed on a long-term commitment to accelerate toward specific reforms. The Commission presented a proposal to reinforce the economic governance of the EMU through a series of measures.[346] The objectives of the proposal were clear, given the higher interdependence achieved between Member States in both their public and private financial sectors, that it was necessary that economic coordination of national budgets be "consistent with the European dimension".[347] Some of these proposals, including the Euro Plus Pact, were agreed on or adopted by the European Council in March 2011,[348] while others, namely the Six Pack, were the result of the ordinary legislative process which ultimately ended in late 2011. Additionally, over the course of 2012, Member States complemented these measures with the Treaty on Stability, Coordination and Governance (Fiscal Compact) and the Treaty establishing the European Stability Mechanism (ESM). Overall, the general reform occurred around three main strands, which partially mimicked the EMU's common principles of the second chapter:

(i) A stricter system of coordination and surveillance of economic and budgetary policies through a new comprehensive calendar system: the European Semester, a new inclusive

---

[342] See the analysis in C Wyplosz, 'Multilateral Surveillance' directorate general for internal policies policy department a: economic and scientific policies economic and monetary affair (2010), Available at http://www.europarl.europa.eu/activities/committees/studies.do?language=EN.
[343] See the Commission Communication on "EMU@10: successes and challenges after 10 years of Economic and Monetary Union" – 7 May 2008 - IP/08/716.
[344] The European Parliament report (INI) on "Improving the economic governance and stability framework of the Union, in particular in the euro area", 2009 (Feio Report) avalaible on EP Legislative Observatory under: http://www.europarl.europa.eu/oeil/FindByProcnum.do?lang=2&procnum=INI/2010/2099.
[345] M Ruffert, (n. 311) 1779.
[346] Commission Communication on Reinforcing economic policy coordination, 12.5.2010 COM(2010) 250 final.
[347] This statement was made by commissioner Ohli Rehn in the Communication IP/10/561.
[348] European Council Conclusions of 24-25 March 2011, EUCO 10/1/11 REV1.

procedure to address macroeconomic imbalances and competitiveness developments (the Macroeconomic Imbalance Procedure), and additional commitments to enhance policy coordination, also for non-euro countries, with the Euro Plus Pact;

(ii) A more stringent regime of budget constraints and a more credible enforcement mechanism provided by the specific privisions of Six Pack and of the Fiscal Compact; and

(iii) A new framework of financial assistance for Member States in distress, the ESM.

Alongside the acceptance of these measures, the approval of the support package did not, however, temper the financial markets. By mid-2012, the risk of contagion intensified and in order to preserve the financial stability of the Euro area, an important meeting of the European Council and the Euro Summit commenced in June 2012.[349] After a long negotiation addressing the crisis threatening the euro's very existence, Eurozone leaders stressed the need to tackle multiple issues, such as to break the vicious cycle between banks and sovereigns, to financially support countries under financial distress and more generally "to do what is necessary to ensure the financial stability of the euro area".[350] More specifically, on the economic and monetary matters, the European Council decided on a "Compact for Growth and Jobs" including several actions to be taken by the Member States and the European Union to re-launch growth, investment and employment.

The Council also endorsed the country-specific recommendations and emphasised the role of the forthcoming Multiannual Financial Framework. It invited the presidents of the European Council, Commission, Eurogroup and ECB to design a "specific and time-bound road map for the achievement of a genuine Economic and Monetary Union".[351] The resulting report was presented under the title "Towards a genuine Economic and Monetary Union" (the so-called Four President Report).[352] The report outlined a series of reforms in stages for the future of the

[349] The Euro summit is a meeting of the heads of state or government of the member states of the Eurozone. From 2008 until 2011 the meeting was not formalized and occurred on a as-needed basis. In 2011, Eurozone Member States decided to hold at least two Euro Summit meetings per year, to be convened, unless justified by exceptional circumstances, immediately after meetings of the European Council or meetings with the participation of all Contracting Parties having ratified this Treaty.

[350] Euro area summit statement - 29 June 2012 available at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/131359.pdf.

[351] European Council Conclusions of 28-29 June 2012, EUCO 76/12.

[352] H. Van Rompuy, J. M. Barroso, J. C. Juncker, M. Draghi (2012) 'Towards a genuine Economic and Monetary Union', Brussels: European Council (Four President Report of the 5 December 2012) available at http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ec/134069.pdf.

EMU under four pillars: financial market union, fiscal union, economic union and political union.[353] It represented the first comprehensive plan to tackle all the shortcomings of the EMU from multiple standpoints.

The first block referred to an integrated financial framework to ensure financial stability in the Euro area. This proposal would have directly addressed one of the major weaknesses causing the financial crisis: the lack of a unified and independent supervisory institution over the largest European banks, in order to prevent future solvency and liquidity problems and ultimately avoid future government bailouts. This system would complement, on the microprudential level, what the De Larosière Report provided for at the macroprudential level. The proposal resulted in the approval of the European Banking Union, an overall framework based on three pillars: a common set of rules to prevent financial risks (the single rulebook)[354], a common prudential supervision under the ECB the Single Supervisory Mechanism (SSM),[355] and a common fund in case of bank's failure (SRM)[356].

With particular regards to the economic and fiscal union, which are the subject of our current analysis, the Four President Report envisioned a series of structural reforms to move gradually toward an integrated budgetary framework and eventually a fiscal union. The report, in particular, advanced a proposal to be implemented in the second stage of the process (around 2014), for "limited, temporary, flexible and targeted financial incentives as Member States enter into arrangements of a contractual nature with EU institutions". This would lead in the

[353] Ibid 4.
[354] The single rulebook is comprised of a number of legislative acts: the Capital Requirements Regulation (CRR) on common prudential requirements for credit institutions and investment firms; the Capital Requirements Directive IV (CRDIV) which implements strict capital requirements for banks based on Basel III; the Deposit Guarantee Scheme Directive (DGSD) which provides a common regulation of deposit insurance to protect European consumers in case of bank's failure; and the Bank Recovery and Resolution Directive (BRRD), for the recovery and resolution of credit institutions and investment firms and a common framework to manage the process of winding down the banks. The single rulebook is additionally completed by a number of Binding Technical Standards (BTS) drafted by the EBA and adopted by the Commission aimed at implementing the CRD IV, the BRRD and the DGSD for uniform harmonization.
[355] The SSM gives the ECB responsibility for supervision over the approximately 123 largest banking groups in the Euro area (and other SSM participating Member States). The national supervisor still retains the responsibility to monitor the remaining banks. Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (2012) O.J L 287/63.
[356] The Single Resolution Mechanism (SRM) is comprised of a board, the Single Resolution Board (SRB) and a fund, the Single Resolution Fund (SRF). In case of financial distress, the Board, duly informed by the ECB as supervisor, would have the responsibility to make a decision accordingly and potentially to prepare for the resolution of the bank through the fund. Regulation (EU) No 806/2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund (2014) OJ L 225/1.

third stage (after 2014) to "the establishment of a fiscal capacity to facilitate adjustment to economic shocks. This could take the form of an insurance-type mechanism between euro area countries to buffer large country-specific economic shocks."[357] In other words, the report supported the idea that coordination and fiscal rules had to be strengthened and embedded into previously adopted measures. On the other hand, it also proposed to put in place newly conceived arrangements based on incentives and risk sharing ideas to move toward a fiscal union. Ultimately, in this context, the report pressed for stronger mechanisms to support democratic legitimacy and accountability, for instance by involving the European Parliament and national parliaments on the recommendations adopted in the context of the European Semester.[358] The Four President Report, and more generally the June Summit in 2012, had a major impact on the crisis. It set the agenda for the establishment of the Banking Union and contributed to the adoption of specific legal measures that were already under discussion, such as the Two Pack. It also gave legitimacy and strength to the following non-standard monetary policies carried out by the ECB, specifically the OMT program, which was able to settle the financial markets. However, with regards to the fiscal union and the integrated budgetary framework, only the idea of "contractual arrangements" remained on the agenda; but ultimately, it was not able to reach a consensus on all aspects and as a result, the issue was postponed to consequent meetings.[359]

In 2015, a similar idea was re-launched by a second report commissioned by the Euro Summit. The report was prepared and presented by the President of the Commission in cooperation with the other four presidents (European Council, Eurogroup, ECB and the European Parliament) and is also known as Five President Report.[360] The purpose was again to deepen the reforms already underway, and to protect the currency union from potential economic shocks. The Five President Report, along the line of the previous report, proposed a multi-stage process towards a genuine Economic and Monetary Union (EMU). Preliminarily, it advised the completion of both the Banking Union and the Capital Market Union in order to form a more intregrated financial union. With regards to economic polices, the report suggested, during the second stage, a strengthening of the implementation of the Macroeconomic Imbalance Procedure and

[357] Four President Report (n. 352), 9.
[358] Four President Report (n. 352), 16.
[359] European Council Conclusions of 19-20 December 2013, EUCO 217/13.
[360] Report by J Juncker in close cooperation with D Tusk J. Dijsselbloem M Draghi and M Schulz Completing Europe's Economic and Monetary Union. (Five President Report, 2015) available at https://ec.europa.eu/commission/sites/beta-political/files/5-presidents-report_en.pdf.

put greater focus on employment and social performance. This was meant to achieve full economic convergence in the third stage.

As for budgetary policies, the report proposed again to progress toward a Fiscal Union. During the first stage, this would be carried out through a new advisory European Fiscal Board, to provide a public and independent assessment on national budgets within the context of the European Semester. In the second stage, the report suggested proceeding with a common macroeconomic stabilization function to better deal with shocks that cannot be managed at the national level alone. According to the report, the Euro area stabilization function should be developed within the framework of the European Union (for instance as part of the European Fund for Strategic Investments) in order to equalize incomes between Member States. They should, however, not involve permanent transfers between countries or transfers in one direction only, and to prevent moral hazard should be tightly linked to compliance with the broad EU governance framework and with the required structural reforms.[361] The Report also discussed the idea of a European treasury, and proposed reorganizing the European Semester into two consecutive stages and strengthening parliamentary control within the European Semester, in connection with the Annual Growth Survey, the Country-Specific Recommendations and the assessments of national budgets. Ultimately, it suggested carrying out the integration into the framework of EU law of the Treaty on Stability, Coordination and Governance (Fiscal Compact) and the relevant parts of the Euro Plus Pact. On the basis of this report, the Commission presented a package of measures in 2015.[362] Among the many advances, the package revised parts of the European Semester, by enhancing the macroeconomic dialogue with the the European Parliaments and by introducing the advisory European Fiscal Board. It also detailed the steps to complete the Banking Union, via a European Deposit Insurance Guarantee Scheme, as well as new instruments to further reduce risk in the banking system. Ultimately, on 1 March 2017, the Commission presented a White Paper setting out a long-term vision for the EU. The White Paper, as well as the following reflection paper, insisted on the achievement by 2025 of the economic, financial and fiscal union as envisioned in the Five President Report.[363]

[361] Five President Report (n. 360) 14-15.
[362] European Commission (2015), *On steps towards Completing Economic and Monetary Union*, COM (2015) 600 final, 21 October.
[363] European Commission, White Paper on the future of Europe, COM(2017)2025 of 1 March 2017. See also European Commission, reflection paper on the deepening of the Economic and Monetary Union, COM(2017) 291 of 31 May 2017.

5. CONCLUSIONS

From this first chapter we primarily understand how the EMU has been developed over time. This evolution and the resulting creation of a monetary union without a complementary economic union have progressivily increased the complexity of this entire legal system. Ultimately, following the recent institutional developments, the interplay between the different institutions and legal norms is now, highly intricated, and thus it can only be fully understood in light of this entire historical context.

Furthermore, such historical background is also helpful and functional to assess not only the current structure, but also the alternative institutional designs which will be explored in the third chapter. In particular, our normative assessment will have to provide an answer to two main recurrent themes that we may recognize throughout the EMU's history, as well as learn from past experience in such connection.

First, the role played by European institutions to solve coordination problems and to induce or enforce credible commitments. We explained in this sense how the EPU represented the first institutional agreement being able to provide a working solution to such question, by relying on binding decisions on the one hand, and self-enforcing mechanism based on positive incentives on the other hand. Pure market discipline clearly did not work since opportunitistic behavior were to large at the time. Similarly, a rigid rule-based approach was unsussessfull given the traditional difficult enforceability within an international context. This is helpful for our research as it provides a first and important European historical precedent to the possible solutions facing the Eurozone nowdays, where the same problems still exists. Such precedent has been however progressivily reversed from an institutional standpoint up to the actual design of the EMU. We saw that the Delors Report and the resulting Maastricht Treaty adopted a rigid rules-based system, which was later reinforced by the Stability and Growth Pact. The resulting system has however proven to be unsussessful and infective in inducing or enforcing credible commitments as the sovereign debt crisis dramatically proved. The large number of different legal measures adopted in the wake of the Eurozone crisis did not challenge such fundamental assumptions, and its pure rule-based approach, but mainly reinforced it, and this, as we will claim in more details in the third chapter, is still producing ineffective results.

While this first issue is related to the concept of effectiveness, the second element deals with the concept of efficiency. From this historical overview we understand that efficiency has always been an important factor in the development of the EMU. In particular, the term "transctions costs" has always been present during the EMU's historical evolution. We have explained that the entire history of the EMU in this sense particularly reflects the role of institutions in minimizing transactions costs. The definition of transaction costs, especially in this European context, as the main economic litterature also would agree, has been always quite liquid. In the initial period of the EPU, transactions costs were included in the idea of "market distortions", i.e. distortions affecting the stability and convertibility of currencies on current accounts. With the EEC Treaty, transaction costs became associated with the term "trade restrictions", i.e. restrictions created by the existance of tariff and mainly non-tariff barriers. Ultimately, the idea of transaction costs became expressly defined by the Delors report, as "the costs of converting currencies". Despite these different interpretation, what is key here is that the reduction of transactions costs has always been a crucial element in the development of the economic and monetary union. An element that has to be taken into consideration when we will then examine alternative institutional arrangements.

CHAPTER II

THE COMMON PRINCIPLES OF THE ECONOMIC UNION

INTRODUCTION AND SUMMARY

The comprehensive set of reforms arising from the sovereign debt crisis contributed to a number of new rules and procedures, which have partially amended previous regulations, specifically the SGP, in a multi-stage process. Within the different measures there exists a high level of overlap and complementarity. In some cases, the regulation itself tends to clarify the overlapping of disciplines,[364] while in other cases a more interpretative approach is required, as in the case between the Fiscal Compact and the Six Pack. These overlaps are essentially the result of the fact that each measure served a different purpose. According to some authors, for example, the Fiscal Compact is effectively a political tool, meant to legitimize the adoption of measures of financial assistance with respect to the national public opinion.[365] On the other hand, the Six Pack is generally considered a more legally conceived instrument to amend the SGP. Such a complex structure is consistent with the nature of the European integration process. As noted, "the characteristic of the European constitution, is a process-like nature; it is not a

[364] For instance Regulation 472/2013 of the Two-Pack comprises a number of articles defining the consistency with other instruments, such as the Stability and Growth Pact, the European Semester or the Six Pack, See Articles 10, 11, 12, 13 of Regulation 472/2013.

[365] See M Maduro Opening Statement in A Kocharov (ed.) 'Another Legal *Monster*? An EUI Debate on the *Fiscal Compact* Treaty', EUI Working paper LAW 2012/09 (2012) 3.

temporarily and substantively clear-cut normative entity but, rather, a continuous process of constitutionalisation."[366]

In any case, it is clear that the harmonization between old rules and new rules is legally challenging.[367] Given this broad and complex legal setting, it would be meaningless to simply provide a separate inquiry for each of these regulations. More importantly, any positive analysis need to be functional in order to serve as a useful basis for the normative assessment provided in the third chapter. Therefore, the most effective method of analysis is rather to single out and study the main common principles of the entire architecture and the resulting legal measures adopted to address such principles within an evolutionary perspective. On the basis of such principles it is then possible to detect the main lines to be weighed in the balancing process of the last chapter.

The first principle to be addressed is fiscal discipline and the resulting coordination of economic policies. To maintain fiscal discipline means to preserve a balanced budget and a sustainable level of public debt. This principle was largely advocated by exponents of the German Ordoliberal school during the European integration process under three main lines of argument. First, fiscal displine was meant to preserve price stability in the Eurozone by guaranteeing that Member States could not influence or coerce the ECB into loosening its monetary policy. Second, fiscal discipline was meant to avoid the domino effect produced by the increasing level of inflation and the trade balance in the common market. Third, fiscal discipline had the additional purpose of avoiding negative spillovers, such as a vicious cycle of rising interest rates on government's bond throughout the Euro area. Coordination of economic policies was the choice to impose a wide fiscal discipline in a system with a common and independent central bank and a decentralized fiscal setting. In fact, a coordinated approach to fiscal discipline and consolidation was the legal choice of the European founding father from the beginning of the European Economic Community, up to the Delors report and the resulting EMU governance structure. The economic literature traditionally adopts the term 'soft' or 'hard' to define the nature of the economic policy coordination depending on the strcture and its binding elements. The Treaties do not define what coordination means, but in order to provide a possible definition, and thus to evaluate whether this system might fall under a soft or a hard system of coordination, we must analyze its two main elements.

---

[366] K Tuori and K Tuori, *The Eurozone Crisis - A Constitutional Analysis* (Cambridge, Cambridge University Press, 2014) 1.

[367] For an economic analysis of the rules see H Wagner, 'Is harmonization of legal rules an appropriate target? Lessons from the global financial crisis' 33 *European Journal of Law and Economics* 3 (2012) 541–564.

First, a framework of macroeconomic dialogue between the national level and the Community level must exist in order for the Community to regularly monitor and assess the ongoing progress toward fiscal discipline. This requires macroeconomic guidance, collection of macroeconomic and budgetary information from the supranational authority, and finally, a system of monitoring and assessment of budgetary and macroeconomic positions. These elements were initially carried out under a soft approach, and more specifically as part of the Open Method of Coordination established with the Lisbon Strategy. After the sovereign debt crisis, the EU abandoned the approach for a stricter system of coordination through the adoption of several measures amending previous rules and creating new frameworks and procedures. The most important of these innovations is the new EU calendar system for budgetary information, the European Semester, and the new system to detect macroeconomic imbalances and competitiveness developments, the Macroeconomic Imbalance Procedure. A second element is the regime of fiscal rules. Fiscal rules have the specific goal of limiting fiscal policy with specific legally binding constraints, or hard budget constraints, and non-legally binding constraints, or soft budget constraints. The budget constraints under the Treaty, convergence criteria, and extended with the SGP on a permanent basis, were mainly considered of soft nature based on the widespread lack of compliance both before and after the adoption of the SGP. As a result, the recent reform with the Fiscal Compact and the Six Pack provided major changes.

Among the changes was the introduction of additional budget constraints with the expenditure benchmark, a more stringent definition of what constitutes a significant deviation from the MTO or from the appropriate adjustment path toward it, and by making the public debt ratio operational. The recent reform also amended the enforcement procedure for these budget constraints. In particular, until the establishment of the EMU, the Treaty only envisioned spontaneous enforcement. The Maastricht Treaty introduced a new form of external enforcement via the Excessive Deficit Procedure. The procedure, which was implemented by SGP with a clear timetable, principally relied on the Council, acting by a qualified majority, to assess whether an excessive deficit existed and whether, at the end of the process, it would be appropriate to impose economic sanctions. Because of the widespread lack of compliance, the recent reform moved toward a significant reinforcement of external enforcement with the application of the reverse qualified majority principle as well as toward a more stringent internal enforcement procedure, with the automatic correction mechanism, the debt brake provision, and with the creation of a specific procedure for macroeconomic imbalances.

The second principle underlying the entire Economic Union architecture is the principle of the irreversibility of the Euro. This principle was provided by the Maastricht Treaty, which referred to the irrevocable fixing of exchange rates that leads to the introduction of a single currency. It is additionally supported by the fact that there is no provision or mechanism allowing the exit from the EMU. The irreversibility of the Euro had two main purposes. First, it was conceived as a response to the shortcomings of the flexible approach of the previous ERM. Second, it was conceived as a system of checks and balances between the German and the French. However, the irreversibility was, for a long time, only a theoretical and legal concept. The sovereign debt crisis changed this perception, and underlined how the plain language of the Treaties was not sufficient to demonstrate such a binding agreement. Rather, concrete actions were needed to demonstrate such a commitment.

As a result, the ECB in conjunction with the Member States adopted a number of financial measures to support the irreversibility of the monetary union. First, the ECB expanded its non-standard monetary policies by adopting a new program, the Outright Monetary Transactions program (OMT) under which the Eurosystem could acquire sovereign bonds of Member States with more flexibility than under previous programs. This bond purchase program is crucial in this sense because it addresses those countries under financial stress (typically distress concerning their sovereign bond market). In addition, the Member States of the Eurozone created a mechanism of financial assistance, the European Stability Mechanism (ESM). The ESM is a permanent lending facility with capital raised from Eurozone Member States that can provide direct funding to Member States and banks facing financial difficulties through a process requiring significant structural reform for receiving any assistance.

Although the European Court of Justice has legally supported both programs, they have significantly changed many of the original assumptions under the European economic constitution. In particular, they have substantially expanded the risk-sharing regime under the EMU. Ultimately, these two measures have been relevant for future reform of the EMU. In this sense, they have been discussed by many authors as the potential legal support in favor of a possible Eurobond program, and of the new role of the ECB as lender of last resort.

1. FISCAL DISCIPLINE - ECONOMIC POLICY COORDINATION

Fiscal discipline, as the requirement to maintain a balanced budget and a sustainable level of public debt, represents one of the core principles arising from the legal and economic framework of the Monetary Union. At the beginning of the European integration process, this principle was indirectly served by the idea that national economies had to progressively converge. We saw that the EEC Treaty generally provided for the progressive approximation of economic policies of Member States in terms of equilibrium of balance of payments, currency stability, price stability and employment. This was meant to avoid currency devaluation and to safeguard the stability of the newly established common market. We also saw that these provisions were generic and lacked any potential enforcement, and as a result, various proposals were advanced to implement the Treaty in the following years. In particular, the EU created a number of committees in order to carry out informal discussions concerning economic and monetary policy coordination at the Community level.

As economic interdependency among European countries increased, so did the need for a more comprehensive system of coordination among the European national economies. The Werner Report and later the Barrre Report put forward a more advanced system of coordination, which included reference to budgetary policies. As we have explained, these proposals did not succeed for many political and economic reasons. Ultimately, with the establishment of the EMU, there was a change in the framework of governance. Coordination of monetary policies, which ran in parallel with economic policy coordination during the entire integration process, were abandoned in favor of a centralized monetary system, with the creation of a single currency and the devolution to the ECB of the common monetary policy. This was carried out as a reaction to the substancial failure of monetary coordination, observed initially by the European Court of Justice in the context of agricultural policies and most dramatically during the speculative attacks of 1992.[368] Economic policies, on the other hand, became subject to a more stringent system of coordination and supervision concerning national budgets under the new paradigm of fiscal discipline.

The new principle of fiscal discipline and economic coordination was largely the result, as anticipated, of the influence from the German Ordoliberal School.[369] The Ordoliberal School is

[368] J Usher (n. 94) 115.

[369] For a general overview of the development of the Ordoliberal School in the context of private law see S Grundmann, 'The Concept of the Private Law Society: After 50 Years of European and European Business Law' 16 *European Review of Private Law* 4 (2008) 553–581. For a view on the EMU, see S Dullina and U Guerot, 'The

an influential strand of German economic literature, that inspired the economic reforms in the post-war period to restore the market economy. It was developed by the Freiburg School and drew to some extent from the ideas of the Hayekian School. In the context of public finance, such theory sees monetary stability and fiscal discipline as two side of the same coin to achieve sustainable economic stability and growth.[370] Ordinarily, monetary policies and fiscal policies are considered separately, as they serve different macroeconomic objectives. Monetary policies are directed toward maintaining price stability, while fiscal policies are typically directed toward specific public policies and possibly economic growth. As a result, monetary policy usually deals with symmetric shocks, i.e. economic effects that have a system-wide impact, while fiscal policies deal with asymmetric shocks, i.e. economic effects that impact only specific countries.[371] Nevertheless, there is a significant interaction between the two as their outcome is reciprocally influenced. Price stability and inflation are influenced by fiscal policies as much as public policies and economic growth heavily depend on the level of interest rates. Also, symmetric and asymmetric shocks may sometimes be correlated or may occur at the same time, and, as a result, a coordinated solution may be necessary.

For this reason, despite the traditional principle of independence attached to the role of the central banks, there is always a sense of mutual consideration and interaction between the responsible institutions, with the central bank on the one side and the national treasury on the other.[372] Indeed, on various recent occasions, EU governments have called upon the ECB to relax its monetary policy and lower interest rates, while the board of the ECB has equally repeatedly asked the Member States to respect the rules under the Stability and Growth Pact.[373] The Eurozone is unique, however, in that fiscal policies are not carried out by a single treasury, but rather singularly by each Member State. A coordinated approach, i.e. the fact that each national government is able to maintain a coordinated approach to fiscal policies, may be necessary for a number of reasons.

Long Shadow of Ordo-Liberalism: Germany's Approach to the Euro Crisis' European Council on Foreign Relations', Policy Brief No.49 (2012).

[370] W Sauter, 'The Economic Constitution of the European Union', 4 *Columbia Journal of European Law* 27 (1998) 43–56.

[371] I Begg, 'Hard and soft economic policy coordination under EMU: problems, paradoxes and prospects' Center for European Studies 103 Working Paper Series (2003) 3 available at https://sites.fas.harvard.edu/~ces/publications/docs/pdfs/BeggHardEMU.pdf.

[372] For a general analysis see R Cooper, 'Economic Interdependence and Coordination of Economic Policies', in R W Jones and P B Kenen (eds), *Handbook of International Economics, vol. II* (Amsterdam, ElsevierScience Publishers, 1985) 1195-1234.

[373] For instance, the former French President Nicolas Sarkozy called for a weaker euro and lower interest rates multiple times over the years: Financial Times (2007), 3 April, p. 9; The Times (2009), 17 September, p. 40.

The primary reason for the need for fiscal discipline and coordination relates to the belief expressed by the Ordoliberal School that large inflation always arises from an excessive deficit and public debt that can no longer be financed through market borrowing. As a result, governments tend to impose monetary financing upon their central banks. Given the importance of price stability for the monetary integration process, the ordoliberal view was that it was necessary to guarantee that Member States could not influence or coerce the ECB into loosening its monetary policy in order to accommodate their fiscal laxity.[374] It was for this reason that T.Waigel, the former German Ministry of Finance, proposed the SGP as an additional layer of legal safeguard for maintaining fiscal discipline and ultimately price stability.[375] From a similar standpoint, excessive deficit or public debt of one Member State may also rise to the point where default becomes unavoidable, and could *de facto* trigger a bailout by the other Member States. In other words, this represents a free-riding situation, where a participant might have insufficient incentive to put in high effort of fiscal discipline or consolidation, and finds it convenient to allow its public debt to rise until the unavoidable financial support of the other members is triggered. We have explained that it was precisely for these reasons that the Community ruled out any possible action of monetary financing or bailouts. Both hypotheses deal with the potential creation of a system of full risk sharing, where risks associated with possible defaults are essentially shared among the Eurozone Member States. The SGP was thus an additional legal safeguard to support the no-bailout rule under the Maastricht Treaty.[376]

There is a second line of argument supporting fiscal discipline. Even if the European Central Bank is able to maintain its restrictive monetary policies under pressure, and even if the potential default is not able to trigger the bailout by the other Member States, fiscal mis-managements at the national level could still produce harmful spillovers for the other Member States and for the Union overall. This was acknowledged by the Barre Report even before the monetary union by recognizing that independent national measures could not effectively be pursued any longer in isolation without producing some sort of externality. With the establishment of the monetary union, these externalities naturally became stronger. In particular, there can be two types of spillover effects. The first deals with the equilibrium in the balance of payments, where a fiscal stimulus in one Member States may increase the level of

[374] Exploring this motivation and the other possible motivations behind the Stability Pact is M Artis and B Winkler, 'The Stability Pact: Safeguarding the Credibility of the European Central Bank' National Institute Economic Review No. 163 (1998) 87-98.
[375] More on the initial Weigel proposal in R Beetsma, 'Does EMU need a Stability Pact?' in: A Brunila, M Buti, D Franco (n. 293).
[376] For this argument B Eichengreen and C Wyplosz (n. 269) 78.

inflation as well as the trade balance within the Community.[377] In order to tackle this first externality, the economic literature refers to the notion of policy mix, meaning that monetary policies and economic policies need to be jointly conducted. In the context of the EU, this would necessarily require a widely coordinated approach. This is easy to understand if we think, for instance, of a context where there is a significant discrepancy between inflationary levels among Member States. In the case of uncoordinated attempts, the common central bank would naturally tend to apply a "one size fits all" monetary policy that would prove to be unfit for those countries whose inflation rates are well below or well above the medium target.

A second type of spillover deals with the interest rate in government bonds. Fiscal consolidation by one Member State may lower the interest rates of the other countries, leading to a situation of fiscal free riding. More importantly, negative externalities may play out in a situation opposite to the one just described, where the fiscal laxity of one or more Member States would lead to higher interest rates in the government's bond throughout the Euro area.[378] The larger the economy, the larger the deficit involved, and thus the chance is higher of interest rates being significantly affected and rising accordingly.[379] This argument was used by the former German Chancellor Helmut Schmidt who affirmed that: "If a government takes out excessive loans, it drives up either the risk and, consequently, the long-term interest rate for its own loans, because every country is exclusively liable for the payment of its own debts. Or it drives up the interest-rate for the whole Euro-zone."[380] In this second scenario, a policy mix and a coordinated approach to economic policies would be required.

For these reasons, the coordination of economic policies was the legal choice to impose a wide fiscal discipline within a system having a common and independent central bank in a decentralized fiscal setting.[381] Albert Hirschman had recognized this in his vision for an alternative and somewhat piorenistic proposal for a European Monetary Authority (EMA).[382] Hirschman in particular feared that national governments could eventually pursue irresponsible fiscal policies, but observed at the same time that: "It would be quite impossible for a super-

[377] D Gross and N Thygesen (n. 213) 321.

[378] R Beetsma, H Uhlig, 'An analysis of the 'Stability Pact' CEPR Discussion Paper 1669 (1997); N Thygesen, 'Fiscal institutions in EMU and the Stability Pact' in A Hughes Hallett, M. Hutchison, S E Hougaard Jensen (eds.), *Fiscal aspects of European monetary integration* (New York, Cambridge University Press, 1999) 15-36.

[379] D Gross and N Thygesen (n. 213) 326.

[380] H. Schmidt, 'Wenn Stabilita¨t zum Fetisch wird' DIE ZEIT, Nr.12, 17.3.2005.

[381] D Hodson (n. 3) 171.

[382] A Hirschman, (n. 31). See also A Hirschman 'Three Uses of Political Economy in Analyzing European Integration' in Trespassing: Economics to Politics and Beyond (Cambridge U.K., Cambridge Univ Press, 1981).

national body to ‘meddle’ in national affairs to the point of objecting to (or of promoting) a particular expenditure” or tax; or of taking “control of a particular segment of the public finances; or of the direct advances to the national treasuries”. As a result, he predicted the idea of economic coordination by affirming that: “While it may be impossible to tear down the economic and fiscal attributes of national sovereignty by direct assault, it may be possible to coordinate these attributes and to build […] new institutions in the ‘interstices’ of the national prerogatives”.[383] He then proposed “a convention in which the aims of their fiscal policies are spelled out in some details; this convention will also set up EMA as its guardian […] to conduct investigations and to present findings. But in general, EMA will only be called upon to pass a general judgment on the budget […]”.[384]

Economic policy coordination can be defined as a set of “supranational rules or norms which are agreed upon by all Member States, leave primary responsibility for the policy area with national authorities, but set limits on their discretion”.[385] In this sense, the monetary union resembles many of the characteristics of a prisoners’ dilemma, where any attempt from one country to achieve fiscal advantages or consolidation involves significant spillover effects on the others. For this reason, many economists used game theory to suggest the need for a coordinated approach as the only arrangement that would lead to a pareto optimal equilibrium in such a unique setting,[386] especially in a context where monetary and fiscal authorities have different objectives.[387]

All these considerations and arguments were not however widely accepted in the academic world.[388] Some commentators disputed the need for fiscal discipline in itself by arguing that the amount and intensity of negative spillovers on monetary policy or on other countries’

[383] Ibid 41.
[384] Ibid 41.
[385] This definition is provided by I Begg, (n. 371) 5.
[386] For a game theory model on this issue among many see A Dixit and L Lambertini, ‘Monetary–Fiscal Policy Interactions and Commitment versus Discretion in a Monetary Union’ 45 European Economic Review 4 (2001) 977–87; a more recent study is H Kempf, H Von Thadden, ‘On Policy Interactions among Nations: When Do Cooperation and Commitment Matter?’ European Central Bank Working Paper 880 (2008).
[387] A Dixit and L Lambertini, ‘Symbiosis of Monetary and Fiscal Policies in a Monetary Union’ 60 Journal of International Economics 2 (2003) 235–247.
[388] For an economic literature review on the SGP see in particular M Heipertz, ‘The Stability and Growth Pact – Not the Best but Better than Nothing. Reviewing the Debate on Fiscal Policy in Europe's Monetary Union’ MPIfG Working Paper 03/10 (2003); R Beetsma and M Giuliodori, ‘The Macroeconomic Costs and Benefits of the EMU and Other Monetary Unions: An Overview of Recent Research’ 48 Journal of Economic Literature (2010) 603–641.

interest rates would be very limited.[389] Others acknowledged the need for fiscal discipline, but disputed the need for specific rules of coordination.[390] However, the vast majority of the criticisms to the SGP were principally directed toward its rule-based approach.[391] According to many legal and economic scholars, accepting the need for fiscal discipline and the resulting requirement of economic coordination, the chosen rule-based approach of the SGP represented both a dangerous and an ineffective solution given its uniformity,[392] insufficient flexibility,[393] and, ultimately, would be ineffective in hampering the automatic stabilizers in the Eurozone.[394] Most notably, the former president of the Commission Romano Prodi labelled the SGP as "stupid like all decisions which are rigid".[395] The SGP, despite its apparently flexible recitals,[396] established a "one size fits all" system of supervision and coordination, which may easily lead to pro-cyclical policies and deflationary tendencies due to the rise in real interest rates.[397] Pro-cyclical measures would eventually worsen the overall economic conditions of a Member State and in turn, would affect, in a vicious cycle, the same economic fundamentals (GDP ratio) on which the rules are based. Because of the impossibility to make adjustments through exchange rates, in such cases, only internal devaluation could constitute a substitute for currency devaluation, meaning that domestic wages and prices fall, and would become the only feasible option to restore the economic balance.[398] Others argued, on the contrary, that adjustment mechanisms within a single currency would operate through the credit channel so that a deficit country (and its banks) would suffer capital flight and increased borrowing costs.[399] Ultimately, many authors disputed the quantitiative limits of the SGP.[400] In the vast economic literature, at the time of writing there is no consensus about the famous thresholds enshrined in the Treaty

---

[389] D Gross and N Thygesen (n. 213) 324-326; R Dornbusch, 'Debt and monetary policy: the policy issues' NBER working paper 5573 (1996).
[390] O Issing, 'On Macroeconomic Policy Co-ordination in EMU' 40 *JCMS* 2 (2002) 345–58; also for this argument M. Feldstein (n. 290).
[391] B Eichengreen and C Wyplosz (n. 269); P De Grauwe (n. 3) 136; F Amtenbrink and J De Haan, (n. 305).
[392] F Amtenbrink and J De Haan, (n. 305) 408.
[393] P De Grauwe (n. 3) 136.
[394] B Eichengreen and C Wyplosz (n. 269); P De Grauwe (n. 3) 136.
[395] Interview with Romano Prodi, Le Monde, 17 October 2002.
[396] Recital 14 of the Regulation 1466/97 (n. 276) urged the Council, when analyzing and monitoring the stability programmes and the convergence programmes, to take into account the relevant cyclical and structural characteristics of the economy of each Member State.
[397] See for instance T Andersen and R Dogonowski, 'EMU and budget norms' in A Hughes Hallett, M. Hutchison, S E Hougaard Jensen (eds.) (n. 378) 69-95; B. Eichengreen, 'Saving Europe's automatic stabilisers' 159 *National Institute Economic Review* (1996) 92-98.
[398] J Stiglitz, (n. 253) 16.
[399] M Wolf, 'Can One Have Balance of Payments Crises in a Currency Union?' 16 February 2012, Financial Times.
[400] Among many see W Buiter, G Corsetti, N Roubini 'Excessive deficits: Sense and Nonsense in the Treaty of Maastricht', 16 *Economic Policy* 8 (1993) 57–100.

and the SGP.[401] A common understanding was also that such targets were merely the result of a lack of agreement in the negotiation stage, resulting in a reference point, the debt to GDP ratio at 60% and the annual deficit of 3% that was just the Eurozone averages of the time.

The tension and balance between these different visions, and ultimately between a system based on coordination and a system based on flexibility, is captured by the distinction, within the traditional economic literature, between 'hard' and 'soft' coordination based on the characteristics of the interaction between the subjects involved.[402] Soft coordination is defined as aiming at aligning national policies and economies by relying on indicators, benchmarks, guidelines, exchange of information and soft sanctions.[403] The Treaty of Rome and the following coordination by committees in the 60s represented a classical example of such soft form of coordination.[404] Hard coordination is also based on benchmarks and exchange of information, but significantly differs from in that the rules of coordination are binding and any breach is subject to hard sanctions.[405] The Treaties, or any of the others legal instruments adopted thus far, do not provide a formal definition of economic coordination in connection with the EMU. They do not rely on the aforementioned definition provided by the economic literature. In order to provide a possible definition, therefore, we must understand the amount of flexibility that these rules and norms involve, specifically after the amendments arising from the recent reforms. In other words, in order to conclude whether the EMU might fall under a soft or a hard system of coordination, we must analyze in detail the main features of this complex structure. A framework of macroeconomic dialogue between the national level and the Community level represents the first of these features that define the nature of this system of economic policy coordination.

[401] For example, Rogoff and Reinhart have famously maintained a 90% Debt/GDP ratio as upper limit. C Reinhart, K Rogoff, 'Growth in a Time of Debt,' 100 *American Economic Review* 2 (2010) 573-78.
[402] See the seminal contribution of A Alesina and G Tabellini, 'Rules and discretion with non-coordinated monetary and fiscal policies', 25 *Economic Inquiry* 4 (1987) 619-630.
[403] A. Steinbach, *Economic Policy Coordination in the Euro Area,* (London New York, Routledge, London, 2014) 46.
[404] J. Mortensen (n. 204) 1.
[405] A. Steinbach (n. 403); I Begg, (n. 371) 5.

1.1 – MACROECONOMIC GUIDANCE

Macroeconomic dialogue between the different levels of authority is crucial, in the context of the EMU, in order for the Community to regularly monitor and assess the compliance with fiscal rules, and the ongoing progress toward fiscal discipline and economic policy coordination. This macroeconomic dialogue preliminarily requires that a list of economic guidelines be conceived at the Community level and conveyed to the national authorities.

The Broad Economic Policy Guidelines (BEPGs) represent the core element of this first pillar. These are a set of non-binding economic recommendations dealing with macroeconomic and structural policies for the overall EU as well as for each single Member State.[406] The idea behind policy guidelines can be traced back to the first proposals for economic policy coordination in the 60s which, as explained before, had very limited scope and could not seriously influence relevant decisions at the national level. The Maastricht Treaty pushed this idea further by introducing the concept of broad guidelines of economic policies as the core legal instrument to converge the economies of the Member States.[407]

Specifically, the BEPGs are economic parameters of fiscal policy. The main objectives of the BEPGs have been generally framed in terms of: (i) preserving fiscal discipline and encouraging fiscal consolidation; (ii) achieving higher sustainable growth especially in terms of employment and productivity; and (iii) strengthening economic convergence among Member States.[408] The BEPGs are the result of a rather composite process with defined roles for the different institutions.[409] They are adopted in June after a complex macroeconomic dialogue involving all the main European institutions. At first, a recommendation is issued by the Commission on the basis of a number of contributions (previous BEPGs, the annual review of the EU economy, reports by Member States, contributions by the Ecofin and other EU Institutions) and finally based on the political guidance of the European Council held in sping. This first recommendation is debated within the Ecofin meeting. Following this debate, and on the basis of the Commission's recommendation and the formal opinions at the European Parliament and the different economic committees, the Council, i.e. the Ecofin, formulates the first draft of the

---

[406] For a good survey on the BEPGs see S Deroose, D Hodson, J Kuhlmann, 'The Broad Economic Policy Guidelines: Before and After the Re-launch of the Lisbon Strategy', 46 *JCMS* 4 (2008) 830.
[407] Article 103 of the Treaty of Maastricht, now Article 121 Treaty on the Functioning of the European Union (TFEU).
[408] See for instance Council Recommendation 2008/390/EC of 14 May 2008 on the broad economic policy guidelines for the Member States and the Community (2008-2010) OJ L 137/13.
[409] S Deroose, D Hodson, J Kuhlmann (n. 406) 828.

BEPGs acting by a qualified majority. The draft is then put on the agenda and discussed at the following European Council. In the end, based on the European Council's conclusions, the Econfin adopts the BEPGs in the legal form of a recommendation.

The first set of BEPGs, introduced in 1993, was short with only four pages and three guidelines in total, as they only covered the general economic situation of the European Union.[410] These initial recommendations, athough not binding, were still able to launch a Europe-wide dialogue on the optimal level of economic policies and reforms, such as product, labor, capital market reforms and other aspects. In the subsequent years, the BEPGs went under major transformation that significantly changed their economic assumptions and nature. A first turning point occurred in 1998, with the inclusion in the BEPGs of country-specific recommendations.[411] As a result, the Commission and the Council were able to broaden their focus as well as to start including a limited analysis concerning structural reforms in labor, capital and product markets.[412] A second turning point occurred between 2000 and 2005. During this period, the BEPGs were increasingly expanded to include 23 general guidelines and 94 country-specific recommendations. This rapid growth was principally due to the BEPGs being focused on structural reform based on the Lisbon 10-year strategy and the expansion of the EU policies.[413]

During the same period, the Community launched a second set of policy guidelines, the Employment Guidelines (EGs), in order to specifically address labor and employment priorities. Additionally, from 2003, the BEPGs and EGs started covering a three-year cycle, in order to avoid overlap and repetition in the formulation of guidelines, and increased the focus on their implementations.[414] A third period of major change occurred in 2005, when the BEPGs were merged with the EGs to form the new Integrated Guidelines for Growth and Jobs (IGs).[415] The BEPGs and the EGs became interconnected in order to increase their consistency and mutual spillovers. With the first Integrated Guidelines, still covering a three-year period, more

[410] Council Recommendation 94/7/EC of 22 December 1993 on the broad guidelines of the economic policies of the Member States and of the Community, OJ L 7/9.
[411] Council Recommendation 98/454/EC of 6 July 1998 on the broad guidelines of the economic policies of the Member States and of the Community OJ L 200/34.
[412] S Deroose, D Hodson, J Kuhlmann (n. 406) 831.
[413] S Deroose, D Hodson, J Kuhlmann (n. 406) 834.
[414] Council Recommendation 2003/555/EC of 26 June 2013 on the broad guidelines of the economic policies of the Member States and the Community (for the 2003-2005 period) OJ L 195/1.
[415] Council Recommendation 2005/601/EC of 12 July 2005 on the broad economic policy guidelines of the Member States and the Community (2005-2008) OJ L 205/28. The guidelines were updated in 2007 with Council Recommendation 2007/209/EC of 27 March 2007 on the 2007 update of the broad guidelines for the economic policies of the Member States and the Community and on the implementation of Member States' employment policies OJ L 92/23.

emphasis was given to areas such as research, innovation, energy and social inclusion. This combination of guidelines was also implemented in the spirit of the SGP reform, in order to move toward a comprehensive approach to economic policy coordination and avoid the so-called asymmetry between obligations in periods of upturn and downturn.[416] Ultimately, the IGs became the Europe 2020 Integrated Guidelines with the purpose of specifically addressing the priorities envisioned in the new Europe 2020 strategy.[417] Under the Europe 2020 strategy, the guidelines are now more comprehensive, covering both economic and employment policy, and they have been reduced in number, with only ten guidelines in total. These two features make today's guidelines more effective, as they are able to demonstrate a clear core of policy orientation in order to promote the Europe 2020 strategy as well as domestic accountability.[418]

With the recent set of reforms on the Europen Economic Governance, and more particularly with the European Semester (see below), the IGs have been supplied with several other documents of economic guidance, of which the main are: the Annual Growth Survey (AGS),[419] the Council Recommendation on the economic policy of the Euro area,[420] and the Communication on fiscal stance.[421] All the guiding documents are submitted in November, at the beginning of the European Semester (see below) in the form of a communication by the Commission. With the AGS, the Commission sets forth the common priorities and the key areas in terms of specific economic reforms and fiscal consolidation on which the European Union and its Member States need to focus their attention for the immediate following year. The Commission guidance is built around three interconnected strands: investment, structural reforms and fiscal consolidation.

Around these elements, the AGS sets a number of priorities for the EU as a whole and identifies objectives that would fulfill those priorities. The Spring European Council then endorses the

416 J Louis (n. 305) 90.

417 Part I of the Europe 2020 Integrated Guidelines is Council Recommendation of 13 July 2010 on broad guidelines for economic policies of the Member States and of the Union, OJ L191/28. Part II of the Europe 2020 Integrated Guidelines is Council Decision 2010/707/EU of 21 October 2010 on guidelines for the employment policies of the Member States OJ L308/46.

418 see K Armstrong, 'The Lisbon Agenda and Europe 2020: From the Governance of Coordination to the Coordination of Governance', in P Copeland, D Papadimitriou (eds), *The EU's Lisbon Strategy: Evaluating Success, Understanding Failure* (Basingstoke, Palgrave Macmillan, 2012) 220.

419 For the latest see Commision Communication, Annual Growth Survey 2017, Brussels, 16.11.2016 COM (2016) 725 final.

420 For the latest see Council Recommendation of 21 March 2017 on the economic policy of the euro area, OJ C 92/1.

421 For the latest see Commission Communication, Towards a positive fiscal stance for the euro area, Brussels, 16.11.2016 COM (2016) 727 final.

AGS after discussion in the Council and the European Parliament within the so-called Economic Dialogue. The Spring European Council explicitly invites EU Member States to take account of the AGS in drafting their SCP and NRP, which they now need to submit to the EU in the spring. The Recommendation on the economic policy of the Euro area is drafted by the Commission in November, but is later endorsed by the Council in the spring with a Recommendation. It engages with the main priorities critical to the functioning of the single currency area and suggests the generally necessary actions to be taken by the Member States, in their individual capacity, or collectively within the Eurogroup. This is meant to ensure that Eurozone and national issues are included in the EU economic governance planning. Finally, the Communication on fiscal stance is adopted together with the previous guidelines as it sets out the rationale behind their fiscal aspects. More specifically, it provides an overall assessment of the fiscal policy of the Euro area in aggregate terms, and recommends specific fiscal policies objectives for the Euro area.

The different guidelines are meant to stimulate the debate within the Ecofin and the Eurogroup, and in particular to affect the resulting Member States' policies by peer pressure. Among these guiding documents there are a number of similarities and complementarities, especially after the approval of the European Semester. The new version of the IGs adopted in 2015, for instance, reflects the new approach to economic policy-making in line with the three strands set out in the Commission's AGS: investment, structural reform and fiscal responsibility.[422] Overall, the different documents need to be mutually consistent. The Commission, in drafting of the AGS, must take into account the recommendations expressed under the IGs. Equally, the Communication on fiscal stance is based on the AGS and the resulting Recommendation on the economic policy of the Euro area.

In the last few years, the Commission used these guiding documents as the main legal instrument to put a stronger focus and emphasis not only on fiscal discipline but also on investment and structural reforms. To achieve these objectives without changing the existing rules, the Commission issued a communication providing a series of recommendations on making the best possible use of the flexibility that is built into the existing rules of the SGP.[423]

[422] Part I of the Europe 2020 Integrated Guidelines is Council Recommendation (EU) 2015/1184 of 14 July 2015 on broad guidelines for the economic policies of the Member States and of the European Union OJ L 192/27. Part II of the Europe 2020 Integrated Guidelines is Council Decision (EU) 2015/1848 of 5 October 2015 on guidelines for the employment policies of the Member States for 2015 OJ L 268/28.

[423] See on this point the Commission Communication on making the best use of the flexibility within the existing rules of the stability and growth pact, Brussels, 13.1.2015 COM (2015) 12 final.

Additionally, there is now an increased level of cooperation between the European Parliament and national parliaments in the finalization of the AGS.

With respect to the actual fiscal stance at the Euro area and national level, the Commission established, in light of the Five President Report, a European Fiscal Board (EFB) with an advisory role to the Commission.[424] Its main task is to advise the European Commission on the implementation of the European fiscal framework so as to ensure that all decisions on budgetary surveillance, fiscal rules and enforcement procedures, and more generally on the prospective fiscal stance appropriate for the Euro area as a whole, are based on economic judgment and are consistent.[425] The EFB also cooperates with the new independent national fiscal bodies through the exchange of best practices and through facilitating common understanding on matters related to the fiscal rules of the EU. The basic rationale for this new entity is to complement the Economic Union with a more politically independent and technical body to influence the Euro fiscal stance in the same way that the independent central banks provide technical influence and, more importantly, decisions on monetary policy. [426]

1.2 – COLLECTION OF MACROECONOMIC AND BUDGETARY INFORMATIONS

The second element characterizing this system is the submission by the Member States of a collection of macroecoconomic and budgetary information. We have explained how the original construction of the SGP was only based on two documents: the Stability Program and the Convergence Programs (commonly known as SCPs). These first documents represent an analysis of the current year (as well as the preceding year) and a projection for the following three years, of each country's MTOs, including the adjustment path toward it as well as the expected path of the general government debt ratio. They are required to include the main economic assumptions taken into consideration for such assessment, including any potential changes to these assumptions, and a detailed description of the present and future economic policy actions to achieve the objectives.[427] The main difference between the two is that the

[424] Commission Decision (EU) 2015/1937 of 21 October 2015 establishing an independent advisory European Fiscal Board, OJ L 282/37; Commission Decision (EU) 2016/221 of 12 February 2016 amending Decision (EU) 2015/1937 establishing an independent advisory European Fiscal Board. OJ L 40/15.

[425] On its advisory taks see S Marks and M Saltmarsh, 'Will EU's New Independent Fiscal Board Turn into a Commission Committee?' *MNI Euro Insight* (2016).

[426] A Zareh et al. 'Making the most of the European Fiscal Board', *ZEW policy brief*, No. 3 (2017).

[427] The rules of content, submission, examination and the monitoring of these two documents are set out in Section 2 and Section 3 of the amended Council Regulation (EC) 1466/97 (n. 276).

convergence programs are more inclusive and cover additional information concerning monetary coordination, such as the medium-term monetary policy objectives as well as the relationship of those objectives to price and exchange rate stability. This is because the scope of the program was to ensure that in relation to non-participating Member States their policies were "geared to stability and thus to avoid real exchange rate misalignments and excessive nominal exchange rate fluctuations".[428] The code of conduct on the content and format of the SCP, as amended over time, provides a number of guidelines to assist the Member States in drafting their programs. The rationale of the code is also to ease the uniformity of these documents for a more facilitated examination by the Commission, the Economic and Financial Committee and the Council.[429]

The National Reform Programs (NRPs) were introduced, as mentioned before, with the 2005 reform in order to complement the current economic situation of each Member State in light of the Lisbon Strategy. With the NRPs, each Member State provides an overview of its ongoing or future structural reforms, including the specific recommendations expressed by the Council in its IGs. The NRPs are in fact the legal instrument for the implementation and the assessment by EU institutions of the progress toward the Lisbon Strategy, now the Europe 2020 Strategy, at the national level. The Commission in its Annual Progress Report at the end of the year specifically assesses the compliance between the IGs and the NRP. This dialogue between the Commission and the Member States, and within the Council, is meant to create peer pressure to increase the domestic efforts to approve structural reforms and, at the same time, avoid the risk of free-riding.[430] Under the newly agreed Fiscal Compact, Member States are also required to supply their NRP with additional information concerning any plan to issue new debt by each signatory Member State and to ensure that the structural reforms are consistent with a concrete and long-lasting correction of the excessive deficits.[431]

[428] See Article 10 of the amended Council Regulation (EC) 1466/97 (n. 276).

[429] The latest code of conduct was adopted by the Economic and Financial Committee on 15 May 2017 and endorsed by the European Council on 18 May 2017. Council of the European Union Brussels, Revised Specifications on the implementation of the Stability and Growth Pact and Guidelines on the format and content of Stability and Convergence Programmes (Code of Conduct of the Stability and Growth Pact), 18 May 2017 (OR. en) 9344/17 ECOFIN 423 UEM 170.

[430] J Zeitlin, 'The Open Method of Co-ordination and the Governance of the Lisbon Strategy', 46 *JCMS* 2 (2008) 436-446.

[431] See Article 5 and 6 of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union of 2 March 2012 - not published in the Official Journal (also known as the fiscal compact) available at https://www.consilium.europa.eu/media/20399/st00tscg26_en12.pdf.

This economic dialogue between the national and the Community level is crucial for the success of the EMU. The European Parliament specifically pointed this out in its evaluation of the entire governance system. The Parliament, in its Feio Report, noted that "the quality, reliability and early publication of budgetary information are to strengthen […] without uniformity of accounting standards and, more importantly, without earlier deadlines for the submission of comprehensive budgetary information, the EU budgetary framework remained necessarily weak and less credible".[432] As a result of the debt crisis, the Commission decided to establish the so-called European Semester (ES), to have a more integrated and comprehensive macroeconomic dialogue and an improved timing for the submission of these budgetary documents. In this sense, the Semester legally rests on the SGP, as it was launched as an amendment to the code of conduct for the implementation of the SGP, but was later codified as part of the Six Pack by Regulation (EU) No. 1175/2011.[433] It also rests on the Europe 2020 Integrated Guidelines, the Macroeconomic Imbalances Procedure and the Euro-Plus Pact.

The ES is an annual cycle for guidance and for a simultaneous and coordinated system of assessment and adjustments of fiscal and structural policies.[434] The part of the ES dealing with macroeconomic guidance and exchange of information starts in November with the Autumn Economic Forecast and the aforementioned guiding documents (the AGS, the Council Recommendation on the economic policy of the Euro area, and the Communication on fiscal stance) as well as the Alert Mechanism Report as the beginning of the Macroeconomic Imbalance Procedure (see below). The AGS is then discussed at the Council meeting in December and at the European Parliament in February, while at the same time the Commission publishes its Winter Economic Forecast. In March, as the last step of this economic dialogue, the European Council finally endorses the AGS. In April, Eurozone Member States must submit the SCP as well as the NRP to the Commission and their peers. On this point, the ES added a significant innovation to previous practices in terms of timing.[435] According to the earlier practice, the SCP was submitted at the end of each year (usually in December) and was based on the yearly budgetary draft adopted by the executive branch and laid before National Parliament, as well as on the financial planning already adopted by National Parliament for the

[432] See the Feio Report (n. 344).
[433] 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, OJ L 306/12. The Regulation introduced in the preventive arm a new Section 1-A named "European semester for economic policy coordination".
[434] Commission Communication (n. 346).
[435] K Armstrong, (n.418) 221.

following years. The ES strengthens and anticipates this practice by prescribing that the SCP be submitted in April, thus before the draft budgets are discussed in National Parliaments.

As a result, the national procedure has also been anticipated since the SCP are now adopted at the national level by the Government and endorsed by Parliament before being submitted to the Commission. In the same way, the NRP timing of submission was also anticipated. The ES prescribes now that the NRP be submitted together with the SCP, implying that Member States need to take greater account of complementarities and spill-over effects between the two documents. In this sense, the ultimate function of the ES is "to ensure not just an enhanced coordination of economic governance but also a coordination of coordination across economic governance and Europe 2020".[436]

This macroeconomic exchange of information has also been strengthened in the last few years. Member States signing the Euro Plus Pact[437] are now also required to make reference in their SCPs and NRPs to the commitments included under the Pact. More specifically, these commitments refer to coordinated reforms, beyond those required by existing EU regulations, addressing the labor market and tax policies; the sustainability of the public finances in relation to pensions, health care, and social benefits, with specific policy actions to reach the goals envisioned in the Pact within the following twelve months.

Additionally, following the approval of Regulation 473/2013[438], which together with Regulation 472/2013[439] make up the so-called Two Pack, Member States whose currency is the Euro[440] need also to include in their SP their medium-term fiscal plans by April. More importantly, they have to submit, by 15 October, to the Commission and the Eurogroup, the draft budgetary plan for the forthcoming year as well as the Economic Partnership Programs (EPP), the latter just for those Member States currently subject to excessive budget deficits.[441]

[436] K Armstrong, (n. 418) 222.

[437] The Euro Plus Pact was agreed in March 2011 by 23 Member States (including 6 non-euro zone, Bulgaria, Denmark, Latvia, Lithuania, Poland, Romania). The aim was "to further strengthen the economic pillar of monetary union by improving competitiveness and enhancing economic policy coordination, thereby leading to a higher degree of convergence" see European Council, Presidency Conclusions of 24-25 March 2011, EUCO10/1/11 of 20 April 2011, Annex 1.

[438] Regulation (EU) No 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area, OJ L 140/11.

[439] Regulation (EU) No 472/2013 of the European Parliament and of the Council of 21 May 2013 on the strengthening of economic and budgetary surveillance of Member States in the Euro area experiencing or threatened with serious difficulties with respect to their financial stability, OJ L 140/1.

[440] The Two Pack are based on Art 136 TFEU, and they are therefore applicable to Euro-area Member States only.

[441] See the common budgetary timeline under Article 4 of Regulation (EU) No 473/2013 (n. 438).

On the basis of the draft, the Commission formulates an opinion, which is then discussed within the Eurogroup before the budgets are finally internally adopted in December. This timeline completes the European Semester and, as a result, national budgets are now examined within two different European Semesters.

1.3 –MONITORING AND ASSESSMENTS

This system of macroeconomic dialogue is completed by regular supervision and an assessment process. There are two procedures envisioned by the Treaty and the SGP as amended over time: the multilateral surveillance procedure and the macroeconomic imbalance procedure.

The Multilateral Surveillance Procedure (MSP) is the first review process. As we have seen in the first chapter, it was established under the Treaty and developed in detail by the SGP with the purpose of allowing the Commission and the Council to monitor the economic and fiscal situation of each Member State and to intensify peer pressure among Member States. The process rests on the submission of the SCPs as well as the NRPs as part of the early warning system within the ES. More specifically, after the programs are submitted in April, they are preliminarily assessed by the Commission and the Economic and Financial Committee[442] in order to determine whether they are in line with their respective MTOs, as well as with the IGs. The Commission, following this review, issues a country-specific recommendation (CSR), which provides an evaluation of all the aspects mentioned above with reference to each single country. The European Council formally adopts these CSRs in July after a discussion at the EP within the Economic Dialogue, but the Ecofin legally adopts them at the June meeting.[443]

The Commission and the Council need to specifically assess "whether the economic assumptions are plausible" and "whether the adjustment path towards the MTO is appropriate", including any consideration regarding the expected path of debt ratio. They have also to assess "whether the measures being taken or proposed to respect that adjustment path are sufficient to achieve the MTO over the cycle", and "whether the Member State pursues an appropriate annual improvement of its cyclically-adjusted budget balance, net of one-off and other temporary measures, required to meet its MTO". The overall assessment takes into

[442] As required by Art 109c(2) EC stating that the Committee shall contribute to the preparations of the work of the Council - among others - in the framework of Art 103(3) - (5) EC.
[443] K. Armstrong, (n. 418) 226.

consideration both the structural balance as well as the newly created expenditure benchmark (see below). The Council and the Commission must also examine "whether the SCP facilitates the achievement of sustained and real convergence within the euro area (for the SC) and the closer coordination of economic policies, and whether the economic policies of the Member State and the NRPs are consistent with the IGs".[444]

Member States must take these specific recommendations into account when they draw up their draft budgetary plan in the second half of the year, as well as when they implement their NRPs. The draft budgetary plan submitted by 15 October is examined by the Commission by 30 November in light of the CSR and in case of severe non-compliance, the Commission may request a revised draft budget.[445] Similarly, Member States are required to give accounts of their progress in terms of structural reforms in their Implementation Report concerning the NRP. This annual procedure ends when the Commission publishes a Country Report assessing the progress in addressing the CSR adopted in the previous year, the follow-up given to the recommendations adopted in previous years and the progress towards its national Europe 2020 targets.[446] In 2015, the Commission revised some of its practice under the ES and started to publish the Country Reports already in February, three months before the CSRs for the following year were finalized. Additionally, with the 2015 package, discussions and recommendations for the Euro area as a whole are now held before the country-specific discussions, so that challenges are commonly addressed, and employment and social aspects are also taken into consideration.

At the same time, the Commission now publishes a second country-specific report (and a general summary), on the measures adopted by the contracting countries to comply with the requirement of the Fiscal Compact.[447] In particular, the Commission needs to verify, according to Article 3(2) (see below), whether the contracting countries have introduced into national law a balanced budget rule with certain characteristics, as well as whether a national correction

[444] See Article 5 (for the SP) and article 9 (for the CP) of Council Regulation (EC) 1466/97 (n. 276) as amended by Council regulation (EC) No 1055/2005 and Council Regulation (EU) No 1175/2011.
[445] The Commission is also required, by the same deadline, to publish an assessment of the budgetary outlook for the entire Euro area for the forthcoming year.
[446] See for instance the Country Report Italy 2018 Including an In-Depth Review on the prevention and correction of macroeconomic imbalances Accompanying the document Communication from the commission to the European parliament, the council, the European central bank and the Eurogroup 2017 European Semester See Commission Communication, Country Report Italy 2018, Including an In-Depth Review on the prevention and correction of macroeconomic imbalances, Brussels, 7.3.2018, SWD(2018) 210 final.
[447] See Article 8 of the Fiscal Compact (n. 431).

mechanism and an independent monitoring institution are present and in compliance with the common principles proposed by the Commission.[448]

Within this multilateral assessment, the Commission and the Council ultimately need "to identify actual or expected significant divergences of the budgetary position from the MTO, or from the appropriate adjustment path towards it". In the event of a significant deviation, there is an early procedure that starts with an early warning by the Commission, followed by a Council recommendation on the necessary corrective measures.[449] If the Member State fails to take appropriate action, the Commission immediately recommends that the Council adopt, by qualified majority, a decision establishing that "no effective action has been taken, and eventually to adopt a revised recommendation on the necessary policy measures". If the Council does not adopt the decision and the Member State is still not compliant, the Commission will "reiterate its recommendation to the Council to adopt the decision establishing that no effective action has been taken", in which case, the decision is considered adopted unless the Council "decides, by simple majority, to reject the recommendation within 10 days of its adoption by the Commission".[450] The approval of a decision stating that no effective action has been taken represents the foundation for the launch of the EDP (see below).

The MSP is now stricter in connection with specific instances. Take as a first example the event that a Member State whose currency is the Euro "requests financial assistance or is experiencing or threatened with serious difficulties with respect to its financial stability which are likely to have adverse spill-over effects on other Member States in the euro area". According to Article 2 of the Regulation (EU) No 472/2013 (as part of the Two Pack), in this case, the Commission may decide to place the Member State under enhanced surveillance. Member States under enhanced surveillance need to consult and cooperate with the Commission, acting in liaison with the ECB, the ESAs, the ESRB and, where appropriate, the IMF, in order to adopt measures aimed at addressing the sources or potential sources of difficulties.[451] As a result, the fiscal

[448] For the latest see Commission Report presented under Article 8 of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, Brussels, 22.2.2017 C(2017) 1201 final, available at https://ec.europa.eu/info/sites/info/files/c20171201_en.pdf.
[449] The procedure is based on Article 121(4) TFEU and is detailed under Article 6 Council Regulation (EC) 1466/97 (n. 276) as amended by Council regulation (EC) No 1055/2005 and Council Regulation (EU) No 1175/2011.
[450] Article 6 clarifies also that "when taking the decision on non-compliance referred to in the fourth and fifth subparagraphs, only members of the Council representing participating Member States shall vote and the Council shall act without taking into account the vote of the member of the Council representing the Member State concerned."
[451] For the enhanced surveillance procedure see Article 2 of Regulation (EU) No 472/2013 (n. 439).

situation becomes closely monitored and the Member State is required to regularly produce additional reporting, as it is the case of Member States subject to the EDP.[452]

A second case occurs when a Member State whose currency is the Euro only requests financial assistance. In these cases, a draft macroeconomic adjustment program is prepared by the Member States in agreement with the Commission and the ECB. The draft substitutes the relative economic partnership program under the EDP. Such program addresses the specific risks for the financial stability in the Euro area and arising from that Member State with the aim of restoring the sound financial position of the Member State and its ability to finance itself through financial markets. The draft is finally approved by the Council, acting by a qualified majority on a proposal from the Commission, and the Commission closely monitors its progress and implementation.[453]

The Macroeconomic Imbalance Procedure (MIP) is the second review process introduced by two Regulations of the Six Pack. Regulation (EU) No 1176/2011[454] establishes the details of the surveillance procedure for all Member States, while Regulation (EU) No 1174/2011[455] lays out its enforcement, though limited to Euro area Member States. The two Regulations deal with both the preventive and the corrective arms (the corrective arm stage will be addressed in this chapter under section 1.5).

The MIP serves as the main surveillance procedure to tackle regional economic imbalances among Member States. With the previous multilateral surveillance, the EU was and is in fact able to exercise preventive and simultaneous monitoring assessment of the Member States' national budgets and possible reforms, and it is able to provide the necessary policy recommendations for the following year. However, macroeconomic imbalances were missing. As a matter of fact, the Delors Report already highlighted that in a system where competitive devaluation is no longer possible, given the common currency, economic imbalances become extremely difficult to manage and may create significant negative externalities. As pointed out: "Such imbalances might arise because the process of adjustment and restructuring set in motion by the removal of physical, technical and fiscal barriers is unlikely to have an even impact on

[452] For these requirements see Article 10 of Regulation (EU) No 473/2013 (n. 438).
[453] For the macroeconomic adjustment programme procedure see Article 7 of Regulation (EU) No 472/2013 (n. 439).
[454] Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances, OJ L 306/25.
[455] Regulation (EU) No 1174/2011 of the European Parliament and of the Council of 16 November 2011 on enforcement measures to correct excessive macroeconomic imbalances in the Euro area, OJ L 306/8.

different regions or always produce satisfactory results within reasonable periods of time. Imbalances might also emanate from labour and other cost developments, external shocks with differing repercussions on individual economies, or divergent economic policies pursued at national level."[456]

In addition, statistical measurements of economic imbalances are harder to read and interpreted in a fully integrated market balance-of-payments figures, but "Nonetheless, such imbalances, if left uncorrected, would manifest themselves as regional disequilibria".[457] Over the past decade, the EU has registered serious issues of competitiveness and major macroeconomic imbalances, especially during the sovereign debt crisis. On this basis, the EU has recognized the need to supplement the multilateral surveillance procedure with specific rules for the detection of macroeconomic imbalances at an early stage, as well as the prevention and correction of excessive macroeconomic imbalances within the context of the ES.

The MIP tackles these issues by allowing the Commission and the Council to adopt preventive recommendations under article 121 TFEU at an early stage of the European Semester. The Commission issues, in November, in parallel to the AGS, the so-called Alert Mechanism Report (AMR), which provides a general assessment of Member States to identify any macroeconomic imbalances.[458] Such reports are prepared in accordance with Articles 3 and 4 of Regulation (EU) No 1176/2011 with "a qualitative economic and financial assessment based on a scoreboard with a set of indicators the values of which are compared to their indicative thresholds". The scoreboard comprises a number of "relevant, practical, simple, measurable and available macroeconomic and macrofinancial indicators"[459] in order to identify macroeconomic imbalances that emerge in the short-term and imbalances that arise due to structural and long-term trends. Such indicators may evolve over time, but the main purpose is to eventually trigger a deeper analysis through the so-called in-depth review. Macroeconomic

[456] Delors Report (n. 161) 17.
[457] Delors Report (n. 161) 17.
[458] See the most updated version at the time of writing, Commission Communication, Alert Mechanism Report 2017, Brussels, 22.11.2017, COM (2017) 771 final.
[459] The scoreboard encompasses indicators that can arise from public and private indebtedness; financial and asset market developments, including housing; the evolution of private sector credit flow; and the evolution of unemployment; external imbalances, including those that can arise from the evolution of current account and net investment positions of Member States; real effective exchange rates; export market shares; changes in price and cost developments; and non-price competitiveness, taking into account the different components of productivity. For a good survey on the design and composition of the scoreboard see D Costello and J Fischer (eds.), 'Scoreboard for the surveillance of macroeconomic imbalances', in European Economy. Occasional Papers, No. 92 (2012), available at: http://ec.europa.eu/economy_finance/publications/occasional_paper/2012/op92_en.htm.

imbalances are then detected from a simple reading of the scoreboard, taking also into account the evolution of imbalances in the Union and in the Euro area, as well as the developments in terms of, for example, economic growth, employment, and productivity.

In January, after the adoption of the annual budgets by each Member State, the Ecofin adopts its final conclusion regarding the proposed AMR. The Commission submits the annual report to the European Parliament, the Council and the European Economic and Social Committee, to be discussed within the Council and the Eurogroup. Member States identified by the AMR are then subject to an in-depth review (IDR) by the Commission. The IDRs represent a detailed analysis of country-specific circumstances, including a broad range of economic variables, analytical tools and qualitative information of country-specific nature, which takes into consideration also industrial relations and social dialogue. Through them, the Commission is able to monitor and evaluate the development of macroeconomic risks up to the possible conclusion that imbalances or excessive imbalances exist.[460] The IDRs are published in late March for Member States under risk and are generally followed by a new IDR in the next round. According to Article 6, if, on the basis of the IDR, the Commission concludes that macroimbalances exist, it must inform the European Parliament, the Council and the Eurogroup accordingly. The Council, on a recommendation from the Commission, which is annually examined and updated, may address the necessary recommendations to the Member State concerned, in accordance with the procedure set out in Article 121(2) TFEU[461].

A third surveillance procedure is now carried out at the state level by the so-called independent fiscal bodies. As with the European wide counterpart mentioned above, these have been recently introduced in many Member States in order to provide a technical and unbiased level of assessment on all the relevevant budgetary information provided by the national government before being submitted to the European institutions. More specifically, according to Directive 2011/85/EU (see below) all the macroeconomic and budgetary forecasts included in the SCP shall be compared with the most updated forecasts provided by independent fiscal bodies.[462]

[460] See Commission Communication, results of in-depth reviews under Regulation (EU) No 1176/2011 on the prevention and correction of macroeconomic imbalances Brussels, 5.3.2014, COM (2014) 150 final.
[461] The recommendations of the Council and of the Commission shall fully observe Article 152 TFEU and shall take into account Article 28 of the Charter of Fundamental Rights of the European Union.
[462] Article 4 of EU Directive 2011/85/EU (n. 493) stipulates that the "macroeconomic and budgetary forecasts shall be compared with the most updated forecasts of the Commission and, if appropriate, those of other independent bodies (...)". A similar requirement in connection with the forecasts included in the SCP is also provived by Article 3 Regulation (EC) No 1466/97 (n. 276) as recently amended.

Furthermore, these independent fiscal bodies should monitor the compliance of the Member States with the numerical fiscal rules.[463]

For those Member States whose currency is the Euro, these independent fiscal bodies should also, according to Regulation 473/2013, "produce or endorse national medium-term fiscal plans and draft budgets".[464] In the performance of their tasks, national fiscal bodies can cooperate with the newly established European Fiscal Board Beyond so as to create an additional layer of fiscal policy coordination in the euro area.[465] The ultimate purpose of these fiscal councils is to ensure transparency on fiscal rules and their implementation, and consequently promote accountability toward elected governments. To effectively deliver these tasks, it is necessary that they meet a number of standards of independence.[466] Some evidence suggests that national fiscal bodies can significantly improve fiscal discipline if all the requirements are met.[467] However, there is no widespread consensus on the need and effectiveness of such fiscal council in general.[468]

1.4 –Fiscal rules of budget constraints

A system of fiscal rules and enforcement procedures complement the macroeconomic dialogue described above to form a fully developed framework of economic policy coordination. Fiscal rules have the specific goal of constraining fiscal policy with specific economic benchmarks. In the context of the EMU, they supplement the macroeconomic dialogue outlined before by

[463] See Article 6 of EU Directive 2011/85/EU (n. 493); This is also now required by article 3 of the Fiscal Compact (n. 431).
[464] See Article 4 and 5 of Regulation 473/2013 (n. 438).
[465] On the relationship between the two see B Cœuré, The importance of independent fiscal councils
Opening remarks by B Cœuré, speech at the workshop on "Fiscal councils, central banks and sound public finances", Frankfurt am Main, 27 January 2016 available at https://www.ecb.europa.eu/press/key/date/2016/html/sp160127.en.html.
[466] A definition of "independent bodies" is provided by Regulation 473/2013 as "bodies that are structurally independent or bodies endowed with functional autonomy vis-à- vis the budgetary authorities of the Member State, and which are underpinned by national legal provisions ensuring a high degree of functional autonomy and accountability, including (i) a statutory regime grounded in national laws, regulations or binding administrative provisions; (ii) not taking instructions from the budgetary authorities of the Member State concerned or from any other public or private body; (iii) the capacity to communicate publicly in a timely manner; (iv) procedures for nominating members on the basis of their experience and competence; (v) adequate resources and appropriate access to information to carry out their mandate."
[467] See ECB "Fiscal councils in EU countries", *Monthly Bulletin*, June, (2014) 96-100; C Nerlich and W H Reuter, 'The design of national fiscal frameworks and their budgetary impact', *ECB Working Paper Series*, No 1588 (2013).
[468] Among many see L Calmfors and S Wren-Lewis, 'What should fiscal councils do?' 26 *Economic Policy* 68 (2011) 649-695.

providing a set of benchmarks for its coordination and surveillance procedures. Such constraints can encompass a wide range of economic variables, but we have seen that, starting from the Maastricht convergence criteria, the EMU mainly focused on government budget and finance. These benchmarks can be legally binding or non-legally binding. In the economic literature, the former corresponds to a system of Hard Budget Constraints (HBC), according to which, governments are required to maintain a balanced budget and public bailouts are expressly excluded.

On the other hand, the latter corresponds to a system of soft budget constraints (SBC) when the organization is not required to comply with specific binding benchmarks and it expects to be bailed out in case of financial trouble.[469] HBS has been generally supported by the main economic literature in the field, especially for the case of fiscal federalism, on the assumption that soft budget constraints (SBC) create adverse incentive problems.[470] Decentralized governments may not have sufficient incentives in place to implement financial discipline or consolidation if bailouts are possible. More importantly, when this is the case, projects may be initiated in the first place, even when it is inefficient to do so. The concept of HBS and SBS is extremely important for our analysis and ultimate evaluation in terms of hard or soft economic policy coordination.

The idea behind fiscal rules for imposing fiscal discipline within the EMU was envisioned with the Delors Report. The Report suggested a rule-based approach while it expressly refused to rely on market pressure for a number of different reasons that we have mentioned before. As a result, the Maastricht Treaty established a system of rule-based approaches in the form of convergence criteria to be used in order to determine which Member States met the necessary conditions to move to the third stage of the EMU. The criteria consisted of a number of economic parameters specified under Protocol 6 annexed to the Treaty. With particular regards to government budgets and debt, Protocol 6 required that “at the time of the examination the Member State was not the subject of a Council decision that an excessive deficit existed”. In other words, Member States were not to exceed the: (i) 3 % in the government deficit to gross domestic product ratio; and (ii) 60 % in the government debt to gross domestic product ratio.

[469] This definition was first introduced in the field of public governance by J Kornai, ‘Hard and Soft budget constraint’, 25 *Acta Oeconomica* 3 (1980).

[470] See for instance J Kornai (n. 469); See also Y Qian and R Gérard, Federalism and the Soft Budget Constraint. 88 American Economic Review 5 (1998) available at https://ssrn.com/abstract=149988; M Dewatripont and E Maskin, Credit and Efficiency in Centralized and Decentralized Economies, 62 *Review of Economic Studies* 4 (1995) 541-555.

It was not clear, however, whether these fiscal rules constituted legally binding constraints. The Treaty defined these values as "reference values", and thus, according to some, they could allow some form of discretion in their implementation, making them effectively soft budget constraints.[471] The official position of the EU,[472] as well as the decision of the German Federal Constitutional Court,[473] was that these values were binding and without margin of discretion, thus they both considered them hard budget constraints. In practice, however, their soft nature was highlighted by the admission to the third stage of the EMU of a number of Member States which did not fully comply according to these criteria (Italy, Belgium and Greece). This exemplifies one of the many instances where, in connection with the EMU, the rules in the book significantly diverged from the practice and implementation.

As a result of this, and in connection with stage three of the EMU, we explained how some Member States felt the need to push for an additional layer of legal safeguard to impose a stricter adherence to the principle of fiscal discipline. The SGP was the legal instrument adopted with this purpose, and more specifically, for imposing sound government finances on a permanent level.[474] The Pact was based on the concept of budget constraints, as provided by the Treaty, and more specifically on the concept of medium term objectives (MTO), which progressively became the central duty of the Member States under the new economic governance system.[475]

Under the SGP, Member States were required to adhere "to the medium term objective of budgetary positions of close to balance or in surplus".[476] This specific commitment was meant to allow Member States to deal with normal cyclical fluctuations, while providing a safety margin to keep the government deficit within the 3 % of GDP reference value.[477] The code of conduct for the SGP provided some interpretation to this objective, concerning the time frame

[471] H Siekman (n. 141) 368.

[472] The EMI 1998 Convergence Report clarified that: "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". EMI. Convergence Report, March 1998, p 3.

[473] BVerfGE 89, 155 (202 f.).

[474] R Beetsma, 'The Stability and Growth Pact in a model with politically induced deficit biases' in A Hughes Hallett, M. Hutchison, S E Hougaard Jensen (eds.) (n. 378) 189-215.

[475] D Chalmers, 'The European Redistributive State and a European Law of Struggle', 18 *European Law Journal* 5 (2012) 677-678.

[476] See Article 3 of Regulation (EC) No 1466/97 (n. 276).

[477] See Recital 4 of Regulation (EC) No 1466/97 (n. 276).

of "medium term", and the fiscal indicator for "close to balance or in surplus".[478] The time frame for interpreting the medium-term was considered the length of the business cycle. Close to balance or in surplus was interpreted in terms of cyclically adjusted budget balance nets of one-off and temporary measures (also known as structural budget), provided that a minimal benchmark was respected. Minimal benchmark indicates, for each country, the level of the cyclically adjusted budget which allows the working of automatic stabilizers without incurring the risk that the nominal budget breaches the 3 % reference value in the course of the cycle.[479]

The medium-term budget target under the SGP was defined as a much more economics-friendly innovation compared to the nominal uniform 3 % value of the Treaty.[480] More specifically, the concept of structural budget was considered more elastic than the nominal deficit as it took into consideration the business cycle swings net of one-off and other temporary measures (such as, for instance, the sale of non-financial assets or the receipt of auctions of publicly-owned licenses).[481] This analysis was based on the assumption that member countries treated the prospect of infringing the 3 % deficit ratio as one to be strictly avoided and that sanctions were fully credible.[482]

However, as we have mentioned, during the first years of implementation, the rules of the SGP experienced a significant lack of compliance resulting in a complex institutional crisis (see above). One of the critiques of the system was in fact, as we mentioned before, that the MTO under the SGP was not considered flexible enough to allow the automatic stabilizers to operate.[483] The so-called "automatic stabilizers" operate as an anticyclical stream in the form of higher government expenditure at times of economic downturn. As a result, the reform in 2005 introduced the concept of country-specific MTO in order to create a more flexibile and hence credible system of fiscal discipline and assessment. Under this new notion, each Member State could set a differentiated objective for its budgetary position and, as a result, the MTOs could deviate from the previous agreed position of "close to balance or in surplus".[484]

---

[478]Opinion on the content and format of stability and convergence programmes (2001 code of conduct) which were endorsed at the Ecofin meeting on 10 July 2001. This Code of conduct amended the first code of conduct endorsed in 1998 by the Ecofin.
[479] See 2001 code of conduct (n. 478).
[480] For an analysis of this concept under the SGP see M Artis and A Buti, 'Close-to-Balance or in Surplus': A Policy-Maker's Guide to the Implementation of the Stability and Growth Pact' 38 *JCMS* 4 (2000) 564.
[481]Ibid 565.
[482]Ibid 565.
[483] See among many B Eichengreen and C Wyplosz (n. 269); P De Grauwe (n. 3) 136.
[484] "Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council of 11 October 2005 (Code

Each Member State, in order to establish its own differentiated MTO, could take into consideration three specific criteria: (i) the debt ratio, implying that Member States with relatively low debt could benefit from more flexibility; (ii) the debt reduction effort, implying that countries with a debt ratio in excess of the 60% of GDP could also take into account the future economic effort of debt reduction; and (iii) the future increase of expeditures due to age-related government expenditure.[485] Within this new country-specific system, the MTO still had to provide a safety margin with respect to the 3% of GDP deficit reference value and, for Euro area and ERM II Member States, the respect of a lower 1% of GDP deficit reference value. The reform also outlined a specific adjustment path for those Member States that have not reached their MTO. In particular, Member States of the Eurozone or of ERM-II should have pursued a minimum annual adjustment path in cyclically adjusted terms, net of one-offs and other temporary measures, of 0.5% of GDP as a benchmark.[486]

In any case, the reform specifically addressed the problem of pro-cyclical policies by suggesting higher effort in good economic times, and limited effort in bad economic times.[487] A final element of flexibility was added to the picture in connection with potential structural reforms. It was agreed that the implementation of major structural reforms should have automatically allowed for a temporary deviation from the MTO or its adjustment path provided that the 3% deficit limit is still respected and the MTO or MTO-adjustment path is reached again within the four-year program period.[488] The country-specific MTO can be revised when a major structural reform is implemented and at least every four years.[489] The reformed version of the MTO had

---

of Conduct 2005). This Code of Conduct updates and replaces the 2001 Code of Conduct in line with the two Regulations, No 1055/05 and No 1056/05, amending Regulations No 1466/97 and No 1467/97.

[485] According to the definition of the MTO under the Code of Conduct 2005, "the country-specific MTOs should take into account three components: i) the debt-stabilising balance for a debt ratio equal to the (60% of GDP) reference value (dependent on long-term potential growth), implying room for budgetary manoeuvre for Member States with relatively low debt; ii) a supplementary debt-reduction effort for Member States with a debt ratio in excess of the (60% of GDP) reference value, implying rapid progress towards it; and iii) a fraction of the adjustment needed to cover the present value of the future increase in age-related government expenditure." Code of Conduct 2005 (n. 484) 4.

[486] Code of Conduct 2005 (n. 484) 5.

[487] Economic 'good times' is identified "as periods where output exceeds its potential level, taking into account tax elasticities." However, the Conduct also recites that "Given the uncertainty surrounding output gap levels' estimates, the change in the output gap could also be considered, especially when the output gap is estimated to be close to zero. For instance, periods where the output gap is slightly negative but moving rapidly towards positive values could be considered as 'good times'. Symmetrically, periods where the output gap is slightly positive but moving rapidly towards negative values could not be considered as 'good times'." Code of Conduct 2005 (n. 484) 5.

[488] Code of Conduct 2005 (n. 484) 6.

[489] For this argument see R Morris, H Ongena, L Schuknecht, 'The reform and implementation of the Stability and Growth Pact' ECB Occasional Paper, No. 47 (2006).

three specific goals. First, it aimed to provide flexibility but still maintain a safety margin with respect to the 3% rule deficit criteria. Second, it aimed to enhance fiscal sustainability by taking into account future expeditures given by the aging population. Third, it sought to take into account the need for long-term investment of the state and structural reforms.[490]

The EU has taken a wide range of measures to strengthen the economic governance as a response to a number of weaknesses revealed by the economic and financial crisis. Central to these efforts have been the legislative packages of the Six Pack (plus the Two Pack already explained above) and of the Fiscal Compact.

The Six Pack reform was primarily advanced by the Commission in its early Communications, by recognizing that "the rules and principles of the Stability and Growth Pact are relevant and valid", but "compliance with the rules needs to be improved and more focus needs to be given to sustainability of public finances".[491] Under the view of the Commission, improving the functioning of the existing mechanisms SGP would require several reforms which in turn needed a change in secondary legislation. In particular, the proposal of the Commission, which was further elaborated afterwards, advocated for: (i) an integration of the Treaty objective of sound public finances into national law, specifically into national fiscal frameworks; (ii) an improvement of the functioning of the EDP; (iii) addressing high public debt and safeguarding long-term fiscal sustainability by giving prominence to the debt criterion of the Treaty; and (iv) a better structure of incentives and sanctions to comply with the SGP.

Directive 2011/85/EU endorsed many of the Commission's proposals in terms of national fiscal frameworks, as a set of arrangements, procedures, rules and institutions that set forth the conduct of budgetary policies of general government.[492] Initially, this was in terms of reliability of the data, by requiring macroeconomic and budgetary forecasts to be realistic and covering all administrative governmental levels, under an effective medium-term budgetary framework for a multi-annual fiscal planning horizon of at least 3 years, and including all the relevant information on existing extra-budgetary bodies and funds, tax expenditures and contingent liabilities with potentially large impacts on public budgets.[493] Second, in terms of quality of the data, it required national fiscal data to be consistent with minimum quality accounting standards

---

[490] S N Durlauf, L E Blume, *The New Palgrave Dictionary of Economics* (London, Palgrave Macmillan, 2016) 823.
[491] Commission Communication (n. 346).
[492] Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States, OJ L 306/41.
[493] See Ibid Article 4 and 9.

(by referring to the new EU accounting standard, i.e. ESA95).[494] Third, in terms of budget constraints and enforcement, it required Member States to enact national fiscal rules, to be reflected also in the annual budget legislation, as well as proper enforcement mechanisms to promote the compliance with the Treaty reference values on deficit and public debt as well as with the adoption of a multi-annual fiscal planning horizon which includes adherence to the Member State's MTO.[495] The Directive was to be implemented by 31 December 2013, and its implementation was to be assessed by the Commission through an interim progress report. The last interim progress report, and the later more specific report on the implementation of single provisions, shows how the Directive has been implemented by almost all Member States, and specifically by all Member States under financial distress.[496] A final and more detailed review is to be published by 14 December 2018.[497]

As a second element, the EU approved Regulation (EU) No 1175/2011 in order to address the third objective mentioned above by the Commission. This legal measure, as we explained, established the new framework of the European Semester, and, at the same time, also reinforced the regime of budget constraints under the SGP. In particular, it complemented the definition of MTO, by introducing the concept of "expenditure benchmark". This expenditure benchmark places an additional constraint on the annual growth of expenditure net of discretionary revenue measures according to specific a medium-term rate of growth. This instrument is meant to ensure that expenditure plans are adequately resourced by equivalent permanent revenues. The benchmark does not constrain the level of public expenditure, as long as it is financed effectively.[498]

---

[494] See Ibid Article 3.

[495] According to Article 6 and 7, country-specific numerical fiscal rules shall contain specifications as to the following elements: (i) the target definition and scope of the rules; (ii) the effective and timely monitoring of compliance with the rules, based on reliable and independent analysis carried out by independent bodies or bodies endowed with functional autonomy vis-à-vis the fiscal authorities of the Member States; (iii) the consequences in the event of non-compliance. If numerical fiscal rules contain escape clauses, such clauses shall set out a limited number of specific circumstances consistent with the Member States' obligations deriving from the TFEU in the area of budgetary policy, and stringent procedures in which temporary non-compliance with the rule is permitted.

[496] Commission Communication, Interim Progress Report on the implementation of Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States Brussels, 14.12.2012 COM(2012) 761 final; See also European Commission, Progress report on the Member States' implementation of Council Directive 2011/85/EU, Article 3(2) related to fiscal data Excessive Deficit Procedure Statistics Working Group 15 −17 June 2015. For instance in Italy, the directive was implemented through the Legislative Decree 4 march 2014, n. 54.

[497] See Article 15 of Directive 2011/85/EU (n. 492).

[498] For details on the reference medium-term rate of potential GDP growth see the Code of Conduct (n. 484) 5.

More specifically, the growth of government expenditure is differently assessed depending on whether the Member State has achieved its MTO or not. In the first case, the annual expenditure growth cannot simply exceed a reference medium-term rate of potential GDP growth, unless the excess is matched by discretionary revenue measures. In the second case, the annual expenditure growth cannot exceed a rate below a reference medium-term rate of potential GDP growth, unless the excess is matched by discretionary revenue measures. Furthermore, the discretionary reductions of government revenue items are to be matched either by expenditure reductions or by discretionary increases in other government revenue items or both.[499] The Regulation also requires the MTO to be revised every 3 years, or even further revised in the event of the implementation of a structural reform with a major impact on the sustainability of public finances.[500] This Regulation also provides a more stringent definition of what constitutes a significant deviation from the MTO or from the appropriate adjustment path toward it. Two criteria have been adopted for such an assessment. For a Member State that has not reached the MTO, a deviation occurs in the context of the structural balance if it is at least 0.5% of GDP in a single year or at least 0.25% of GDP on average per year in two consecutive years. In the context of expenditure developments net of discretionary revenue measures, this is whether the deviation has a total impact on the government balance of at least 0.5% of GDP in a single year or cumulatively in two consecutive years.[501] The Regulation also clarifies that any deviation of expenditure developments is not considered significant if the Member State has overachieved the MTO, or when it results from an unusual event outside the control of the Member State concerned and which has a major impact on the financial position of the general government or in case of severe economic downturn for the Euro area or the Union as a whole, provided that this does not endanger fiscal sustainability in the medium-term.[502] A similar definition of exceptional circumstance is also provided under Council Regulation (EU) No 1177/2011.[503]

A third measure, regulation (EU) No 1177/2011, is also relevant in the context of budget constraints because, among others things, it made the debt criterion operational. The SGP and the following reforms focused extensively on government deficit while it did not expressly address the issue of government debt, except by requiring the SCP to provide data and assumptions concerning the path for the general government debt ratio. The debt criterion,

[499] See Article 5 of Regulation 1175/2011 (n. 492).
[500] See Article 2ab of Regulation 1175/2011 (n. 492).
[501] See Article 6 of Regulation 1175/2011 (n. 492).
[502] See Article 6 of Regulation 1175/2011 (n. 492).
[503] See Article 2ab of Regulation 1177/2011 (n. 492).

which could also trigger the EDP according to article 104(3), was in fact interpreted in trend rather than in level.[504] The debt criteria was not operational without a numerical benchmark and explanation of its specific budgetary levels, as was provided for the deficit criteria.

The new Regulation precisely provided a numerical benchmark, taking into account the business cycle, against which to assess whether the ratio of the government debt to GDP is sufficiently diminishing and is approaching the reference value at a satisfactory pace. In the event that the Member State exceeds the reference value, the Member State is considered to be sufficiently diminishing and approaching the reference value at a satisfactory pace when the differential with respect to the reference value has decreased over the previous three years at an average rate of one twentieth per year as a benchmark, based on changes over the last three years for which the data is available. The provision also clarifies that the requirement under the debt criterion is also fulfilled if the budgetary forecasts of the Commission indicate that the required reduction in the differential will occur over the three-year period encompassing the two years following the final year for which the data is available. For a Member State that is subject, at the time, to an EDP and for a period of three years from the correction of the excessive deficit, the requirement under the debt criterion is considered fulfilled if the Member State makes sufficient progress towards compliance as assessed in the opinion adopted by the Council on its SCP.[505]

Following these changes, several Member States proposed to additionally strengthen the legal basis for budget constraints by amending the TFEU and/or the attached protocols. However, at a meeting of the European Council in December 2011, an agreement on a possible Treaty amendment was not possible due to the resistance of the UK to include specific rules on financial services.[506] As a result, the remaining Member States decided to agree through the adoption of an international treaty that would reflect the content of the Treaty amendment. The countries agreed on a "new fiscal compact and on significantly stronger coordination of economic policies in areas of common interest"[507]. The choice for an international agreement was legally questionable, but as rightly pointed out by some authors, it also implied some clear

[504] The New Palgrave Dictionary of Economics (n. 490) 820.
[505] See Article 1 of Regulation 1177/2011 (n. 492).
[506] See H. Van Rompuy, Towards a Stronger Economic Union: Interim Report to the European Council, 6 December 2011.
[507] European Council, Statement by the Euro area heads of state or government, (the so called "December 2011 statement"), 9 December 2011 available at https://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/126658.pdf.

advantages in terms of avoiding veto positions and in terms of specific rules for its entry into force.[508]

The Treaty on Stability, Coordination and Governance, often referred to as the Stability Treaty or The Fiscal Compact (in connection with its basic component) was eventually signed on 2 March 2012 by 25 European Union (EU) member states – all except the UK and the Czech Republic eventually, and entered into force on 1 January 2013.[509] Although this agreement was signed as an international treaty, and therefore not integrated into EU law, it provides a commitment to transfer its substance into the EU legal framework within five years. Although a plain reading of this agreement does not conflict with EU law,[510] the relationship between this Treaty and EU law remains uncertain.[511]

The essence of the Treaty is represented by Title III, which is specifically referred as the Fiscal Compact. It is centered around a few crucial themes, which mirror those already established under the Six Pack, but are nonetheless based on a stronger legal regime.[512] The Treaty sets out the so-called "balanced budget rule". According to this provision, a government budget is balanced or in surplus when the annual structural balance is at its country-specific MTO, as defined in the revised SGP, with a lower limit of a structural deficit of 0.5% of the GDP at market prices.[513] A temporary deviation from the MTO or the adjustment path towards is allowed in case of exceptional circumstances as provided by the revidsed SGP, and when the ratio of the GDP/debt at market prices is significantly below 60% provided that the risks in terms of long-term sustainability of public finances are low. Under such cricumstances, the lower limit of the MTO can reach a structural deficit of at most 1% of the GDP at market

[508] See B de Witte in A Kocharov (ed.) (n. 365) 6.
[509] On the 1 January 2013 the treaty entered into force for the 16 states that completed its ratification. For the remaining states, it entered into force once they completed the ratification process according to article 14. The Treaty maintains the express purpose under Article 1 of strengthening the economic pillar of the economic and monetary union by adopting a set of rules intended to foster budgetary discipline through a fiscal compact, to strengthen the coordination of their economic policies and to improve the governance of the Euro area.
[510] Under Title II, named "Consistency and relationship with the law of the union" Article 2 clarifies that the Treaty "shall be applied and interpreted by the Contracting Parties in conformity with the Treaties on which the European Union… shall apply insofar as it is compatible with the Treaties on which the European Union is founded and with European Union law. It shall not encroach upon the competence of the Union to act in the area of the economic union."
[511] See more generaly, P Craig, 'The Stability, Coordination and Governance Treaty: principle, politics and pragmatism' 37 *European Law Review* 3 (2012) 231-248.
[512] S Peers, 'The Stability Treaty: Permanent Austerity or Gesture Politics?' 8 *European Constitutional Law Review*, 3 (2012) 410.
[513] Article 3 (1) (a) (b) of the Fiscal Compact (n. 431).

prices.[514] In the event of significant deviations from the MTO or the adjustment path towards it, the Treaty requires the existence of an automatic correction mechanism, which triggers an obligation for the Member State to implement measures to correct the deviations over a defined period of time (see below).

The Treaty also introduced the so-called "debt brake provision". Under this provision, the balanced budget rule, as well as the automatic correction mechanism outlined above, are to be enshrined into national law at the latest one year after the entry into force of this Treaty. These provisions are required to be of binding force and permanent in character, preferably constitutional, or otherwise guaranteed to be fully respected and adhered to throughout the national budgetary processes.[515] This was a significant innovation from previous practice, as some authors have explained how these tools were truly meant to "instrumentalise national constitutional law for the benefit of Union law".[516] The Commission is responsible for laying out the common principles of the automatic correction mechanism, concerning the nature, size and time frame of the corrective action to be undertaken, also in the case of exceptional circumstances, and the role and independence of the institutions responsible at national level for monitoring compliance with the rules.[517]

As we have already stated, in the last few years, the EU has tried to move in the opposite direction to the more stringent approach of the Six Pack and the Fiscal Compact. In light of the difficulties to abide by these rules and the pro-cyclical measures adopted in the aftermath of the crisis, the Commission decided to put greater emphasis on the link between investment, structural reform, and fiscal responsibility. Without changing the existing rules, a commonly agreed position was issued on the best possible use of the flexibility that is built into the existing rules of the SGP.[518] The commonly agreed position clarifies how three specific "policy dimensions" can best be taken into account in applying the rules.

[514] Article 3 (1) (c) (d) of the Fiscal Compact (n. 431).
[515] Article 3(2) of the Fiscal Compact (n. 431).
[516] L Besselink and J H Reestman, 'Editorial: The Fiscal Compact and the European Constitutions: "Europe Speaking German"', 8 *European Const. Law Review* 1 (2012) 5.
[517] Article 3(2) of the Fiscal Compact (n. 431).
[518] On 13 January 2015 the Commission adopted its Communication on flexibility within the SGP. The Economic and Financial Committee discussed the operalizationality of such Communication through a commonly agreed position. This document was formally endorsed by the Council on 12 February 2016. See "A commonly agreed position on flexibility within the stability and growth pact: flexibility for cyclical conditions, structural reforms and investment" available at http://data.consilium.europa.eu/doc/document/ST-14345-2015-INIT/en/pdf.

First, in relation to cyclical conditions, it was agreed that Member States should achieve a more symmetrical approach to fiscal policy over the cycle through enhanced budgetary discipline in periods of economic recovery. For this purpose, the document provided a matrix that clarifies and specifies the fiscal adjustment requirements differentiating between larger fiscal effort during better times and a smaller fiscal effort during difficult economic conditions.

Second, in the event of major and specific structural reforms, the EU will take those reforms into account in the definition of the adjustment path to the MTO for countries that have not yet reached this objective and allow a temporary deviation from this objective for countries that have already reached it. The reform must meet three necessary conditions to be eligible: (i) the reforms must have a major positive impact on growth and the long-term sustainability of public finances; (ii) the reforms must have direct long-term positive budgetary effects, including by raising potential sustainable growth, and therefore a verifiable impact on the long-term sustainability of public finances; and (iii) the reforms must be fully implemented, i.e. adopted by the national authorities through provisions of binding force.

Third, some investments aiming at, ancillary to, and economically equivalent to the implementation of major structural reforms may, under certain conditions, justify a temporary deviation from the MTO of the concerned Member State or from the adjustment path towards it. In a similar spirit, on 29 November 2016, the Economic and Financial Committee agreed on improving the predictability and transparency of the SGP through a greater focus on the expenditure benchmark in the preventive and corrective arms of the Pact.[519] The agreement covers both arms of the pact as they relate to the assessment of Member States' fiscal policies and outcomes. The document does not modify the rules, but rather provides stronger focus on specific elements, such as the structural balance definition and the expenditure-based indicator. The latter is precisely considered an operational and easy-to-measure target that will guide Member States in the preparation and monitoring of their budgets.

[519] For a broad overview see Vademecum on the Stability and Growth Pact 2017 Edition available at https://ec.europa.eu/info/sites/info/files/ip052_en_0.pdf

1.5 – ENFORCEMENT OF FISCAL RULES

Adherence to fiscal rules can be spontaneous or enforced. The process of economic and monetary coordination leading up to the EMU relied almost entirely on mere spontaneous enforcement. With the establishment of the single currency and, with the development of the specific rules on fiscal discipline outlined above, the EU set up a mixed system of external and internal enforcement. The Member State represents the internal agent responsible for enforcing the rules as a "contractual" obligation. The Treaty in fact required that Member States were to be responsible for their deficits and for ensuring that national procedures in the budgetary area would enable them to meet their obligations in this area deriving from the Treaty.[520] Market discipline, resulting from the combination of the no-bailout clause, the prohibition on monetary financing, and the ban of government privileges in loan access, was also meant to induce and enhance spontaneous fiscal responsibility.[521] The Council, and the other Member States collectively represent the external enforcement agent. As noted, the Treaty provided for a specific enforcement procedure, the Excessive Deficit Procedure (EDP), which could be triggered by a breach of either the deficit or the debt criterion. The procedure primarily relied on the Council, acting by a qualified majority, to ultimately assess whether an excessive deficit existed and whether, at the end of the process, it would be appropriate to impose economic sanctions.

We also explained that with the corrective arm of the SGP, Regulation 1467/97, the Council decided to speed up and clarify the implementation of the excessive deficit procedure in order to correct the occurrence of excessive government deficits. The regulation completed the definition of excessive deficit by clarifying what constitutes an exceptional and temporary deficit. It also outlined a clear timetable for the EDP. According to the Regulation, the Commission was responsible for formulating an opinion and a recommendation to the Council as to whether an excessive deficit existed on the basis of its preliminary report, with the Economic and Financial Committee opinion to be issued within two weeks of their decision. Based on this report, the Council would then decide, within three months, on the existence of an excessive deficit by qualified majority of the Euro-area states, except for the Member States involved. If the Council were to conclude that an excessive deficit did exist, it would make a

[520] See Article 3 of Protocol 5 on the Excessive Deficit Procedure annexed to the EC Treaty.
[521] M Dolls, C Fuest, F Heinemann, and A Peichl, 'Reconciling Insurance with Market Discipline: A Blueprint for a European Fiscal Union' ZEW Centre for Economic Research, Discussion Paper No. 15-044 (2015) 8.

recommendation to the Member State within four months for its correction.[522] If the Member State then failed to comply with the successive decisions of the Council, the Council could impose sanctions, within the next ten months. The sanction may consist of a fixed non-interest-bearing deposit equal to 0,2 % of GDP and a variable component.[523] Each year, the Council is responsible for monitoring the Member State's action for compliance and could possibly intensify the sanctions in its variable part if the compliance were unsatisfactory. The deposit could eventually be converted into a non-reimbursable fine in which case, within two years from the issue of the deposit, the Council could decide that the excessive deficit had not been corrected.[524] The Council could also impose, as economic sanctions, the suspension or the termination of the lending facility by the European Investment Bank,[525] as well as the suspension or the termination of EU cohesion funds.[526]

As previously described, this version of the EDP was very different from the version based on automatic sanctions proposed under the original Weigel Plan. The adopted solution was based on self-commitment and peer pressure to negotiate structural reforms and fiscal adjusments toward fiscal discipline in the shadow of the procedure. However, the adoption of the SGP, did not promote a sufficient level of fiscal responsibility. In particular, from the entering into force of the SGP, only three countries have been consistently in compliance with these benchmarks (Sweden, Estonia and Luxembourg)[527]. Despite this, all EDPs have been concluded without the application of any sanctions but only formal warnings. As we will develop more in the next chapter, this was due to peer pressure was weak with no real legal enforcement. For this reason, after the recent crisis, Member States and the EU significantly reformed the corrective arm of the SGP in order to create a more credible and effective enforcement mechanism. As mentioned above, the two procedures now in place are: a) the Excessive Deficit Procedure (EDP), which

---

[522] Article 3 of Council Regulation (EC) 1467/97 (n. 277).

[523] Article 12 of Council Regulation (EC) 1467/97 (n. 277). The Regulation also provides that the variable part is 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 % of GDP. In any case, the deposit cannot exceed the upper limit of 0,5 % of GDP.

[524] Article 13 of Council Regulation (EC) 1467/97 (n. 277). Article 14 and 15 of Council Regulation (EC) 1467/97 (n. 277) provide that the Council can repeal the sanctions depending on the significance of the progress made by the Member State in correcting the excessive deficit, or in the case that the decision on the existence of an excessive deficit is terminated. Nevertheless, the fines already imposed cannot be reimbursed to the Member State.

[525] Art 126(11) TFEU.

[526] Art 4 of Council Regulation (EC) n. 1084/2006 of 11 July 2006 establishing a Cohesion Fund and repealing Regulation (EC) No 1164/94, OJ L210/79.

[527] Eurostat database, Economic and Finance National Accounts – GDP and major components; Government statistics; Government deficit/surplus; debt and associated data; European Economic Forecast 2017.

addresses fiscal imbalances, and b) the Excessive Imbalance Procedure (EIP), which deals with macro-economic imbalances.

The Commission, in its initial proposal, argued for the improvement of the EDP "by speeding up the procedures, in particular with regard to Member States in repeated breach of the act". The Commission emphasized the clear financial inter-linkages within the Euro area and the possible risks for the functioning of economic and monetary union in case of repeated breaching of the rules or recommendations, and as a result the need for a specific enforcement mechanism under such conditions.[528]

The result is Council Regulation (EU) No 1177/2011. The Regulation tends to clarify the implementation of the excessive deficit procedure by defining what excess of a government deficit is considered "exceptional and what diminishing path towards the appropriate deficit ratio and debt ratio is considered sufficient". More importantly, in this context, it made the launch of the EDP on the basis of a debt ratio possible, which is not diminishing towards the reference value at a satisfactory pace, and not only on the basis of the deficit ratio. As recognized by the Commission in its proposal: "While the deficit and the debt criterion are in principle on an equal footing, and persistently high levels of debt arguably represent a more serious threat to public finance sustainability than occasionally high deficits, in practice the '3% of GDP' threshold has been the almost exclusive focus of the EDP, with debt playing a marginal role"[529]. Furthermore, the Regulation provides that the Commission and the Council must take into account all relevant factors for its evaluation under Article 126(3) TFEU, in terms of pension reforms or developments in the medium-term economic (GDP growth, private savings) budgetary (primary balance) and government debt (dynamics and sustainability). On the other hand, the Regulation quickened the EDP by strengthening the dialogue between the institutions of the Union, particularly the European Parliament, the Council and the Commission, on budgetary and economic matters.

The fourth purpose envisioned by the Commmission relates to a better design of incentives and sanctions to comply with the rules of the SGP, toward which direction several innovations in Regulation (EU) No 1173/2011 have aimed. Financial sanctions for Euro-area Member States are now gradually imposed. In the preventive arm stage, in case of failure to take action in

---

528 Commission Communication (n. 346).

529 Commission Communication, proposal for a Regulation of the European Parliament and of the Council - on the effective enforcement of budgetary surveillance in the Euro area, Brussels, 29.9.2010, COM(2010) 524 final.

response to a Council recommendation under Art. 121(4) TFEU, an interest-bearing deposit amounting to 0.2% of GDP was imposed to the Member States.[530] The amount of 0.2% could eventually be converted into a non-interest bearing deposit if the Member States had already been subject to an interest-bearing deposit, and if the Council made a decision based on Art. 126(6) TFEU (i.e. existence of an excessive deficit) or in case of particularly serious noncompliance with the rules. In the corrective arm stage, if the Council made a decision based on Art. 126(8) TFEU (i.e. non-effective action in response to the recommendation to correct the excessive deficit under Art. 126(7)), a fine amounting to 0.2% of GDP would be imposed. Ultimately, if the Council made a decision based on Art. 126(11) TFEU (i.e. non-effective action in response to the notice to correct the excessive deficit under Art. 126(9)), a fine amounting to 0.2% of GDP and an additional variable component would be imposed. The Regulation also introduced a specific sanction concerning the manipulation of national statistics.

Perhaps the most significant innovation of all concerns the procedure for issuing financial sanctions. Under the original version of the SGP, the final decision on sanctions had to be agreed on by a qualified majority in the Council (i.e. voting at a majority of two thirds of the Member States participating to the Euro). As pointed out by many authors, this was the core limit of peer control since the vote depended on the general willingness of the Member State where the three bigger Member States, representing almost two-thirds of the GDP of the Euro area, might sooner or later be subject to such measures.[531] Therefore, in order to increase the likelihood of success of such a procedure and, thus, of being considered a credible threat by Euro-area Member States, Regulation 1173/2011 introduced the principles of reverse qualified majority voting for most of the above sanctions. This meant that a recommendation or a proposal of the Commission to impose a sanction was now considered adopted in the Council unless a qualified majority of Member States voted against it. Only Member States whose currency is the Euro are entitled to vote in such circumstances, and without taking into account the vote of the Member State concerned. It clearly represents a groundbreaking change, for it implies an almost automatic sanction procedure, closer to the original proposal of the SGP, and a greater role of the Commission in the context of economic governance.

[530] According to article 4, "The interest-bearing deposit shall bear an interest rate reflecting the Commission's credit risk and the relevant investment period".
[531] See for instance J Louis, 'The economic and monetary union: law and institutions', 41 *Common Market Law Review* 2 (2004) 575-608.

The EDP has also been strengtened by the Fiscal Compact, which insists on a reverse qualified majority voting to apply to all phases of the EDP. Additionally, a Contracting State to the Treaty that is subject to an EDP is now required to adopt a budgetary and economic partnership program including a detailed description of the structural reforms which must be put in place and implemented to ensure an effective and durable correction of its excessive deficit.[532] The Treaty had also introduced alternative forms of enforcement. In the event of significant deviations from the MTO or the adjustment path towards it, the Treaty also required the existence of an automatic correction mechanism that would trigger an obligation for the Member State to implement measures to correct the deviations over a defined period of time.[533] The exact implementation of this mechanism is to be defined individually by each Member State, but it has to comply with the basic principles outlined by the European Commission's directive published in June 2012.[534] .[535] In any case, the automatic correction mechanism shall apply only in the case of breach not caused by "extraordinary events outside control of the Member State" or by the arrival of a severe economic downturn.[536] The Treaty,also introduced the debt brake provision which now provides a permanent and possibly independent enforcement, depending on the measures adopted at the national level, of the balance budget rules and of the automatic mechanism outlined above through the surveillance of the parliament and eventually of the national constitutional court. The Commission is responsible for assessing Member States' compliance with this debt brake provision, while each Member State can ask the ECJ to verify the transposition of the rules into national law. This process can end up with financial sanctions of up to 0.1% of GDP imposed by the Court to ensure compliance with its judgements.[537] A report by the European Parliament showed that almost all of the 25 States have enacted some sort of debt brake provisions, though mostly through ordinary law.[538]

---

[532] Article 5 of the Fiscal Compact (n. 431).
[533] Article 3 (1) (e) of the Fiscal Compact (n. 431).
[534] This directive contains common principles for the role and independence of institutions (such as a Fiscal Advisory Council) responsible at the national level for monitoring the observance of the rules, which is one of the key elements to ensure that the "automatic correction mechanism" will actually work.
[535] Commission Communication, Common principles on national fiscal correction mechanisms Brussels, 20.6.2012 COM (2012) 342 final.
[536] The treaty provides for Member States which are already subject to an "Excessive Deficit Procedure" (EDP) as of November 2011 an "adjustment path" towards the MTO.
[537] Article 8 of the Fiscal Compact (n. 431).
[538] European Parliament, 'Ratification requirements and present situation in the member states: Article 136 TFEU, ESM, Fiscal Stability Treaty (January 2014)' Policy Department of 15 January 2014, available at http://www.europarl.europa.eu/meetdocs/2009_2014/documents/afco/dv/2013-06-12_pe462455-v16_/2013-06-12_pe462455-v16_en.pdf.

With regard to macroeconomic imabalances, Regulation (EU) No 1174/2011 not only adopted a system of surveillance, but also introduced a corrective arm similar to the EDP, the Excessive Imbalance Procedure (EIP). The procedure applies when the Commission detects an excessive imbalance on the basis of the in-depth review. As a result, the Council issues a recommendation, in accordance with Article 121(4) TFEU, establishing the existence of an excessive imbalance and corrective action plan. The Member State must then submit a corrective action plan with a clear timetable and deadlines, and their implementation of the Council's recommendation will be monitored by the Commission on the basis of regular progress reports submitted by the Member States. In case of failure to comply with the recommended corrective action, a new sanctioning regime was established for Euro area countries by Regulation (EU) No 1174/2011. This enforcement mechanism resembles the similar procedure under the reformed EDP and entails a dual phase approach. First, an interest-bearing deposit may be imposed in case of noncompliance with the recommended corrective action. Following a second compliance failure, this interest-bearing deposit can be converted into a fine (up to 0.1% of GDP). As is now the case for the EDP, the procedure to take all the relevant decisions leading up to sanctions adopts the same principle of reverse qualified majority voting of the reformed EDP procedure.

2. Irreversibility of the Euro – financial and monetary assistance

The idea behind the principle of irreversibility of the Euro has its origins in the Delors Report, which suggested the creation of a single currency in order to avoid the transaction costs of converting currencies, and ultimately to make the monetary union irreversible.[539] This principle was later enshrined in the Treaty of Maastricht under Article 3a(2), which referred to the irrevocable fixing of exchange rates leading to the introduction of a single currency. Ultimately, since the Lisbon Treaty, both Article 49 and Article 140 TFEU now make reference to the exchange rates to which the currencies are irrevocably set. These provisions provide the legal basis for the irreversibility of the Euro.[540] Specifically, they are interpreted not only in support of the idea that the entire monetary union process cannot be reversed, but also that a single country is not allowed to leave the monetary union once it enters under any circumstance.[541] As a matter of fact, there is no legal provision allowing the exit from the EMU. Before the Lisbon Treaty, some commentators maintained the possibility of a right of withdrawal based on the fact that sovereign states are always able to freely withdraw from international commitments.[542] After the Lisbon Treaty, however, the vast majority of the commentators were convinced that leaving the Euro was not legally possible under the current legal framework and would constitute a breach of the treaties. The only available option now offered by Article 50 TFEU allows for withdrawal from the EU, but, as we will develop later, does not include any reference to the conditions under which a Eurozone Member State can leave.[543]

---

[539] Delors Report (n. 161) 15.

[540] All the board members of the ECB have strongly supported this principle on multiple occasions. In the introductory statement of the Governing Council on 2 August 2012, the ECB President repeatedly stressed the irrevocability of the Euro, and clarified that "irreversibility means that it cannot be reversed. There is no going back to the Lira or the Drachma or to any other currency. It is pointless to bet against the Euro. It is pointless to go short on the Euro. That was the message. It is pointless because the Euro will stay and it is irreversible" M. Draghi, (n. 552). Similarly, B. Cœuré affirmed: "Let me be very clear: the Maastricht Treaty refers to the 'irrevocable fixing of exchange rates' when a country enters monetary union. The Euro is irrevocable" B. Cœuré, 'Completing Europe's Economic and Monetary Union, Palestinian Public Finance Institute Ramallah (23 September 2012) available at http://www.ecb.europa.eu/press/key/date/2012/html/sp120923.en.html.

[541] J Louis, Commentaire Megret (n.228); J Weiler, 'Alternative to Withdrawal from an International Organization: The case of the European Economic Community', 20 *Israel Law Review* 2 (1985) 282.

[542] J Zeh, 'Recht auf Austritt', 2 Zeitschrift für Europarechtliche Studien (2004) 209. On the opposing end see J Herbst, 'Observations on the Right to Withdraw from the European Union: Who are the "Masters of the Treaties"?', 6 *German Law Journal* 1 (2005) 1755.

[543] For a recent analysis see P Athanassiou, 'Withdrawal and expulsion from the EU and EMU — Some Reflections' ECB Legal Working Paper Series 10 (December 2009).

Two main lines of reasoning exist for the establishment of such a principle. First, from an economic standpoint, it was conceived as a response to the shortcomings of the previous ERM. This was, as we explained, a non-binding agreement that allowed Member States to freely join or exit the currency exchange regime. This flexibility produced the necessary conditions for the speculative attacks that occurred in 1992, which was triggered by the perceived unsustainability of the ERM and by the fact that, under market pressure, Member States could be forced to leave the system. Member States understood the severity of the consequences and decided to set up an unconditional and irrevocable monetary union. The second reason is more political. The principle of irreversibility was also conceived as a system of checks and balances between the German and the French. From the reconstruction of the negotiation leading up to the Maastricht Treaty, the principle was mainly advanced by the French, who saw it as a way to bind the German commitment in the monetary sphere. The Germans, on the other hand, saw the irreversibility as an instrument to maintain monetary stability and, at the same time, complement the principle of monetary and fiscal discipline by ensuring in the wide European context the discontinuity of the policy of "competitive disinflation". As a result, during the negotiation process, they debated over a possible deadline for the monetary union and for the Euro, but it was eventually excluded.[544]

The irreversibility of the Euro was, for a long time, a merely theoretical and legal concept. The sovereign debt crisis changed this perception and in many ways also changed the aforementioned assumptions. In particular, the crisis principally showed that under severe financial distress, the union could still be subject to financial market pressure as was the case under the ERM regime, and that the plain language of the Treaties was not able to demonstrate to the financial markets the unconditional and irrevocable commitment by the Member States to the preservation of the monetary union. Only concrete actions could demonstrate this level of commitment. This idea was exemplified by the President of the ECB, M. Draghi, in his famous London speech in July 2012, when he affirmed: "We think the euro is irreversible. And it is not an empty word now, because I preceded saying exactly what actions have been made, are being made to make it irreversible".[545] The London statement was, among the many during the sovereign debt crisis, the most influencial one. As we will expound later, it produced the

[544] For a more detailed reconstuction on this issue see K Dyson and K Featherstone (n. 3) 202 and ff.
[545] M. Draghi, 'Speech at the Global Investment Conference in London' (London, 26 July 2012): Verbatim of the remarks available at http://www.ecb.europa.eu/press/key/date/2012/html/sp120726.en.html.

immediate effect of reassuring the financial markets, and was able to drive the decline in sovereign bond risk premia from mid 2012 onward.

The speech was particularly important for its strong resolution, but also as a prelude to the most concrete measures to support the irreversibility of the monetary union that followed. First, the ECB expanded its non-standard monetary policies by adopting a new program, the Outright Monetary Transactions program (OMT), under which the Euroystem could acquire sovereign bonds of Member States under financial distress with more flexibility than could be done in previous programs. In addition, the Member States of the Eurozone created a mechanism of financial assistance, the European Stability Mechanism (ESM), which could provide direct funding to Member States and banks facing financial difficulties. The London speech was also connected to a third measure that reinforced the principle of irreversibility, the Banking Union.[546] As the Commission highlighted in its original proposal, the approval of a single supervision mechanism, built around the European Central Bank (ECB) and the single resolution mechanism was meant to send a political signal of credibility to financial markets: "It will show once again the irreversibility of the euro."[547] All the measures of financial and monetary assistance now represent the cornerstone of the principle of irreversibility of the Euro.

2.1- FINANCIAL ASSISTANCE

Mechanisms of financial assistance are not new to the European economic integration process. Already under the Barre report, the Commission proposed and the Council agreed on the establishment of a short-term monetary support and a medium-term financial assistance program. These mechanisms, although limited, have been used in a number of instances. For example, immediately before the approval of the Maastricht Treaty, under the medium-term financial assistance mechanism, the Council granted a loan of 2.2 billion ECU to Greece on the condition that Greece would implement an economic recovery program.[548] Similarly, in 1991 the Council approved a loan of 8 billion ECU to Italy.[549] As noted before, Maastricht expressly ruled out any other possible form of assistance in terms of monetary financing through Article 123(1) TFEU or bailouts through Article 125 TFEU. Only a special procedure of support was

[546] For the connection between the two see A Busca, 'The thin red line between the omt decision and the banking union' in S Grundmann, H Micklitz (eds.) Banking Union and Constitution, (Hart, forthcoming).
[547] European Commission Memo, 'Towards a banking union' (Brussels, 10 September 2012).
[548] Council Decision 91/136/EEC of 13 March 1991 on a Community loan in favour of Greece OJ L 66/22.
[549] Council Decision 91/136/EEC of 13 March 1991 on a Community loan in favour of Italy OJ L 66/.

included in Article 103a (now Article 122 of the TFEU), which required the unanimous authorization of the Council to provide a certain type of financial assistance in favor of the Member State affected by severe difficulties caused by exceptional circumstances beyond the country's control or caused by natural disasters.

With the outbreak of the sovereign debt crisis, financial assistance became a necessity. Two financial instruments were established, namely the European Financial Stability Facility (EFSF) and the European Financial Stabilization Mechanism (EFSM). The aim of these instruments was to finance, within the several economic adjustment programs, loans and other forms of financial assistance to Members States by raising capital through issuing debt instruments. Both instruments were construed as temporary measures for a three-year period in order to tackle the immediate financial needs of the Member States in distress. The EFSM was placed within the scope of Article 122(2) TFEU, and was thus limited by the Community's own resources. The EFSF could supply the latter fund with a larger amount, but for this reason it was placed outside the Treaties and designated as an intergovernmental mechanism.

To replace these temporary instruments, in 2012 the European Stability Mechanism (ESM) was established as a permanent lending facility.[550] The purpose of the ESM was to "mobilize funding and provide stability support under strict conditionality", in order "to safeguard the financial stability of the euro area as a whole and of its Member States".[551] The ESM was precisely set up to overcome the shortcomings of the first instruments. From an institutional perspective, it was conceived as an international organization ("international financial institution"), similar to the former EFSF, but it was endowed with governing bodies and the power to adopt legally binding decisions. Additionally, it was legitimized under EU law through a Treaty amendment, adopted by a simplified revision procedure under Article 48(6) TFEU.[552] The amendment added a new third paragraph in Article 136 TFEU that reads: "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."

[550] Treaty Establishing the European Stability Mechanism (ESM Treaty) (2011) OJ L91/1.
[551] Article 3 of the ESM Treaty (n. 557).
[552] Council Decision of 25 March 2011 amending Article 136 of the Treaty on the Functioning of the European Union with regard to a stability mechanism for Member States whose currency is the Euro, O.J. 2011, L 91/1.

The ESM is ‘entitled to raise funds by issuing financial instruments or by entering into financial or other agreements or arrangements with ESM Members, financial institutions or other third parties”.[553] However, the ESM loans are different from previous forms of financial assistance. They are covered by the same capital of the ESM[554], and they enjoy preferred creditor status *vis-à-vis* the other debts contracted by the beneficiary State, with the only exception being the IMF loans.[555] The ESM can provide several instruments of financial support, such as precautionary financial assistance, purchase of State bonds on either the primary or the secondary market, and ultimately ESM loans as last resort. As of late 2014, the ESM is also able to directly recapitalize banks as a measure of last resort.[556] The purpose of the direct recapitalization instrument is to cut the link between governments and banks that has been a crucial destabilizing factor for some Euro area countries. Accordingly, banks that have requested or received direct public financial assistance under the ESM become subject to the common European supervision of the ECB.

Two governing bodies, the Board of Governors and the Board of Directors, run the ESM. The Board of Governors is composed of a governor appointed by each Member State and chaired by the President of the EuroGroup. In practice, the appointees are the Member States' ministers of finance, since the Treaty requires each Member State to appoint a "member of the government of that ESM Member who has responsibility for finance".[557] The Board of Governors is formally the most important body of the ESM, as it retains the ultimate responsibility for the decision to provide financial support.[558] The day-to-day business of the ESM, however, is run by the Managing Director under the supervision of the Board of Directors. The Managing Director is appointed for a term of five years by the Board of Governors from "among candidates having the nationality of an ESM Member, relevant international experience and a high level of competence in economic and financial matters".[559]

[553] Article 3 of the ESM Treaty (n. 557).
[554] According to Article 8 of the ESM Treaty (n. 557), the ESM is expected to have an authorized capital stock of 700 billion Euros of which 80 billion is paid-in capital, and the remaining 620 billion - if needed - will be loaned through the issuance of some special ESM obligations at the capital markets. The shares are distributed among the ESM members on the basis of their key for subscription of the ECB's capital.
[555] A. De Gregorio Merino, (n. 335) 1622.
[556] This was initially decided at the EU summit on 19 October 2012, and later adopted on 08 December 2014 by the Board of Governors of the European Stability Mechanism (the ESM direct recapitalisation instrument for Euro area financial institutions). See http://www.esm.europa.eu/press/releases/esm-direct-bank-recapitalisation-instrument-adopted.htm.
[557] Art. 5(1) of the ESM Treaty (n. 557).
[558] Art. 5(6)(f) of the ESM Treaty (n. 557).
[559] Art. 7 of the ESM Treaty (n. 557).

The Board of Directors is composed of seventeen "people of high competence in economic and financial matters" appointed by each governor.[560]

While the Board of Directors reaches most of its decisions by qualified majority voting, the Board of Governors instead makes the most important decisions by mutual agreement. Among these is the decision to provide stability support by the ESM, and the decision to delegate certain tasks to the Board of Directors. As a result, in these cases the ESM gives any Governor the power to veto the decision.[561] However, with particular regard to the decision to provide stability support, an emergency voting procedure can be adopted under certain circumstances of urgency.[562] This particular procedure only requires a qualified majority of the voting (85 %) according to the capital stock of the ESM.[563] This allows more flexibility in case of emergency, but, at the same time, preserves the veto power of the largest contributors.[564] Another important provision in terms of flexibility is the decision by the Board of Governors to amend certain provisions of the ESM Treaty, such as changes to the authorized capital stock and to the maximum lending volume through a simplified procedure, without the need for a full process of ratification.[565] This is significant because the liability of each ESM Member is limited to its portion of the authorized capital stock. Any change to the authorized capital stock is thus able to enlarge the liability of each Member State. The question of state liability under the ESM, as we will develop in the third chapter, has been under intense legal scrutiny for its possible violation of the bailout clause under the Treaty (see Chapter 3.3).

From the above structure, some authors have pointed out that the ESM substantially adopts the IMF model.[566] In this sense, the structure does not reflect a full egalitarian regime as the several exemptions to the mutual agreement principle translates the economic power of most creditor

[560] Art. 6(1) of the ESM Treaty (n. 557).
[561] For a list see Art. 5(6) of the ESM Treaty (n. 557).
[562] In accordance with Article 4(4) of the ESM Treaty (n. 557), an emergency voting procedure is used where the Commission and the ECB both conclude that a failure to urgently adopt a decision to grant or implement financial assistance would threaten the economic and financial sustainability of the Euro area.
[563] The impact of the formal voting right of each ESM member is tied to "the number of shares allocated to it in the authorized capital stock of the ESM".
[564] M Schwarz, 'A memorandum of misunderstanding – the doomed road of the European Stability Mechanism and a possible way out: enhanced cooperation',51 *Common Market Law Review* 2 (2014) 389–424.
[565] A De Gregorio Merino, (n. 335) 1623.
[566] see J Louis, 'The unexpected revision of the Lisbon Treaty and the establishment of a European Stability Mechanism', in Ashiagbor, Countouris and Lianos (Eds.), *The European Union after the Treaty of Lisbon* (CUP, 2012) 298-319.

States into formal voting rights.[567] Despite this, it is important to acknowledge that the ESM Treaty provides some checks and balances with regard to the decision to provide financial assistance. First, the Treaty states that any financial support must be subject to "strict conditionality, appropriate to the financial assistance instrument chosen".[568] This requirement, which also characterizes the OMT, was included in the Treaty amendment, for it represented the trade-off between financial assistance and public reforms in terms of fiscal consolidation. Second, the decision to provide financial assistance is not carried out by the ESM alone, but by a broad institutional network comprised of a multitude of supranational, international and national actors. The procedure significantly empowers, in addition to the Board of Governors of the ESM, the Commission and the ECB (and where possible, the IMF).

Initiation of any type of support scheme depends on the formal request by the ESM member under financial distress.[569] The procedure rests on a preliminary analysis by the Commission and the ECB in order to assess any risks to the financial stability of the Euro area, the sustainability of the public debt, and financing needs of the ESM Member concerned. On the basis of such evaluations, the Board of Governors of the ESM may decide to grant financial stability support "in principle". In case of positive decision, the Board of Governors "entrust the European Commission – in liaison with the ECB and, wherever possible, together with the IMF –with the task of negotiating a memorandum of understanding (an "MoU") detailing the conditionality attached to the financial assistance facility". The proposal for financial assistance is then drafted by the Managing Director of the ESM and then signed by The European Commission on behalf of the ESM, subject to prior compliance with the conditionality and approval by the Board of Governors. The European Commission is also in liaison with the ECB and, wherever possible, together with the IMF is responsible for the monitoring of the conditionality attached to the financial assistance facility.

2.2- MONETARY ASSISTANCE[570]

The European Central Bank's intervention during the financial crisis principally tackled the regular transmission of monetary policy by restoring liquidity in the banking sector. We have

[567] A Chiti and P Teixeira, 'The constitutional implications of the European responses to the financial and public debt crisis', 50 *Common Market Law Review* 3 (2013), 686, 705–708.
[568] Art. 12 of the ESM Treaty (n. 557).
[569] For the details of the procedure see Art. 13 of the ESM Treaty (n. 557).
[570] This chapter draws from A. Busca (n. 553).

seen that these crucial factors were severely hit by the crisis and, as a result, the ECB adopted a number of non-standard measures, including the LTRO operations and the covered bond purchase program. We explained also that, as the financial crisis turned into a sovereign debt crisis, the ECB was forced to intervene for a second time with the adoption of the Securities Market Program (SMP). The SMP represented a larger purchase program than previous arrangements but it was nevertheless limited to a fixed amount of bond purchases. This, according to many sources, was its main weakness for it did not convince private investors of the ECB to give unconditional support for government bonds under financial pressure.[571] In other words, private investors perceived the SMP as limited and temporary, which in turn raised concerns about the effectiveness of the program. The SMP was, as the result of this, a major disappointment in its two years of application. By the end of April 2012, the risk premia for governmental bonds of various Euro-area States was very high despite the fact that the program's holdings (mainly Greek, Irish, Spanish and Italian bonds) were quite significant, in the amount of 210 billion Euro.[572]

The decision by the ECB to move toward larger and more advanced programs occurred in this context where, on the one hand, the SMP proved to be unsuccessful, and on the other hand, the lack of confidence in fiscal consolidation and mistrust in the European institutions to solve the crisis of governance was widespread in the financial markets. The ECB decided to take all the necessary measures to save the EMU as affirmed by the neo-elected president of the ECB, M. Draghi, in London on 26 July 2012.[573] Draghi concluded his speech by affirming that: "Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough […] To the extent that the size of these sovereign premia hampers the functioning of the monetary policy transmission channel, they come within our mandate."[574]

[571] See L Pagani, 'OMT: Watchdog for Spreads That Barks but May Not Bite' *European Perspectives* (February 2013), 2. Available at http://www.pimco.com/en/insights/pages/omt-watchdog-for-spreads-that-barks-but-may-not-bite.aspx.

[572] The ECB holding are available at http://www.ecb.europa.eu/mopo/liq/html/index.en.html#portfolios.

[573] The content of such speech was anticipated by Draghi himself in a previous interview with Le Monde: 'We [the ECB] stand ready to do more, if our powers were to be strengthened. In the extraordinary conditions that we are experiencing, it is necessary to see the ECB take a stand beyond monetary policy for matters that cannot be addressed by monetary policy, such as high public deficits, a lack of competitiveness or unsustainable imbalances, especially where financial stability may be at risk. Safeguarding the Euro is part of our mandate.' E. Izraelewicz, C. Gatinois and P. Ricard, 'M. Draghi: interview with Le Monde' (21 July 2012), transcript is available at http://www.ecb.europa.eu/press/key/date/2012/html/sp120721.en.html.

[574] M Draghi (n. 552).

The statement surprised the audience as well as financial markets, and it was initially praised by the German Government according to some insiders in Berlin.[575] Many immediately considered the speech, along with the Lehman Brothers collapse, one of the key moments in the financial and sovereign crisis. The speech was in fact quite resolute in its terms ('whatever it takes') and provided pieces of the constitutional foundation and content of the resulting OMT program. Clearly, the London speech had the immediate effect of driving the decline in sovereign bond risk premia[576]. In the modern world where financial markets have become more and more central for corporations, individuals, as well as for States, a simple but nonetheless extremely resolute speech was able to achieve, in terms of reassuring the financial markets, what neither the Euro summit nor the establishment of the ESM were able to do.

The speech resulted in the adoption of the Outright Monetary Transactions program (OMT) by the Governing Council at the meeting held on 2 August 2012. The adoption was not unanimous, with one dissenting (or reserved) view,[577] according to the President's introductory statement, as the official minutes of the meetings remained confidential.[578] The announcement of the program was immediately followed by the details of the main features, the technical details, of the OMT program on 6 September 2012.[579] The ECB President again explained that the voting was not unanimous, but at the same time, stressed the importance of having the strongest consensus possible within the Governing Council.[580] It is relevant to note that the OMT program marks the first time the ECB's Governing Council openly acknowledged an internal

[575] 'According to government insiders in Berlin, Merkel and German Finance Minister Wolfgang Schäuble characterized the Italian economist's plan as "important and valuable" and felt that Draghi's announcement alone had already had an effect.' C Reiermann, M Sauga and A Seith, 'The Bundesbank against the World: German Central Bank Opposes Euro Strategy' *Der Spiegel* (30 July 2012), available at http://www.spiegel.de/international/europe/german-bundesbank-opposes-euro-crisis-strategy-a-852237.html.

[576] Some economists estimated that the announcement decreased the Italian and Spanish two-year government bond yields by about two percentage points as well as an increase in credit, up to three percentage point, and ultimately a significant decrease in bond market volatility. See C Altavilla, D Giannone and M Lenza, 'The Financial and Macroeconomic Effects of the OMT Announcements' CSEF working paper 32 (2014).

[577] Draghi remarked: 'The voting was, as I said, unanimous with one reservation, with one position that reserved itself.' M Draghi, *Introductory statement to the press conference* (Frankfurt am Main, 2 August 2012) available at https://www.ecb.europa.eu/press/pressconf/2012/html/is120802.en.html.

[578] The ECB conventionally considers the President's introductory statements to be the equivalent of the minutes of the Governing Council meeting, since its draft is approved by the Governing Council prior to the press conference. See E Apel, *Central Banking Systems Compared: The ECB, The Pre-Euro Bundesbank and the Federal Reserve System* (London, Taylor & Francis Ltd, 2007) 58.

[579] ECB, Technical features of Outright Monetary Transactions, Press Release of 6 September 2012 available at https://www.ecb.europa.eu/press/pr/date/2012/html/pr120906_1.en.html.

[580] 'I have been blessed by almost having unanimity on the very important and fundamental decisions that we have taken in the last few months. There is nothing I would wish more than to have total unanimity, of course. So I am looking forward to having that'. M. Draghi (n. 586).

disagreement. Before, it had officially always reached decisions by consensus. Draghi later clarified that: 'The endorsement is to do whatever it takes – again, to use the same words – whatever it takes to preserve the euro as a stable currency has been unanimous. But, it is clear and it is known that Mr Weidmann and the Bundesbank – although we are here in a personal capacity and we should never forget that – have their reservations about programmes that envisage buying bonds'. On the other hand, Bundesbank President J. Weidmann very clearly explained his position: 'I was already critical of the sovereign bond purchases that have been made to date -- and I was by no means alone in that respect. Such a policy is too close to state financing via the money press for me. The central bank cannot fundamentally solve the problems this way. It runs the risk of creating new problems.'[581]

The legal basis of the OMT decision, as was the case for the previous SMP program, is Article 18.1 of the ECB Statute, according to which the Eurosystem may conduct operations of 'buying and selling marketable instruments'[582]. In the present case, marketable instruments are sovereign bonds purchased or sold in the secondary markets. The legal details of the program were provided through a press release[583]. It first clarified the name of the program ('Outright Monetary Transactions (OMTs)'), and the aim of the program, as 'safeguarding an appropriate monetary policy transmission and the singleness of the monetary policy' as well as the scope, as the 'Eurosystem's outright transactions in secondary sovereign bond markets'. The press release in particular outlined the details of the main features of the program divided into six pillars.

The last four technical features did not add anything new to the features of the existing SMP program. In the third pillar, the ECB clarified that in the OMT process of purchasing, as was the case for the SMP purchase, the Eurosystem will legally act as a normal creditor accepting the same (*pari passu*) treatment as private or other creditors in accordance with the terms of

[581] G Mascolo, M Sauga and A Seith 'Interview with Jens Weidmann: Too Close to State Financing Via the Money Press' Der Spiegel (August 27, 2012) available at http://www.spiegel.de/international/europe/spiegel-interview-with-bundesbank-president-jens-weidmann-a-852285-2.html.

[582] Article 18.1 of the ECB Statute reads: 'In order to achieve the objectives of the ESCB and to carry out its tasks, the ECB and the national central banks may: — operate in the financial markets by buying and selling outright (spot and forward) or under repurchase agreement and by lending or borrowing claims and marketable instruments, whether in euro or other currencies, as well as precious metals; — conduct credit operations with credit institutions and other market participants, with lending being based on adequate collateral'.

[583] According to the introductory statement of the 6 September 2012 (n. 584), the Council approved the main parameters of the program of OMT. The Council also approved a draft decision on outright monetary transactions and repealing Decision ECB/2010/5, and a draft guideline on the implementation of outright monetary transactions. Both drafts were subsequently amended at the meetings of the Governing Council on 4 October and 7 and 8 November 2012.

such bonds. The Eurosystem will not, in other words, possess any special rights to seniority in connection with the bond purchase. The fourth pillar concerns the sterilization of the OMT, and states that the liquidity created through Outright Monetary Transactions will be fully offset by the withdrawals by the ECB of liquidity from the open market, including, for example, withdrawing from circulation an equivalent amount of money. In sharp contrast with the various program of quantitative easing, the OMT will not involve any money creation. The fifth pillar, called 'transparency', provides that the ECB will also publish the aggregate OMT holdings and their market values on a weekly basis and the breakdown by country on a monthly basis. Finally, with the last pillar, the ECB terminated the SMP clarifying that it will hold the SMP portfolio to maturity.

Most innovative were the first two pillars of the technical features. The first pillar, named 'conditionality', provides that OMT purchase is strictly and effectively conditional to an appropriate European Financial Stability Facility/European Stability Mechanism (EFSF/ESM) program, both in the form of a full EFSF/ESM macroeconomic adjustment program and a precautionary program (so called Enhanced Conditions Credit Line), 'provided that they include the possibility of EFSF/ESM primary market purchases'. Additionally, the technical features clarify that the Governing Council will act 'in full discretion and acting in accordance with its monetary policy mandate' in the decision over the start, continuation, suspension and termination of the program (such as in the case that the objective is achieved or when there is non-compliance with the macroeconomic adjustment or precautionary program of OMT). With this statement, the ECB underlined the link between the OMT activation and the performance of monetary policy, stressing again the strict necessity of this instrument for its regular operation. It also sent a signal to the markets that it would closely monitor with "full discretion" any possible detriment to the Eurozone financial stability given by sovereign bond high-risk premia.

The second pillar explained that OMT could be activated also for Member States currently under a macroeconomic adjustment program in case of regaining bond market access, with the transactions focused on the shorter part of the yield curve (maturity of between one and three years). These three features of the program were incorporated in order to highlight the conditional and limited nature of the program. However, it also powerfully provides that 'No *ex ante* quantitative limits are set on the size of Outright Monetary Transaction.' The *ex ante* unlimited amount of purchase was laid down to convince financial markets of the ECB's unconditional support for government bonds under financial pressure. This was clearly pointed out by M. Draghi in a later interview concerning the OMT decision: 'There was a sense that we had to overcome the limitations of the SMP and make sure that the signal to the market would be proportionate to the gravity of the situation.'[584] This was, as outlined above, the other innovative feature of the OMT, in contrast with the previous SMP, and it was also the main source of criticism concerning the program.

In any case, based on these technical standards and further clarification provided in the aftermath, four conditions need to be satisfied, cumulatively, in order for a Member State to be eligible for assistance under the OMT program[585]:

(i) The Governing Council of the ECB must assess whether on the basis of a variety of indicators (the bid-ask spreads, liquidity, the shape of the yield curves, volatility and the interest rates charged for the government bonds) an unwarranted spreads on the government bond markets exists which could eventually lead to a broken monetary policy transmission;[586]

(ii) The Member State needs to have received financial support from the ESM, either in the form of direct macroeconomic support or precautionary conditioned credit lines. The signing of a Memorandum of Understanding in accordance with the ESM financial support is thus a pre-condition;

(iii) The Member State must constantly comply with the conditionality attached and it must satisfactorily implement the program, under the monitoring of the Governing Council of the ECB;

(iv) The Member State must have access, or regain access, to the government bonds market, precisely because 'the OMT is not a replacement for a lack of primary market'.

It is crucial to observe that, as of 2017, no OMT program has been activated by the ECB. The reason for this rests on the fact that no Member State has met all the conditions to apply for the OMT support nor have they requested assistance under the program. An additional reason is that the OMT program has been somewhat superseded by three important monetary programs,

---

[584] L Barber and M Steen, 'Interview with Mario Draghi', *Financial Times* (Frankfurt, 14 December 2012), edited transcripts available at https://www.ft.com/content/6a4dd882-4537-11e2-858f-00144feabdc0.

[585] Explaining these four conditions see especially Y Mersch, 'Oral hearing of the Federal Constitutional Court in the OMT proceedings' 16 February 2016 (Karlsruhe, 16 February 2016).

[586] L. Barber and M. Steen (n. 591).

together called the Expanded Asset Purchase Program (EAPP), which were implemented between late 2014 and early 2015: the Covered Bond Purchase Program (CBPP3)[587], the Asset Backed Securities Purchase Program (ABSPP)[588], the Public Sector Purchase Program (PSPP)[589]. These policies, commonly referred to as quantitive easing, are not directly aimed at achieving economic growth but rather monetary growth, and in particular in reaching an inflation rate in accordance with the ECB standard (close to 2%). The bulk of the program is the PSPP, according to which the ECB may buy bonds issued by Euro area central governments, agencies and European institutions in the secondary market against central bank money. The peculiarity of the program is that only 20% of the asset purchases are subject to a regime of risk sharing. In other words, only the losses arising from the 20% purchase will be shared.[590] This represents one of the main significant differences between the OMT program and these programs. As clarified by Draghi: "The OMT scheme was meant to address the tail risk to the Eurozone of redenomination risk, which was concentrated in some countries. Broader-based asset purchases are a purely monetary response to the risk of an excessively prolonged period of low inflation".[591]

On the basis of the above considerations, we can conclude that both programs of financial and monetary assistance, as pointed out by Draghi, provided the concrete measures to support the irreversibility of the single currency. They now represent the new foundation of the principle of irreversibility of the Euro by having essentially created a broader system of risk sharing, where risks associated with possible defaults of Member States are proportionally shared within the Eurozone. In the case of the ESM, the assistance is proportional to the capital contributed to the fund. In the case of the OMT, it is proportional to the share that each NCB has in the

[587] The third Covered Bond Purchase Programme (CBPP3) concerns the outright purchase of certain eligible covered bonds in the primary and secondary markets for 2 years. Decision ECB/2014/40 of the European Central Bank of 15 October 2014 on the implementation of the third Covered Bond Purchase Programme, OJ L 335/22.
[588] The Asset Backed Securities Purchase Programme (ABSPP) concerns the outright purchase of certain eligible asset backed securities in the primary and secondary markets for 2 years. Decision ECB/2014/45 of the European Central Bank of 19 November 2014 on the implementation of the asset-backed securities purchase programme OJ L 1/4.
[589] The PSPP complements the ABSPP and the CBPP3. Under the PSPP the ECB and the National Central Banks, in proportions reflecting their respective shares in the ECB's capital key, may purchase outright eligible marketable debt securities issued by, *inter alias*, central governments of a Member State whose currency is the Euro, on the secondary markets. Decision ECB/2015/10 of the European Central Bank of 4 March 2015 on a secondary markets public sector asset purchase programme OJ L 121/20.
[590] Press release published by the ECB on the same day 'ECB announces expanded asset purchase programme', 22 January 2015, available at http://www.ecb.europa.eu/press/pr/date/2015/html/pr150122_1.en.html.
[591] M Draghi, 'Monetary policy in a prolonged period of low inflation' ECB Forum on Central Banking (Sintra, 26 May 2014), available at https://www.ecb.europa.eu/press/key/date/2014/html/sp140526.en.html.

capital of the ECB.[592] The programs are functionally similar, as explained by the German Constitutional Court in its OMT ruling (see below). However, there is still one significant difference between the two. While the volume of purchases of government bonds by the ESM is limited by the ESM's financial endowment and is subject to the approval by the parliaments of the Member States, the ECB can, potentially, buy unlimitedly.[593] Yet some economists maintain that the ESM is the only measure involving a wealth transfer precisely because: "ESM loans and other support available from the ESM are provided to Member States at rates and conditions that very clearly do not reflect the market view of an adequate risk premium, given the perceived default risk of the beneficiary countries".[594]

Although both programs have been legally supported by the European Court of Justice (see the last chapter), it is important to stress that the combination of the two represents a new system of risk sharing and a possible amendment to the original structure of the European economic constitution, which, as explained before, was based on ordoliberal economic thinking. What has been amended is the fact that, considering the original structure, only the national level was meant to carry out redistributive policies, while the supranational level was mainly meant to pursue economic efficiency and undistorted completion.[595] The idea behind a system of redistributive policies at the EU level was supported multiple times prior to the EMU. For instance, we saw that the MacDougall Report supported the idea of a large Community budget that would, among other things, provide a transfer of funds for redistribution effects and economic convergence. For the same reasons, we also saw that the OCA theory, among its key criteria, required a mechanism of fiscal transfer tackling asymmetric shocks.[596] Nevertheless, a system of full risk sharing has always been officially ruled out and expressly excluded by the Treaty.

---

592 'Will the purchases continue to be conducted by the national central banks according to the capital key, and will they take the risks associated with these purchases according to the capital share that they have of the ECB? Draghi: Well, the answer to the first question is yes.' introductory statement of the 6 September 2012.

593 D Murswiek, 'ECB, ECJ, Democracy, and the Federal Constitutional Court: Notes on the Federal Constitutional Court's Referral Order from 14 January 2014', 15 *German Law Journal* 2 (2014), 149.

594 C Gerner-Beuerle, E Kucuk, E Schuster, 'Law Meets Economics in the German Federal Constitutional Court: Outright Monetary Transactions on Trial' 15 *German Law Journal* 2 (2014), 309.

595 C Joerges, 'What is left of the European Economic Constitution?' *Eui working paper Law*, (2004/13), 17. This is partly in line with what Bundesbank President affirmed: 'We shouldn't act according to the motto "necessity knows no laws." There are good reasons why we have clearly defined and separate areas of responsibility. The central bank is responsible for monetary stability, while national and European politicians decide on the composition of the monetary union. It wasn't the central banks that decided which countries are allowed to join the monetary union, but rather the governments.' G. Mascolo, M. Sauga and A. Seith 'Interview with Jens Weidmann: Too Close to State Financing Via the Money Press' Der Spiegel (August 27, 2012).

596 For a recent reconstruction see M Evers, 'Federal fiscal transfer rules in monetary unions', 56 *European Economic Review* 3 (2012) 507–525.

In this context, the argument that the new system of assistance potentially represents an amendment to the original structure of the EMU could be correct. With regards to financial assistance provided by the ESM, this argument is proven by the fact that it required a Treaty amendment before its entry into force. With regards to the OMT program, the same argument still hold but requires a more developed answer. Risk sharing, in fact, has always been the default mode of operation according to the statutes of the ECB and the Governing Council.[597] However, the OMT is unique. Draghi himself pointed out the importance of the risk sharing regime for the OMT program: "In OMT full risk-sharing is fundamental for the effectiveness of that monetary policy measure and you understand why; because it's selective, it addresses specific countries, the countries are under stress, the debt sustainability is an issue and there are tail risks that could make things precipitate for certain individual countries […] the programme is under full risk-sharing.'[598] The key in understanding the OMT nature lies here. The OMT was essentially meant, as Draghi explained, to address the tail risk to the Eurozone of redenomination risk, which was concentrated in some countries. The OMT thus addresses only specific countries, those countries that are under financial stress, and it does that by sharing the risks associated with that specific country.

However, the crucial element is that a full risk sharing regime is carried out along with an (*ex ante*) unlimited sovereign bond purchases.[599] This combination of full risk sharing and (*ex ante*) unlimited purchases makes it unique from both the previous and the following programs. On the one hand, it is different from the SMP because it is relatively large and ex ante unlimited.[600] On the other hand, it is different from the EEAP (quantitative easing) program because it is directed toward specific countries and under full risk sharing. It is then evident that this combination of full risk sharing and (*ex ante*) unlimited purchase ultimately clarifies that the

[597] 'So the question on how to allocate risks in the Euro area has been with the Governing Council since the very beginning. There is a combined ruling coming from the statutes of the ECB and from a Governing Council decision that a default mode is a full risk-sharing mode. However, the Governing Council is also free to decide what it deems more appropriate according to the circumstances.' introductory statement of the 6 September 2012 cit.

[598] Press release published by the ECB on the same day (ECB (2015a) 'ECB announces expanded asset purchase programme', 22 January ,available at http://www.ecb.europa.eu/press/pr/date/2015/html/pr150122_1.en.html);

[599] The ECB and the Commission explained before the ECJ that setting an ex ante quantitative limit on purchases of government bonds would seriously undermine the effects which the intervention on the secondary market seeks to achieve, with the risk of triggering speculation. The ECB specified however that intervention in the secondary government bond market will be subject to quantitative limits, albeit limits that are not set in advance or previously determined by law. The ECB in other words would not publicly announce ex ante quantitative limits but it would set up quantitative limits internally.

[600] The differences between the SMP and the OMT are essentially four: (i) the Strict conditionality of OMT versus SMP; (ii) the Limited to short-end of yield curve (like monetary policy actions) of the OMT; (iii) the Transparency: publication of OMT interventions; (iv) OMT encompasses buying and selling an ex ante unlimited amount.

entire OMT program is unique and is essentially a re-distributional fiscal action aimed at ensuring that some Member States continue to have access to capital markets.

There is, however, one limit that applies to both programs and that makes them legitimate and within the scope of the Treaties. The conditionality requirement, which, as seen above, characterizes both the OMT and the ESM, represents the trade-off between financial assistance and public reforms of fiscal consolidation. The conditionality attached to any financial assistance represents a crucial element for its legality and, for this reason, it was enshrined in the treaty amendment in connection with the establishment of the ESM. It was also the cornerstone of the legal arguments of the ECJ in favor of the legitimacy of the OMT program (see below).

This new framework of risk sharing not only involves a redestributional effect, but also provides, especially under the OMT program, the necessary conditions and legal reasoning for the possible new role of the ECB as lender of last resort (LOLR). According to this concept, central banks should rescue solvent institutions by providing unlimited liquidity against good collateral, at a high rate of interest.[601] This role would indeed constitute the only economic regime under which the principle of irreversibility could be effectively carried out. Under this system, Member States subject to severe market pressure could nevertheless always finance their public debt and ultimately remain part of the Eurozone. A group of well-known economic scholars supported this potential new role of the ECB under the OMT program.[602] The approval of the Banking Union provides an additional argument in favor of the new role of the ECB as lender of last resort, since the new supervisory functions and resolution funds represent a condition for the central bank's function. The Banking Union does enhance integrated banking system and provides more effective management of potential financial crises, which, according to some commentators, could naturally complement the LOLR system.[603]

---

[601] For more details see T Humphrey, 'Lender of last resort: the concept in history' 75 *Economic Review* 8 (1989).
[602] P De Grauwe, 'The European Central Bank: Lender of Last Resort in the Government Bond Markets' 59 *CESifo Economic Studies* 520 (2013); M Fratzscher, F Giavazzi, R Portes, B Weder di Mauro, C Wyplosz, 'A Call for support for the European Central Bank's OMT Programme' 19 July 2013, available at https://berlinoeconomicus.diw.de/monetarypolicy/a-call-for-support-for-the-european-central-banks-omt-programme/.
[603] P Praet, 'The ECB and its role as lender of last resort during the crisis', speech at the committee on Capital Markets Regulation conference on The lender of last resort – an international perspective (Washington DC, 10 February 2016) available at https://www.ecb.europa.eu/press/key/date/2016/html/sp160210.en.html.

3. CONCLUSIONS

From this second chapter we primarily understand that the actual architecture of the EMU is based on two pillars: fiscal discipline and the irreversibility of the Euro. Both pillars are the results of the legal and economic evolution of the EMU. More in particular, we realized that both fiscal discipline in the form of economic policy coordination, and the irreversibility of the Euro, still represent the cornerstones of the entire system of governance after the sovereign debt crisis and its reforms. The reform did change and affect these both elements but it did not alter their nature.

More in details, with regards to fiscal discipline, based on the above analysis we can positively affirm that, before the recent reform of governance, Member States operated under a system of soft form of economic policy coordination. In this context, the open method was an intergovernmental method of "soft coordination" by which Member States were evaluated by one another, with the Commission's role being one of surveillance. Both the convergence criteria under the Treaty and the budget constraints under the SGP were based on self-commitment and peer pressure to negotiate strucutural reforms and fiscal adjusments toward fiscal discipline in the shadow of the procedure.[604] As a result, from a legal standpoint, only the formal decision-making process could be enforced by Community institutions, as the first cases before the ECJ confirmed.[605] After the sovereign debt crisis, we expliand that the EU departed from such a soft approach toward a higher-level of coordination. In terms of macroeconomic guidance, the new IGs now provide for a broader range of budgetary issues (for instance pension reforms, research and developments etc.), and are used by the Council in its surveillance and assessments of budgetary policies.[606] Additionally, all the other elements of macroeconomic guidance, the most important of which is the AGS, completed the picture and provided for a more coordinated approach and a stronger system. With regards to macroeconomic and budgetary information, the EU anticipated the collection of budgetary information within a clear and comprehensive framework. This, coupled with the MIP, certainly constitutes a more stringent *ex-ante* guidance and control than previously in practice.

---

[604] Peer pressure was not strictly limited to the BEPGs but was an element of continuity with all the other elements composing the broad system of economic policy coordination. For a good survey on this instrument see N Thygesen, 'Peer Pressure as Part of Surveillance by International Institutions' OECD, Paris (2002) available at http://www.oecd.org/dataoecd/11/30/1935112.pdf.

[605] See Commission v Council of the European Union (n. 301).

[606] It has been pointed out that they can no longer be reduced to either an addendum to the SGP or an illustration of the Open Method. See S. Deroose, D. Hodson, J. Kuhlmann (n. 406) 835.

Similarly, the surveillance procedure now covers a broader area through a more detailed approach. First, there has been an extension of formal EU surveillance so as to encompass broader economy policy, such as the elements included in the macroeconomic imbalances. Second, there is now a trend towards the adoption of increasingly detailed and enforceable budgetary and economic surveillance recommendations. They no longer impose merely general objectives to reach, but also increasingly require specific reforms to achieve. This is proven by the level of detail of Commission and Council recommendations emanating from the surveillance procedure (Country Specific Reports).[607] Third, a strict surveillance procedure has been set up for Member States with high deficits or debts, or those facing difficulties with regard to their overall financial position, specifically where they could have "significant adverse effects" on the rest of the Euro area. The recent reform has also greatly reinforced the system of budget constraints with the introduction of the balanced budget rule, the expenditure benchmark, and by making the public debt ratio operational. More importantly, we also attend to a shift from the actual deficit rule to the MTO rule, as a measure to assess the sustainability of public finances, with a more strict definition of what constitutes a significant deviation from the MTO or from the appropriate adjustment path toward it. As for the enforcement procedure, the reform moved toward a significant reinforcement of external enforcement with the groundbreaking application of the reverse qualified majority principles as well as the creation of additional national enforcement procedures, through the automatic correction mechanism, and the debt brake provision. This higher level of coordination did not translate, however, into the creation of a centralized economic policy system as there are still no truly binding decisions and the budgetary powers are still under national control.

With regards to the irreversibility of the Euro, we explained that this concept was meant to include the idea that the entire monetary union process cannot be reversed, but also that each single country is not allowed to leave the monetary union once it enters under any circumstances. Before the crisis, this principle was merely a theoretical and legal concept. The sovereign debt crisis raised the need for concrete measures to endorse such largely theoretical

[607] For an instructive study of the level of detail in the Commission's Country Specific Reports 2009–2011, see S Bekker, 'The EU's Stricter Economic Governance: A Step Towards More Binding Coordination of Social Policies?' ReflecT Discussion Paper No. 13/001; Tilburg Law School Research Paper No. 01/2013, available at https://ssrn.com/abstract=2229161. The author's conclusions concerning the increasing level of detail still hold for the Country Specific Reports presented by the Commission in 2013. On the inclusion of these hard law elements and growing interference with national policies: S Bekker and I Palinkas, 'The impact of the financial crisis on EU economic governance: A struggle between hard and soft law and expansion of the EU competences?', 17 *Tilburg Law Review* 2 (2012), 359.

principle. We explained that two measures were adopted in this regard. On the one hand, the purchase of sovereign bonds of Member States under financial distress (OMT), and on the other hand, the creation of a European Stability Mechanism (ESM), which could provide direct funding to Member States and banks facing financial difficulties. Both programs created a new system of risk sharing, which have significately amended the original structure of the European economic constitution and provided the necessary conditions and legal reasoning for the possible new role of the ECB as lender of last resort as an additional element in this direction.

The definition of these two pillars is central and functional to the normative analysis of the last chapter for many reasons. First, a comprehensive analysis of the actual structure of the EMU is necessary to compare the current structure with the alternative regimes which will be presented. The different alternatives proposed and assessed in the third chapter requires indeed a reference point against which they can be measured. More in particular, as we will explain in more details, the definition of these two common principles will serve as parameters or objectives to test, for instance, the "effectiveness" of the EMU before and after the recent reforms. Such evaluation will be essential for our following normative claim that a possible alternative institutional design is possible and can potentially be more effective. Additionally, by underlining that the EMU is essentially founded on these two principles, this will allow us to later recognize the intrinsic tension and conflict between the two, and one of the foundamental problems affecting the operation of the EMU which need to be answered. Each one of these two principles considered in isolation is economically sound, but when we consider their interplay, we understand, as we will explain in more details in the third chapter, their internal inconsistency. The need to achieve a system leading towards hard budget contraints deeply conflict with the new framework of risk sharing which foster bailout expectations. This raises a deeper fundamental contradiction of the entire EMU architecture, between the regime of fiscal rules and the principle of national sovereignty which has profound consequences also under a legitimacy standpoint.

CHAPTER III

ALTERNATIVE ROUTES OF BUDGET CONSTRAINTS

INTRODUCTION AND SUMMARY

In the first two chapters we have analyzed, respectively, the history of the economic and monetary integration process, and the two common principles of the current economic governance architecture. Both chapters were functional to the normative assessment of the present one. As we mentioned before, the previous historical overview helped us to identify the two main tasks that European institutions needed to develop to be both effective and efficient. On the one hand, the role of European institutions to solve coordination problems and to induce or enforce credible commitments. On the other hand, the role of European institutions in minimizing transactions costs. With the second chapter we primarily understood the two pillars system of the current EMU structure based on fiscal discipline and the irreversibility of the Euro. Such positive examination is not only important *per se*, but it is also functional to the normative analysis of the present chapter. As judge Holmes pointed out in connection with the study of the law: "When you get the dragon out of his cave on to the plain and in the daylight, you can count his teeth and claws, and see just what is his strength. But to get him out is only the first step. The next is either to kill him, or to tame him and make him a useful animal."[608] His metaphor elucidates that it is not only important to describe the origin and characteristics of legal norms, but it is equally important to evaluate their success and analyze possible alternatives. Both pillars indeed will serve as the necessary parameters to assess and compare the effectiveness and the efficiency of the different alternative institutions presented in this chapter as well as their ultimate legitimacy positions.

[608] O W Holmes (n. 1) 469.

On these premises and considerations, the present research will evaluate the current legal structure of the European Monetary Union in order to assess and understand its success, and explore possible alternative institutional designs which could be more effective in achieving its objectives and, at the same time, be potentially more efficient and legittimate. From a methodological standpoitnt, this normative analysis adopts a law and economics approach in order to balance effectiveness and efficiency concerns on the one hand, with legitimacy concerns on the other hand.

First and foremost, our primary assessment will be carried out from an economic perspective. As we have seen, the European economic constitution is subject to complex macroeconomic assumptions and ordoliberal ideas. The two pillars outlined in the previous chapter are the results of these assumptions and ideas and, thus, their success can be measured primarily in economic terms. More in particular, we will first evaluate the effectiveness of the present governance structure and of the two common principles outlined in the previous chapter. On the basis of this assessment, we will approach the causes of its past and present ineffectivities by arguing that the fundamental problem of the present governance structure is given by its many internal inconsistencies, and by the fact that the EMU failed to comply with one of its main task, i.e. to solve coordination problems and to induce or enforce credible commitments. We will claim that, the core challenge in designing a more effective system is addressing the problem posed by either the lack of positive incentives or by the misalignment of incentives in the current structure. We will then present the case for possible alternative regimes which could potentially solve such issue and thus be more effective, based on a more centralized system of economic governance, based on pure market mechanism, or based on the incomplete contracts theory and self-enforcing design whose historical origin can be traced somehow in the EPU.

All these alternative governance regimes will then be evaluated in terms of their efficiency, according to a new institutional economics approach. We explained that, within the EMU integration process, transaction costs have always played a prominent part. The role of European institutions in minimizing transactions costs has always been crucial and thus any possible alternative governance scheme not only need to be more effective, but also need to be measured and assess also in terms of its efficiency. We have also explained before that these "transaction costs" have varied from time to time and, according to the main literature in the field, they are not directly measured. However, for our analysis, what matters is not their individual cost, but the relative amount of transaction costs associated with different organizational or contractual choices. In other words, the purpose of this second analysis is not to identify the single most efficient system of governance, but rather to understand the distinctive strengths and weaknesses of the various alternatives outlined in the previous part. More in particular, we will address the trade-off between fiscal centralization and fiscal autonomy of Member States within a macroeconomic context.

Nevertheless, we have to keep in mind that the unit of analysis still remains a legal system, which cannot be assessed in strictly economical terms. As a result, any possible assessment cannot refrain to take into account "justice", which is often considered the ultimate purpose of the law. This is consistent with a specific strand of literature within the field of law and economics led by G. Calabresi, who sees justice as a veto on the pursuit of efficiency, and within the German ordoliberal school of thought, which considers the dialogue between law and economics a dialogue between equal partners. We will examine the overall "legitimacy" issue of this European economic governance on the basis of the principles identified in the second chapter. The multiple dimensions of the legitimacy concept of the European economic governance will then be discussed. The analysis will involve the literature in the legal field, as well as critically review recent case law studies. Based on this analysis, we will then understand whether the proposed alternative arrangements may also represent a better institutional choice from a legitimacy perspective. In other words, our last assessment will try to understand which of these potentially more effective and efficient alternative institutional arrangements would also improve the EMU under a legitimacy standpoint.

1. AN EFFECTIVENESS ASSESSMENT

The purpose of this first paragraph is to evaluate the effectiveness of the Economic Union complementary to the Monetary Union. More specifically, based on the positive analysis carried out in the previous chapter, we must now evaluate how both the coordination of economic policies as well as the irreversibility of the Euro have been pursued before and after the recent reforms.[609]

A preliminary question before we can proceed with our analysis is what we mean by the term "effectiveness". A first standard test to measure the effectiveness of a law is based on its degree of compliance. If the law is preventive, meaning that it is designed to discourage an undesired behavior, the law is effective as long as that behavior is indeed diminished or absent. If the law is remedial, or operating to correct some failing or injustice or dispute, the law is effective as long as it is able to achieve these ends. In our case, the law is both preventive as well as remedial as, most notably, the SGP provides for both a preventive arm and a corrective arm. However, compliance is not always easy to measure, especially in this context, where the rules are complex and directed toward states instead of individuals. Additionally, compliance is not a useful tool to prove how the Economic Union has been effective in preserving the irreversibility of the Euro.

Nevertheless, according to this parameter, it is undisputed that, until the recent reform, the Economic Union had been rather ineffective in connection with te first principle of fiscal discipline.[610] As explained before and acknowledged by multiple sources, the sovereign debt crisis itself represents a prime example of this lack of fiscal discipline. According to the majority of the literature, the reason for this is the failure of the overall Lisbon Strategy, and especially in the context of economic policy coordination, on the failure of the Open Method of Coordination and its peer pressure approach.[611] Peer pressure failed in its preventive function as a deterrent against non-compliance because Member States were unwilling to discuss specific economic policy challenges and they were reluctant to accept criticism of their

[609] For an early analysis concerning the effectiveness of these rules see J Pipkorn, 'Legal Arrangements in the Treaty of Maastricht for the Effectiveness of the EMU', 31 *Common Market Law Review* 2 (1994) 263-291.
[610] See Feio Report (n. 344).
[611] On the failure of the Lisbon Strategy see G Tabellini and C Wyplosz (n. 540), and more recently C Wyplosz, The failure of the Lisbon strategy, VOX, CEPR's Policy Portal (12 January 2010), available at http://www.voxeu.org/article/*failure-lisbon-strategy*. On the failure of the Bepg see D Hodson, *Governing the Euro Area in GoodTimes and Bad* (Oxford, Oxford Scholarship Online, 2011).

economic policies.[612] Additionally, coordination based on peer pressure was not supported by an effective enforcement procedure. As explained, the formal mechanism of enforcement rested on the mere discretionary decision of the qualified majority of the Member States to start a proceeding and impose a sanction.[613] The many years of application have demonstrated that the majority of Member States were unwilling to strictly enforce such fiscal rules and eventually initiate an EDP. As we stated before, from the entering into force of the SGP over a 20-year timespan, only three countries consistently complied with its fiscal benchmarks. Nevertheless, while a number of EDP procedures were launched before the recent crisis, no sanctions have ever been issued. In particular, the Council on a number of occasions has failed to issue sanctions against Member States.

Such ineffectiveness of the Economic Union prior to the recent reform is, however, well documented. What must still be investigated is the effectiveness of the Economic Union to achieve these two principles after the recent reform.[614] In this regard it is possible to make some preliminary observations and draw some limited conclusions on the newly enacted rules because of “the short experience of their operation” and the fact that “it [this period] has also been characterised by a severe economic crisis. This leaves the rules untested in normal economic times” as recognized by the Commission in its own assessment.[615]

First, as an initial remark, what is important to underline is that the reformed Economic Union relies on the same two common principles analyzed before. As we explained in the second chapter, both fiscal discipline in the form of economic policy coordination, and the irreversibility of the Euro, are still the cornerstones of the entire system of governance. At the same time, however, with regard to the principle of fiscal discipline, we attend to the departure from the previous soft approach based only on peer pressure toward a higher level of economic coordination and fiscal discipline. As we have seen, the features of the coordination mechanism, such as macroeconomic guidance, collection of budgetary information, surveillance procedure,

[612] For this argument see S Collignon, ‘Economic Policy Co-ordination in EMU: Institutional and Political Requirements’ Center for European Studies (2001).
[613] M Heipertz, A Verdun (n. 269) 6.
[614] In the literature, among many see A de Streel, ‘EU Fiscal Governance and the Effectiveness of its Reform’ in M. Adams, F. Fabbrini and P. Larouche (eds), *Constitutionalization of European Budgetary Constraints: Comparative and Interdisciplinary Perspectives* (Londo, Hart, 2014) 85-104.
[615] Commission Communication, Economic governance review Report on the application of Regulations (EU) n° 1173/2011, 1174/2011, 1175/2011, 1176/2011, 1177/2011, 472/2013 and 473/2013”, Brussels, COM (2014) 0905 final, available at http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1485161865423&uri=CELEX:52014DC0905.

as well as the rules for budget constraints and its enforcement, have been greatly reinforced. From a general standpoint, this reinforced structure, at first sight, seem to present the case that a more effective system in terms of of national ownership exists.[616] For instance, as acknowledged by the Commission, all countries bound to the Fiscal Compact have adapted their national fiscal frameworks to the Fiscal Compact requirements. In particular, they have all put binding and permanent balanced budget rules into their domestic legal orders.[617] Similarly, most of the countries have complied with the requirement to establish independent fiscal bodies,[618] as well as with the requirement to implement national fiscal rules under Directive 2011/85/EU.[619] These major accomplishments have been coupled with a progressive increase of peer pressure at the EU level. We have noted over the last years an increased discussion of budgetary issues and toward fiscal discipline in general, both within national settings and at the EU level. For instance, within the Ecofin there is now a well-established tendency of substantial discussion over the reciprocal country-specific recommendations. Furthermore and more importantly, with regards to the corrective arm, following the financial crisis and the deterioration of the national budget, a large number of EDPs were launched.[620]

Despite these key pieces of information, in order to answer the question we need a deeper analysis. In terms of national ownership, for instance, the Commission recognized in its review that it had merely scrutinized the legal conformity of the provisions for balanced budget rules, while it did not address their practical application.[621] In this sense, the simple fact that balance budget rules have been introduced into national legislation does not provide by itself proof of higher national onwership. Balance budget rules heavily depend on their application by government officials as well as their interpretation provided by courts, especially Constitutional Courts. An example of this is a recent decision of the Italian Constitutional Court, which gave

[616] The concept of national ownership reflects to what extent EU fiscal rules are transposed into national law or to what extent national institutions are specifically in charge of their implementation. On this point see the analysis in A. de Streel (n. 617) 97.

[617] For the latest overview see Commission Communication, the Fiscal Compact: Taking Stock, Brussels, 22.2.2017, COM (2017) C1200 final. It is possible to access the specific report for each country at: https://ec.europa.eu/info/publications/fiscal-compact-taking-stock_en.

[618] See European Parliament, "In depth analysis on the role of national fiscal bodies: State of play", Directorat-general for internal policies, economic governance support unit (March 2017), available at http://www.europarl.europa.eu/RegData/etudes/IDAN/2017/602071/IPOL_IDA(2017)602071_EN.pdf.

[619] Commission, Progress report on the Member States' implementation of Council Directive 2011/85/EU, Article 3(2) related to fiscal data Excessive Deficit Procedure Statistics Working Group 15 −17 June 2015.

[620] EDPs were initiated against France, Latvia, Ireland, Greece and Spain on 18 February 2009; against Poland, Romania and Lithuania on 13 May 2009; against Austria, Belgium, Czech Republic, Italy, The Netherlands, Portugal, Slovenia and Slovakia on 7 October 2009; and against Denmark and Cyprus on 12 May 2010.

[621] Commission Communication (n. 620).

a much more lenient interpretation of the new balance budget provision under the Italian Constitution by emphasizing both political discretion and responsibility in ensuring that social rights are both effective and sustainable.[622] Similarly, in connection with the introduction of independent fiscal councils, it is necessary to understand not only their material creation, but also their practical effectiveness in terms of economic resources, technical expertise and legal safeguard to ensure independency. In a recent report, the European Parliament precisely questioned all of these features within the existing independent fiscal bodies. The report underlined that only eleven Member States (France, Ireland, Italy, Malta, the Netherlands, Spain, Slovakia, Austria, Portugal, Denmark and the UK) established independent fiscal bodies sufficiently equipped in terms of staff number and/or budget, and in a number of cases their legal independence was moderately precarious. Ultimately, although it is true that we have seen a significant increase in the number of EDP procedures, we have still failed to see any sanctioning procedures against Member States that have not corrected their deficits within the prescribed 2012-16 timeframe.

These issues together highlight how measuring compliance in this context is useful but not sufficient. Compliance to a particular law cannot be judged in isolation. There exist a number of factors and variables affecting the failure or success of a particular law, which tend to increase with the complexity of its content. In our context, this is especially true because the object of analysis is a framework of economic governance, composed by complex legal rules and requirements based on a number of macroeconomic variables. It is therefore important to also judge the effectiveness of the Economic Union on the basis of whether the law has more generally achieved its objectives.[623] This is the only possible method to measure the effectiveness of the second principle of the irreversibility of the Euro. This second test equally presents a number of problems. Preliminarily, the second test is hard to measure by using certain proxies. The purpose of a particular law may not always be clearly stated by the lawmaker, and even if clearly stated, legal norms change and develop over time, so their purpose might dramatically change according to the recipients. Additionally, the effectiveness of a particular law is measurable only upon a specific purpose. However, there may be multiple purposes

[622] Decision of the Italian Constitutional Court n. 275/2016. For an analysis see M Massa, 'Discretion, Sustainability, Responsibility in the Constitutional Case Law on Social Rights', Quaderni costituzionali, Rivista italiana di diritto costituzionale 1 (2017) 73-96.

[623] Some authors, on the contrary, argue that the "degree of fulfilling the targeted objectives" refers to the concept of efficiency. See A Heise, 'European economic governance: what is it, where are we and where do we go?' 3 International Journal of Public Policy 1 (2008) 1-19.

behind a specific law. The failure or success of a particular law may depend on which purpose we take as the reference point. Therefore, the first step in order to measure the effectiveness of the Economic Union is to address and understand its main objective.

From a general standpoint, the two common principles outlined in the previous chapter can also be considered the main objectives of the entire Economic Union. According to such understanding and in terms of fiscal discipline, we may notice that, before the recent reform, the average net government debt-to-GDP ratio increased from 44% in 2007 to 70% in 2014.[624] After the adoption of the Fiscal Compact and the Six Pack, data show there has been some progress in addressing fiscal consolidation, with the EU-28 average fiscal deficit falling from 4.5% of GDP in 2011 to a forecast of around 3% of GDP in 2014. As a result, after the entering into force of the Six Pack and the Fiscal Compact, Member States subject to an EDP fell from 23 out of 28 to 11 out of 28.[625] At the same time, however, this progress in fiscal discipline and consolidation are counterbalanced by the fact that no such progress was made in terms of public debt, which saw an increase, after the recent reform, of the public debt in many peripheral countries.[626] These data points are not only simple proxies that show mixed conclusions in relation to fiscal discipline, but are also based on a limited timeframe as previously explained. In other words, it is still early to provide a correlation between the recent reform and possible improvement in the public finance of Member States, as the latter could simply be the result of the economic recovery Member States are experiencing in the last few years.

As a result, in order to answer the question we need to search for further evidence. An additional unspelled purpose behind the Economic Union could be helpful. The Treaties, the SGP, and all the recent reforms, can fairly be seen as part of an enduring economic negotiation among European countries. Any founding documents of the EMU, starting from the EPU to the Fiscal Compact, was approved within a context of compromise between different visions: different concepts of integration, between intergovernmentalists and federalists; different economic philosophies, between social economists and market economists; and last but not least, as we have have discussed before, different approaches to monetary integration, between the "economists" and the "monetarists". The resulting rules are indeed a compromise or a mix of these visions. As negotiation theory suggests, we should always focus on the parties' interests,

[624] International Monetary Fund (2015).
[625] Commission Communication (n. 618).
[626] Eurostat, General government gross debt - annual data (2016) available at http://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&language=en&pcode=teina225&plugin=1

rather than their positions: “Your position is something you have decided upon. Your interests are what caused you to so decide.”[627] In this sense, economic coordination and the rules of fiscal discipline correspond to the positions expressed and agreed upon by the Member States at the EMU negotiations, but the overall interest was mainly to provide a “perception” of fiscal discipline. It was this perception that was considered indeed necessary for the economists’ countries to avoid the negative externalities and spillover effects and for the monetarists’ countries in order to produce the expected positive externalities.

Given this understanding, most of the negative externalities feared by the economists’ countries never played out. No Member State was successful in imposing monetary financing on the European Central Banks, and similarly, no bailout was ever formally adopted. The Prohibition of financial assistance and the perception of the ECB as a strong and independent monetary institution effectively helped. Additionally, fiscally responsible Member States have not experienced any form of negative spillovers, in terms of higher premium risk. We actually experienced quite the opposite since, for instance, German bonds and bonds from sovereign weak countries were considered close substitutes in the market, and when credit risk deteriorated, investors shifted from sovereign weak countries bonds to German bonds. The spread between sovereign weak countries’ bonds and German bonds increased and accordingly reduced the spread of German bonds relative to American bonds. In other words, fiscally responsible countries received positive spillovers in terms of lower interest rates as a safe-haven response.

These considerations still provide limited insight for our analysis, as such negative externalities were absent both before and after the recent reform. For more clarity, we thus need to look at the positive externalities arising out of the Economic Union, which, constrastingly, dramatically changed with the sovereign debt crisis. As explained in the first chapter, before the crisis, despite weak fiscal positions, interest rates and spreads of sovereign debt bonds were low and similar among EU Member States. In other words, the pricing of these bonds did not reflect the different economic fundamentals. Once the banking crisis began to appear in the balance sheet of many European States in 2010, sovereign credit risk intensified for some peripheral nations (Greece, Ireland, Portugal, Spain, and Italy). This was reflected in much higher yields of

[627] R Fisher, W Ury, B Patton, *Getting to Yes: Negotiating Agreement Without Giving in* (New York, N.Y: Penguin Books, 1991).

government securities, as the government's probability of default also started to intensify for many European States.

Two very different explanations have been suggested for this. According to some, institutional arrangements, such as the EMU, have indeed affected investors' valuation of sovereign risk.[628] According to this view, holders of sovereign bonds of EMU countries did not or could not rigorously monitor country-specific fundamentals of EMU countries when pricing their bonds because they were misled by the integration of EMU financial markets or the reduced barriers and transaction costs which produced, in their view, a price convergence of sovereign bonds. Consequently, they did not discriminate among EMU countries with respect to credit risk associated with their fundamentals. This in turn made the behavior of spreads depend more on the common monetary policy of the ECB rather than on individual countries' performances.[629] According to a second stream of literature, investors' pricing of sovereign risk was contrarily affected by bailout expectations. [630] This theory points to the fact that in general, when creditors expect that a country will receive a bailout package in the case of financial distress, they perceive that their losses in case of a country's default will be reduced and, therefore, request a lower credit risk premium to invest in those bonds. Accordingly, certain European bond pricing was influenced by these bailout expectations and by the creditors' moral hazard.

This second alternative view is more convincing. This is because the first view is not able to answer why, more recently, the sovereign credit risk has significantly decreased down to the level reached before the crisis in almost all the peripheral nations. As we have seen, the overall position of many of these countries has not recently improved enough to justify such credit risk, especially in light of the data showing that no progress has been made in terms of public debt. The same is true of the behavior of disobeyance to the new rules and the roll back concerning

[628] M Attinasi et al., 'What Explains the Surge in Euro Area Sovereign Spreads During the Financial Crisis of 2007–2009?' *ECB Working Paper* (2009); G Kaminsky and S Schmukler, 'Short-Run Pain, Long-Run Gain: The Effects of Financial Liberalization' *NBER Working Paper* No. 9787 (2003).

[629] "In EMU the elimination of exchange rate movements between participant countries has arguably weakened one of the mechanisms through which financial markets can exert discipline on fiscal policies" R Morris, H Ongena, L Schuknecht, (n. 489) 8.

[630] O Bernal et al., 'Observing bailout expectations during a total eclipse of the sun' Dulbea Working Paper 9 (2009); Similarly, K Heppke-Falk and G Wolff, 'Moral hazard and bail-out in fiscal federations: evidence for the German Länder' Discussion Paper Series 1 Economic Studies Deutsche Bundesbank (2007) provide evidence for the existence of creditor moral hazard in subnational bond markets of German states. The first paper finds that, under expectations of bailout to Bremen and Saarland (materialized with the bailout's approval from the Federal Constitutional Court in 1992), lenders demand a lower rate of return to compensate for the default risk of these two regions.

numerous reforms by the newly elected Greek government.[631] As a result, we do not understand why holders of sovereign bonds and financial markets in general did, in fact, change their pricing, especially after they realized with the sovereign debt crisis, as assumed by the first view, that price convergence of sovereign bonds as not supported by any economic foundation. According to the second view, with the progress of the crisis, sovereign credit risk started to intensify for European peripheral nations because government deficit and public debt rose to the point that, for some Member States, expectations of default started to truly materialize and, at the same time, the margin for bailouts started to diminish. The economic governance reform tried to restore the fiscal discipline or the perception of fiscal discipline in the financial markets, but it failed dramatically, as the sovereign risk premia after these measures showed. As a result, the EU overall, and the ECB in particular, was forced to approve, in a relatively short amount of time, a mix of financial related measures, the ESM and the OMT in particular, in order to financially assist Member States in economic distress. Although these measures were not a formal bailout, they were clear and resolute enough, especially in light of the famous speech by Mario Draghi in London, to restore the bailout expectations and eventually drive down the sovereign risk premia.[632] In other words, only the idea of financial and monetary assistance was able to substantially resolve the crisis by restoring the bailout expectations and by preserving the irreversibility of the Euro. As was pointed out in the press: “The remark triggered a lasting rally in government-bond markets in southern Europe. The ECB did not even have to purchase any government bonds. Mario Draghi’s words were enough”.[633]

Yet, we tend to forget that fiscal discipline and irreversibility of the Euro do not constitute the sole purpose of these rules. As the name clearly states, Stability and Growth were both equal objectives of the Stability and Growth Pact. In this sense, the foundational Council Resolution recognized “the importance of safeguarding sound government finances as a means to strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation”.[634] While the single currency was widely successful in promoting price

---

[631] M. Dolls, C. Fuest, F. Heinemann, and A. Peichl, (n. 521).

[632] Some economists, for example, estimated that the announcement decreased the Italian and Spanish two-year government bond yields by about two percentage points as well as an increase in credit, up to three percentage points, and ultimately a significant decrease in bond market volatility. See C Altavilla, D Giannone, M Lenza, (n. 583).

[633] In‘ECB Considers Action to Stem Low Inflation’ (Brian Blackstone, Wall Street Journal, European edition, 26 the March 2014).

[634] European Council Resolution on the Stability and Growth Pact (Amsterdam, 17 June 1997) OJ C 236/1.

stability,[635] economic growth was disappointing, with significant regional differences in growth rates across Euro area members, especially in comparison with non-Euro members.[636] According to empirical data, despite the increase of intra-EU trade, the adoption of the Euro seems to have significantly reduced the rate of growth of the Eurozone economies, both during the pre-Maastricht period, and during the upward period.[637]

Two main reasons are credited for this lack of growth. First, the targets of the SGP in terms of public debt and annual deficit had no sound economic basis since, as we explained above, countries decided to take the Eurozone averages of the time as a reference point in order to reach some form of consensus. Second, the lack of a stabilization device targeted to domestic shocks was also one, if not the, major reason behind the lack of economic growth as well as behind the recent economic crisis.[638] Some of the early critiques to the SGP pointed to the excessively tight and inflexible approach of the pact, especially during time of financial distress. For example, Germany missed the Stability and Growth Pact targets on several occasions because of the Pact's inability to take into account the massive costs of German unification. With the outbreak of the sovereign debt crisis, such inflexibility forced Member States into financial distress and into severe recession, to respond in a cyclical way, i.e. by cutting expenditures and laying off workers. This only worsened the economic situation in the aggregate. The problem has long been recognized as the "fiscal perversity hypothesis."[639] This was imposed in contrast to the same optimal currency theory, which, as we have explained, specifically requires the existence of fiscal transfers to deal with asymmetric shocks.[640]

This overall analysis provides mixed results. On the one hand, it seems that these measures have been somehow effective in terms of national ownership and in terms of preserving the

[635] The annual rate of consumer price inflation between 1999 and 2008 was just 2.2%, which is low by historical standards and close to the ECB's target. There were, however, some macroeconomic imbalances in the Euro area, as for the case of Ireland for instance, which saw property prices grow by an average rate of 10% per annum in real terms between 1999 and 2007 (OECD 2013).

[636] The GDP growth averaged 2.1 per cent between 1999 and 2008, which is lower than in previous decades and compared to the performance of non-Euro Member States. (OECD 2013).

[637] See for example L Drake, T Mills, 'Trends and Cycles in Euro Area Real GDP' 42 *Applied Economics* 11 (2010) 1397-1401. Others have suggested just a slower Euro area growth rate, but not significantly different from what was expected on the basis of the pre-EMU economic structure and in light of the US economy: D Giannone, M Lenza, L Reichlin, 'Business Cycle in the Euro Area', A Alesina (ed.) Europe and the Euro (Chicago, The University of Chicago Press, 2010) 141-167.

[638] See for instance T Andersen and R. Dogonowski, 'EMU and budget norms' in A Hughes Hallett, M Hutchison, S E Hougaard Jensen (eds.) (n. 378) 69-95; B Eichengreen (n. 397).

[639]The seminal study on this issue is by A Hansen and H Perloff, *State and Local Finance in the National Economy* (New York, Norton, 1944).

[640] Reviewing this literature on OCA criteria, R Baldwin and C Wyplosz (n. 3).

irreversibility of the Euro. On the other hand, in terms of fiscal discipline or providing a perception of fiscal discipline, the results are still largely negative. The data related to fiscal discipline after the recent reform are mostly mixed and limited by the short experience of the new rules. However, this must be considered in light of the fact that the Economic Union evidently failed to accomplish, both before and after the crisis, the other underlying objective, which is to provide a mere perception of fiscal discipline. According to the more convincing economic theory, financial markets simply reacted on the expectations of bailouts. Additionally, economic growth has also been very problematic, especially after the debt crisis and the recent measures of austerity, which critically worsened the economic situation in the aggregate. This, too, had palpable consequences on the ration on which deficit and public debt are calculated, thus creating a vicious cycle. The debt crisis revealed how the Economic Union's structure was unfit to equally preserve the irreversibility of the Euro and at the same time induce fiscal discipline and economic growth.

This unfitness can be attributed to the fact that the recent reform failed to address some of the basic problems of effectiveness pointed out before and by the Feio Report. For instance, the guiding principles are still non-binding and largely based on peer pressure, and the influence of the European Parliament within the entire macroeconomic dialogue is still very limited. Additionally, the Commission now has an important role in the collection of data and within the decision-making process. It has, however, a very limited role for influencing the economic cycle by European programs and funds in the context of the surveillance procedure.[641] In the same way, the principle of reverse qualified majority strengthened the possibility of sanctions as the approval of a Commission proposal becomes virtually automatic also in light of the strict time limits.[642] Such potential effectiveness has two major downsides, however. First, the success of the procedure now depends on the Commission's right of initiative. The Commission and its interpretation of the fiscal rules and procedures is central and the problems of imposing monetary or fiscal sanctions on states under financial distress still exist. It has only moved from the duties of the Council to the Commission.

Additionally, the new instrument to address macroeconomic imbalances, the MIP, has been criticized by some economists for using absolute indicators or thresholds looking backwards,

[641] J Louis (n. 305) 105.

[642] W Van Aken and L Artige, 'A Comparative Analysis of Reverse Majority Voting: The WTO's Dispute Settlement Mechanism, the EU Anti-Dumping Policy and the Reinforced SGP and Fiscal Compact' EUSA Thirteenth Biennial Conference, Baltimore, Maryland, USA (May 9-11, 2013). Available at http://ssrn.com/abstract=2202787.

to predict future crises within the Euro area. According to this view, major threats to the EMU derive from countries that already deviate from the average. Therefore, past economic indicators would be useless for corrective action, and the corresponding indicators should instead only be forward-looking.[643] The MIP has also been highly criticized for being too mechanical, specifically in connection with current account surplus. The German case is the prime example of this situation, where the Commission warned Germany in 2013 that it may face possible sanctions if it fails to address its current account surplus, either by boosting internal consumption or by decreasing its economy dependency from excessive reliance on foreign markets.[644] The warning caused criticism in Germany and a bitter exchange of views with Brussels.[645]

However, while these arguments are true, we believe that there exists a more central problem, which left uncorrected, would prevent the necessary effectiveness of the system from emerging. The sovereign debt crisis revealed a number of dramatic contradictions in its fundamental structure, which, despite its recent reform, is clearly dated. For example, it reflects late 80s' conventional wisdom, while economic and political conditions have changed considerably since that time.[646] First and foremost, the crisis underlined the enduring conflict between intergovernmentalism and functionalism within the Economic and Monetary Union. This translates in the conflict between the need to ensure coordination and consistency between monetary and budgetary policy within the current structure of the EMU, where monetary policies are delegated to a supranational institution while fiscal policies rest on the shoulders of Member States.[647]

Second, the current structure of the EMU is internally inconsistent, as it was able to generate, both before and after the crisis, an expectation of bailouts despite the plain and clear language of the Treaty. Capital markets intuitively understood that given the limited enforceability of its sanctioning system and the enourmous financial and economic interconnection among Member

643 See D Gros and A Giovannini, 'The "Relative" Importance of EMU Macroeconomic Imbalances in the Macroeconomic Imbalance Procedure', 14 Documenti IAI, (2014).
644 See European Commission Third Alert Mechanism Report on macroeconomic imbalances in EU Member States MEMO/13/970.
645 See for instance G Erber, 'The German Current Account Surplus and Krugman's and Wolff's Critique', German Institute for Economic Research Working Paper series (2013). On the opposite side see the harsh critique of P Krugman, Op-Ed Columnist "Those Depressing Germans" Published: November 3, 2013 available at http://www.nytimes.com/2013/11/04/opinion/krugman-those-depressing-germans.html?_r=0.
646 C Wyplosz, 'Economic Policy Coordination in EMU: Strategies and Institutions' German-French Economic Forum in Bonn, January 12, (1999) 1.
647 For a conclusion on this point see J Mortensen (n. 204) 17.

States, only a financial bailout could provide a solution to a potential debt emergency. The crisis therefore revealed an internal tension and inconsistency between the two common principles, fiscal discipline on the one hand and irreversibility of the Euro on the other. Such tension significantly increased after the recent reform as the new framework of risk sharing fosters such bailout expectations. While the Maastricht approach had given equal weight to fiscal rules and market discipline, the reformed design reacted by weakening market discipline.[648]

This brings us to the third and fundamental contradiction of this system, which is the contradiction between the regime of fiscal rules and the principle of national sovereignty.[649] According to many authors, forcing a country to abide by certain budgetary obligations and eventually punishing a democratically elected government in case of non-compliance is not materially possible. This is because policies contrary to these fiscal rules are often spending policies that may hold popular support and are in the interest of government officials to pursue. In addition, external enforcement and direct sanctions in a context of sovereign states and, especially in the area of economic policy-making, are traditionally ineffective.

[648] M. Dolls, C. Fuest, F. Heinemann, and A. Peichl, (n. 521); J Pisani-Ferry, V Virhiälä, G Wolff, 'Options for a Euro-Area fiscal capacity', Bruegel Policy Contribution 01, (2013).
[649] See on this point the important analysis in C. Wyplosz (n. 614).

2. ALTERNATIVE ROUTES OF BUDGET CONSTRAINTS?

We have raised a number of fundamental contradictions within the structure of the EMU, which, we argue, have negatively impacted the overall effectiveness of the Economic Union. We now must analyze these issues in depth, starting from the tension between the regime of fiscal rules and the principle of national sovereignty. Our goal is to assess the possible causes of this conflict in the first place, and subsequently determine how to solve it to design an alternative and more effective institutional arrangement.

The conflict between fiscal rules and national sovereignty primarily rests on the fact that deficit and spending biases are traditionally intrinsic to the field of public finance.[650] Governments generally tend to please the expectations of the voters and interests groups, who tend to oppose fiscal consolidation and the need for correction of fiscal imbalances. This is especially true in the period preceding an election, but could also occur when a political party does not expect to be re-elected and has no interest in the future costs of their decisions. As with the interest group, there are well-documented studies showing how these actors lobby for and eventually achieve inefficient spending ratios.[651] As with the general public, higher spending or lower taxes enjoy popular support even if they are not sustainable. This is traditionally defined as the 'fiscal illusion problem', where voters do not understand or are unaware of intertemporal budget constraints, and accordingly face the consequences of their decisions in terms of public debt and the future taxation.[652] As a result, the cost of public debt is shifted from today's governments to tomorrow's governments as well as from today's generation to the children and the unborn who do not have lobbying power in that they cannot vote, and are thus underrepresented in the present political process.[653] Such deficit and spending biases are even stronger in the context of the EMU, as pointed out by prominent commentators, because they also reflect the presence of the common pool problem.[654] Correspondingly, the cost of higher

[650] J Buchanan and G Tullock, *Calculus of Consent* (Ann Arbor, University of Michigan Press, 1962) represents the first relevant work on incentives and constraints concerning public finance. For a recent analysis in connection with the EMU see R Beetsma (n. 474).

[651] Among many see T Persson and G Tabellini, *Political Economics: Explaining Economic Policy* (Cambridge, MIT Press, 2000).

[652] See in particular the work of J Buchanan and R Wagner, *Democracy in Deficit: The Political Legacy of Lord Keynes* (Ney York, Academic Press, 1977).

[653] A Cukierman and A Meltzer, 'A Political Theory of Government debt and Deficits in a Neo-Ricardian Framework', 79 *American Economic Review* 4 (1989) 353-98.

[654] Among many see J Rattso, 'Fiscal Federation or Confederation in the European Union: The Challenge of the Common Pool Problem' Working paper (2003).

public debt or government deficit, in terms of higher interest rates, is to some extent spread across the entire Economic Union rather than being confined to the single Member State.

In order to restrict the Member States' deficit bias and address the issue of moral hazard, the EU mainly relied on peer pressure as a deterrent against non-compliance, and on external enforcement. The Council, meaning all the Member States collectively, acted as an external enforcement agent to enforce the fiscal rules and eventually sanction the non-compliant Member State. We explained how both these approaches failed to deliver to their expectations as well as the general reasons for this failure. Now we can provide a more in depth analysis as to why external enforcement is always ineffective in such contexts.

More generally, from an economic standpoint, both the theoretical foundation as well as the empirical evidence in connection with external enforcement and direct sanctions in a context of sovereign debt are largely negative.[655] It was pointed out that policy-makers continued building the monetary union by paying limited attention to economic research largely because the research could not keep up with the speed at which decisions were made. Another reason was that the adoption of a common currency was, first and foremost, a political project with political imperatives.[656] Empirical studies only favor the idea of balance budget rules, as they seem to suggest that these type of budgetary enforcements are indeed effective to reduce the state indebtness and borrowing costs for a given deficit in the context of federal systems.[657] However, they would "do little to reduce the likelihood of extreme outcomes in fiscal performance" and thus they cannot be expected to be effective in a European monetary union.[658] Additionally, these studies have been carried out in a federal context, where incentives from the supernational level plays a large part.

[655] The theoretical model comes from J Bulow and K Rogoff 'Sovereign Debt: Is to Forgive to Forget?' 79 *American Economic Review* 1 (1989) 43-50. For empirical evidence see E Borenszteinand U Panizza, 'Do Sovereign Defaults Hurt Exporters?' 21 *Open Economies Review* 3 (2010) 393-412; in connection with the use of political sanctions see K Mitchener and M Weidenmier, 'Supersanctions and Sovereign Debt Repayment', NBER Working Paper No. 11472 (2005).
[656] C Wyplosz (n. 295) 246.
[657] Most notably, such "golden rule" is enshrined in most of the U.S. states (but not in the U.S. Constitution), and under Article 115 of the German Basic Law. For a survey see J Von Hagen, 'Currency Union and Fiscal Union: A Perspective From Fiscal Federalism', in: P Masson and M Taylor (eds.) *Policy Issues in the Operation of Currency Unions* (Cambridge, Cambridge University Press, 1993). See R Inman, 'Do Balanced Budget Rules Work? U.S. Experience and Possible Lessons for the EMU' NBER Working Paper 5838 (1996); J Poterba, 'Budget Institutions and Fiscal Policy in the U.S. States' 86 *American Economic Review* 2 (1996) 395—400; S Rose, 'Do Fiscal Rules Dampen the Political Business Cycle' 128 *Public Choice* (2006) 407-431.
[658] See for this argument J Von Hagen, 'A note on the empirical effectiveness of formal fiscal restraints' 44 *Journal of Public Economics* 2 (1991) 199-210.

In connection with the EMU, external enforcement was also impractical, from a political perspective, as spending bias and adverse incentives are also present collectively in the Council as the enforcing agent. As suggested before, each Member State would not strictly impose certain economic conditions on others that could negatively affect them as well, both in terms of economic impact given the interdependency of the Union as a whole and, more importantly, in terms of their own political freedom and budgetary discretion in the future. Additionally, as legal theory traditionally explains, from a legal standpoint, judicial enforcement is also very problematic in such an international setting. In the EU context in particular, the sanctioning approach did not work in many instances. For example, the reformed procedure under Article 260 TFEU (ex 228 EC), according to which a Member State may be subject to financial penalties for failing to comply with a previous judgment of the Court, has proved to be ineffective.[659] With regards to the Economic Union in particular, the ECJ specifically clarified that only the formal decision-making process under the EDP can be judicially enforced, while the decision to sanction remains discretionary.[660] This is in line with what the former President of the EC Commission J. Rey captured in connection with the EMS: "Legal commitments may usefully crystallize and consolidate a political consensus reached on these matters, but cannot ensure by themselves their own durability, the more as judicial proceeding in case of breach is hardly conceivable".[661]

The recent reform has overall strengthened the abstract possibility of imposing a sanction without answering to the economic, political and legal issues mentioned above. The reform, in particular, failed to address the lack of spontaneous enforcement, and accordingly, the lack of *ex ante* incentives for Member States to not breach the rules in the first place. Incentive compatible rules are in fact quite limited in presence in the current legislation. We mentioned before that the Economic Union already provides at the end the EDP procedure for the possible suspension or termination of the lending by the European Investment Bank as well as the EU cohesion funds. This was indeed successfully applied in 2012 against Hungary.[662] However, at the early stage of the debt crisis, the Commission recognized the limited scope of such incentives and the need for a "broader and more timely use of EU budget expenditure as an

[659] P Wenneras, 'Sanctions against member states under article 260 Tfeu: alive, but not kicking?' 49 *Common Market Law Review 1* (2012) 145–176.
[660] Editorial comments, 'Whither the Stability and Growth Pact?' 41 *Common Market Law Review* 5 (2004) 1198.
[661] J Rey (n. 170) 30.
[662] Council Decision 2012/156/EU of 13 March 2012 suspending commitments from the Cohesion Fund for Hungary with effect from 1 January 2013 (2012) OJ L78/19; Council Decision 2012/323/EU of 22 June 2012 lifting the suspension of commitments from the Cohesion Fund for Hungary (2012) OJ L165/46.

incentive for compliance". The Commission advanced the proposal "to establish fair, timely and effective incentives for compliance with the Stability and Growth Pact rules. Conditionality could be enhanced and Member States could be asked to redirect funds to improve the quality of public finances, once the existence of an excessive deficit is established".[663] This was also supported by some authors who maintained that incentives should be built into the system so that, starting from the initial stages of the process, it exacts a political cost for non-compliance.[664] This was the logic behind the system of financial incentives, the so-called Competitiveness and Convergence Instrument (CCI), to be included into arrangements of contractual nature with EU institutions.[665]

Based on the initial idea included in the Four President Report, the Commission provided a proposal for the establishment of contractual arrangements which would lay down the key measures a Member State commits to, with agreed timelines and financial support for the implementation of the reforms. These measures would be designed to implement the Country Specific Recommendations agreed as part of the European Semester, in particular those resulting from the Macroeconomic Imbalance Procedure.[666] In other words, the idea was to create contractual instruments that would financially assist, in the short-term, Member States undertaking certain key and rather unpopular reforms. The European Council in December mentioned these instruments by affirming that, "Partnerships based on a system of mutually agreed contractual arrangements and associated solidarity mechanisms would contribute to facilitat[ing] and support[ing] sound policies […]".[667] Nevertheless, the European Council could not reach any final decision for the lacking of a wide political support.[668] These ideas and concerns were, nevertheless, incorporated in the newly enacted regulation for the Structural and Investment Funds for the period 2014-2020.[669] Article 23 of the Regulation provides for a

---

[663] See Commission Communication (N. 346). See European Commission Proposal for a Regulation laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund covered by the Common Strategic Framework and laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Council Regulation (EC) No 1083/2006, Brussels, COM(2011) 615 final.

[664] D Gros, T Mayer, A Ubide (n. 298) 2.

[665] Four President Report (n. 352) 9.

[666] from the Commission Communication, Towards a Deep and Genuine Economic and Monetary Union The introduction of a Convergence and Competitiveness Instrument, Brussels, 20.3.2013, COM(2013) 165 final.

[667] European Council Conclusions of 19-20 December 2013, EUCO 217/13.

[668] See J Pisani-Ferry, V Virhiälä, G Wolff (n. 651).

[669] Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the

conditionality mechanism linked to sound economic governance, with particular regard to the NRPs; the most recent relevant country-specific recommendations; any relevant Council recommendations, including those based on the SGP and the economic adjustment programmes.[670]

Two rather complex procedures are specifically outlined to assess the consistency of this macroeconomic conditionality with the Partnership Agreements.[671] First, the Commission may request that a Member State review and propose amendments to its Partnership Agreement and relevant programs, where it is necessary to support the implementation of relevant Council Recommendations or maximize the growth and competitiveness impact of the ESI Funds in Member States receiving financial assistance.[672] When a Member State fails to take action in response to this request, the Council may, upon the Commission's proposal, suspend part or all of payments for the programs or priorities concerned. The decision on lifting any suspensions is made once the Member State has proposed amendments as requested by the Commission.

Second, the Commission will submit a proposal to the Council to suspend part or all of the commitments or payments for the programs of a Member State if it does not comply with the rules regarding the EDP, the EIP or, for Member States under financial assistance, the related adjustment program. The Council will then decide on suspension and, where the Member State has taken appropriate corrective action, on lifting suspension. In any case, suspensions should be proportionate to the scope and level as set out in Annex III of the Regulation, and subject to

Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006. OJ L 347/320.

[670] EU Commission, European structural and investment funds 2014-2020: Official texts and commentaries, November 2015 available at http://ec.europa.eu/regional_policy/sources/docgener/guides/blue_book/blueguide_en.pdf. CPR Article 19 CPR Article 20-22.

[671] The Partnership Agreement acts as an overall strategic document, providing an overview of how ESI Funds will be used in each Member State in the 2014-2020 programming period.

[672] According to article 23, such a request may be made for the following purposes: (a) to support the implementation of a relevant country-specific recommendation adopted in accordance with Article 121(2) TFEU and of a relevant Council recommendation adopted in accordance with Article 148(4) TFEU, addressed to the Member State concerned; (b) to support the implementation of relevant Council Recommendations addressed to the Member State concerned and adopted in accordance with Articles 7(2) or 8(2) of Regulation (EU) No 1176/2011 (29) of the European Parliament and of the Council provided that these amendments are deemed necessary to help correct the macro-economic imbalances; or (c) to maximize the growth and competitiveness impact of the available ESI Funds, if a Member State meets one of the following conditions: (i) Union financial assistance is made available to it under Council Regulation (EU) No 407/2010 (30); (ii) financial assistance is made available to it in accordance with Council Regulation (EC) No 332/2002 (31); (iii) financial assistance is made available to it that triggers a macroeconomic adjustment program in accordance with Regulation (EU) No 472/2013 of the European Parliament and of the Council (32) or that triggers a decision of the Council in accordance with Article 136(1) TFEU.

certain lower ceilings. Additionally, Article 24 of the Regulation provides for a different type of support, as it allow an increase in payments by 10 percentage points, up to the cap of 100%, for Member State with temporary budgetary difficulties if certain conditions are met.[673]

However, there are two types of problems with these incentive instruments. First, they are not automatic, as they still rely on the decision of the Council. As a result, from a practical standpoint, they are not different from the current sanctioning system. Second, and more importantly, the amount of funds available to incentivize Member States is not clearly sufficient. Member States would require sufficiently large profits from behaving cooperatively to exceed the gains from opportunism/non-cooperative behavior. The EU budget, with particular regards to the structural and investment funds, is too limited. The new European Structural and Investment Funds 2014-2020 has been established with a total amount of 450 billion Euro.[674] Therefore, the sum to be granted to the single Member State in a given year through structural and investment funds will never represent a sufficiently large incentive to comply with the fiscal rules.

The Commission in its latest reflection paper on the deepening of the Economic and Monetary Union recognized the need for "the link between policy reforms and the EU budget [to] be strengthened to foster convergence. This could take the form of either a dedicated fund to provide incentives to Member States to carry out reforms or by making the disbursement of the ESI Funds". At the same time, the Commission also recognized precisely that: "Given the limited size of the EU budget in comparison to most Member State economies, the overall macroeconomic stabilisation properties of such an approach remain limited by definition".[675] Such a lack of incentives does not only have a negative impact on enforcing fiscal rules, but on economic growth as well. Many authors, by looking at the US experience, maintained that if fiscal restraints of the Maastricht Treaty were vigorously enforced, they could significantly diminish the stabilization capacity of national budgets, given the small size of the EU budget

[673] The conditions described in Article 24 are: (a) where the Member State concerned receives a loan from the Union under Council Regulation (EU) No 407/2010; (b) where the Member State concerned receives medium-term financial assistance in accordance with Regulation (EC) No 332/2002 conditional on the implementation of a macro-economic adjustment program; (c) where financial assistance is made available to the Member State concerned conditional on the implementation of a macroeconomic adjustment program as specified in Regulation (EU) No 472/2013.

[674] More in particular, 351.8 billion Euro for the cohesion policy (ERDF, ESF and Cohesion Fund), 99.6 billion Euro for the rural development under the Common Agricultural Policy and 5.7 billion Euro for the Maritime and Fisheries Fund under the Common Fisheries Policy.

[675] European Commission (n. 363) 25.

and thus the necessary lack of fiscal stabilization at the EC level.[676] If we look at some of the available empirical data, we understand, for instance, that the redistribution carried out with structural funds is extremely limited in comparison with the redistributive effect operating in traditional federal systems. For instance, it was measured in 1995 that the redistributive effect through the structural funds in Europe was equal to a maximum of 3% while it was 22% in the United States, 39% in Canada, and 53% in Germany.[677] A more recent study shows that fiscal redistribution is naturally much higher in the US than in the EU. Member States contribute to the EU common budget for about 0.8 to 0.9% of their GDP and receive EU funds in the range of 0.5 to 3.5% of their GDP. On the other hand, US federal taxes collected from States range from 12 to 20% of state GDP, and receive federal funds in the range from 9 to 31% of state GDP.[678]

The fundamental problem of the present governance structure is given by the presence of limited positive incentives to cooperate. This is due to the setting, where government officials naturally tend to maximize their personal and national interests through spending and deficit, while the EU as a whole, aims at preserving fiscal discipline and consolidation. As a result, the fundamental challenge of designing a more effective system is addressing the problem posed by either the lack of positive incentives or by the misalignment of incentives in the current structure.

As a first step in understanding the question of incentives, we have to clarify the nature of the relationship between the Member States and the EU in connection with economic policy matters. In this field, we have seen throughout history that the EU has traditionally adopted an intergovernmental approach, with the Council often assuming a crucial position.[679] Economic coordination under the supervision of the Council, whether in a soft or stricter form, has been the constant choice over the years. This system is characterized by fiscal rules and monitoring procedures, and resembles a contractual approach with an external enforcement by the Council.[680] The same is true of the recent amendments to the SGP and the new "contractual" agreements, like the Fiscal Compact. Moreover, the Economic Union resembles, as explained

[676] B Eichengreen and T Bayoumi, 'The political economy of fiscal restrictions: Implications for Europe from the United States' 38 *European Economic Review* 3 (1994) 783-791.
[677] T Bayoumi and P Masson, 'Fiscal flows in the United States and Canada: Lessons for monetary union in Europe' 39 *European Economic Review* 2 (1995) 253-274.
[678] Z Darvas, 'Fiscal Federalism in Crisis: Lessons for Europe from the US' *Bruegel Policy Contribution* (2010) 3.
[679] A Moravcsik (n. 50); J Weiler (n. 2).
[680] See J Hagen, A Hughes Hallett, R Strauch, 'Budgetary consolidation in EMU' *European Commission Economic Papers* 148 (2001) 50.

before, many of the characteristics of the prisoners' dilemma. Given the contractual context with potential issues of moral hazards and hold-up problems, it is not surprising that many economists perceive the need for a coordination system from a game theoretical perspective. This is in line with a stream of political and economic literature that claims that "the euro area crisis (…) is a political crisis. Therefore, the most appropriate theoretical framework for analysing it is game theoretical concepts describing strategic bargaining among multiple actors, and not macroeconomic theories like optimal currency area theory (Mundell 1961), the debt sustainability theorem (Chalk and Hemming 2000), or other equilibrium-seeking modelling".[681] As a result, in order to address the problem posed by the lack or the misalignment of incentives, we must rely on a theoretical framework that is able to capture game theoretical aspects within a contractual setting: contract theory.[682]

According to contract theory, agreements like the SGP or the Fiscal Compact present two distinctive features: they are incomplete and they are long-term in nature. An incomplete contract is an agreement that "contain gaps and missing provisions. In particular, it will be silent about the parties' obligations in some states of the world and will specify these obligations only coarsely or ambiguously in other states of the world".[683] Also acknowledged in the first chapter, both the ECC Treaty and the Maastricht Treaty were defined as framework treaties in accordance with some of the main literature in the field.[684] The Treaties did not and could not provide detailed specifications of all the objectives and policy instruments, especially in relation to economic and monetary policies. As a result, the Treaties were conceived as an incomplete contract, or as some authors pointed out, a "relational contract", where all the bargaining action was left to its *ex post* implementation stage and delegated to the responsible supranational institutions, so that they provided only general principles.[685] The SGP, as recently amended, and the Fiscal Compact, were meant to *ex post* the Treaties and, in many ways, they were able to complete the gaps.

[681] F Bergsten and J. Kirkegaard 'The Coming Resolution of the European Crisis: An Update' Petersen Institute, Policy Brief PB12-18 (2012).
[682] In the same line of thought, see Y Suzuki, Centralization, ìDecentralization and Incentive Problems in Eurozone Financial Governance: A Contract Theory Analysis' Tokyo Center for Economic Research (TCER) Paper No. E-72 (2014) available at https://ssrn.com/abstract=2397562.
[683] O Hart, *Firms, Contracts, and Financial Structure* (New York, Oxford University Press, 1995) 23.
[684] See among many G. Majone (n. 50) 71.
[685] See on the argument in G Majone, *Dilemmas of European Integration: The Ambiguities and Pitfalls of Integration by Stealth* (Oxford, Oxford University Press, 2005) 73.

However, they still represent incomplete agreements because of the Member States' inability to anticipate the full array of economic contingencies that might happen in the future.[686] For instance, with regards to the calculation of the MTO or the definition of "significant deviation from the MTO or from the appropriate adjustment path toward it", the EU adopts very general terms, such as "major impact on the financial position of the general government", which necessarily requires extensive and complicated ex post negotiation.[687] More importantly, Member States were not willing to anticipate the full array of contingencies because a large amount of fiscal policy-making decisions were not delegated to the supranational level but left to the discretion of the Member States. In other words, these instruments were only meant to coordinate the general economic policy of the single Member States through macroeconomic dialogue and budget constraints. They were not meant to enter into the national economic decision-making process and, for instance, to decide the amount of public investment or the tax level.[688]

Some of these gaps have been filled by the recent reform, which has provided a much more detailed framework of coordination, such as in relation to macroeconomic guidance. Nevertheless, both the reformed SGP as well as the Fiscal Compact remain incomplete contracts as long as they try, ex ante, to anticipate the full array of economic contingencies in a context where fiscal policy remains decentralized.[689] Additionally, Member States were not able to write complete agreements because of bounded rationality issues. Some commentators pointed out that: "Evidently, the political authorities in many member states were unaware – or only vaguely aware – that the signing of the Maastricht Treaty with its requirement that excessive deficits be avoided has limited national sovereignty in the area of fiscal policy".[690] The long-term nature of the SGP, and of the new Fiscal Compact, is also self-evident by the principle of irreversibility of the Euro, as there is no termination date or sunset clause provided for the Monetary Union as well as for the Economic Union. We explained how a deadline for the monetary union and for the Euro was considered but eventually excluded during the

[686] O Hart, (n. 686) 23.

[687] See Article 6 of Regulation 1175/2011 (n. 492).

[688] We explained how Hirschman adopted the same idea in his proposal. His "convention" for a European Monetary Authority was indeed an incomplete agreement as it would only set forth the aims of the national fiscal policies without speficying the details in terms of expenditure, tax or segment of the public finances. A Hirschman (n. 31) 41.

[689] See also H Spruyt, 'Unbundling sovereignty rights through incomplete contracting: Empowering European Transnational network beyond the States', in D King, P Le Gales (Eds) *Reconfiguring European States in crisis* (New York, Oxford University Press, 2017).

[690] J Stark, 'Genesis of a pact', in A Brunila, M Buti, D Franco (n. 293) 104.

Maastricht negotiation process. From a contractual point of view, such agreeements, long-term and incomplete in nature, are also qualified as "probity transactions", as we will develop further in the next section.[691]

These two contractual features are functional for our analysis. The notion of a long-term contract will be important in dealing with ex post efficiency concerns in the next section, while the notion of an incomplete contract is particularly relevant in the context of the present effectiveness assessment. From a theoretical standpoint, Grossman and Hart were among the first to investigate the incentive effects of the parties in the context of incomplete contracts.[692] They developed this within the context of the principal-agent theory in connection with moral hazard and possible holdup problems between the agent and the principal. According to agency theory, models of risk sharing should be structured so as to create incentives for the agent to ensure they act as the principal wants and avoid moral hazard and holdups.

Grossman and Hart adapted this approach in the context of incomplete contracts in order to break the problem into a computation of the costs and benefits of the different actions taken by the agent. The ultimate objective was to establish which optimal incentive scheme minimizes the (expected) cost of getting the agent to choose a particular set of actions given the original incomplete contract.[693] These studies were carried out under the assumption that external enforcement of contractual terms does not operate for situations occurring outside the scope of the contract, where moral hazard and holdups can occur and prejudice the interests of the principal. Furthermore, Grossman and Hart specified, in their following groundbreaking paper, that because of limited enforceability, the allocation, at the contracting stage, of the residual rights of control is crucial. In their view, the optimal allocation of the residual rights of control structure is the one that minimizes efficiency losses, and in certain cases, optimal allocation necessarily requires integration.[694]

Applying these theoretical concepts to the present EMU structure, we argue that a first possible solution to tackling the lack of incentives would be through fiscal integration and centralized control. On the one hand, a wider European budget would imply a more effective system for

---

[691] O Williamson, *The Economic Institutions of Capitalism* (London-New York, The Free Press, 1985) 315.
[692] See S Grossman and O Hart, 'An Analysis of the Principal-Agent Problem', 51 *Econometrica* 1 (1983) 7-45; O Hart 'Incomplete Contracts and the Theory of the Firm' 4 *Journal of Law, Economics, and Organization* 1 (1988).
[693] S Grossman and O. Hart (n. 695) 9.
[694] S Grossman and O Hart 'The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration" 94 *Journal of Political Economy* 4 (1986) 691-719.

fiscal discipline and serve as an automatic fiscal stabilizer. Even before the sovereign debt crisis, a number of studies and official reports advanced the proposal for an increased EU budget for such purposes.[695] In this sense, the proposal calls to mind the Werner report in which a European economic authority would directly influence national budgets, the direction of the balances and the methods for financing the deficits or utilizing the surpluses. However, it was only after the sovereign debt crisis that the idea of a fully developed European fiscal union with a larger fiscal capacity became widely held.[696] We have explained how both the OMT program and the ESM could be seen as having amended the original structure of the European Economic constitution by creating a system of redistributive policies at the EU level and risk sharing. Furthermore, many studies now suggest the introduction of a federal model where a larger EU budget could indeed serve as an automatic stabilization tool for periods of economic downturns as well as incentives for fiscal discipline and consolidation.[697] In other words, this new structure may be able to address the asymmetries affecting the functioning of the monetary union, and at the same time, use the EU budget to address financial emergencies.[698] According to these studies, the additional revenue could be financed with the introduction of a federal tax, or with the creation of a more advanced risk-sharing regime, the so-called Eurobonds, financially backed by either the ECB or the ESM.[699]

On the other hand, as contract theory suggests, a potentially larger fiscal capacity of the Union also requires a more centralized control over fiscal and economic policies, such as a common European treasury.[700] Both the Four President Report and the Five President Report followed this direction by suggesting the need for a common macroeconomic stabilization system and discussed the idea of a European treasury, responsible for the necessary assessments of national budgets. As for the function of macroeconomic stabilization, the Five President Report declined

---

[695] The first Communty report in this sense was the MacDougall Report (n. 163) 66-72. Among many studies see in particular B Eichengreen and C Wyplosz (n. 269).

[696] For an overview of recent studies see M Dolls, C Fuest, F Heinemann, A Peichl (n. 521); J Pisani-Ferry, V Virhiälä, G Wolff (n. 651).

[697] Among many see C Cottarelli, 'European Fiscal Union: A Vision for the Long Run' 149 *Swiss Journal of Economics and Statistics* 2 (2013) 167-174; G Wolff, 'A budget for Europe's monetary union', *Bruegel Policy Contribution* 22 (2012).

[698] A similar idea was developed by M Maduro, 'A new governance for the European union and The Euro: democracy and justice' *RSCAS Policy Paper* 11 (2012).

[699] M Bordo, A Markiewicz, L Jonung, 'A Fiscal Union for the Euro: Some Lessons from History' 59 CESifo Economic Studies 3 (2013) 449-488; G Corsetti et al. 'The Time is Short and the Need Great: New Institutions and New Policies for a Workable', CEPR Monitoring the Eurozone, November (2014).

to introduce any specific system of permanent transfers, but instead urged the linkage of any possible transfers to compliance with the broad EU governance framework and with the required structural reforms.[701] The Commission's subsequent White Paper on the future of the EU, as well as the more specific EMU reflection paper, also insisted on the need to set up a macroeconomic stabilization system for the Euro area to address possible asymmetric shocks or unusual circumstances where monetary policy is unable to operate.[702]

The Commission proposed a number of different forms for such a system, such as the creation of a European Investment Protection Scheme or a European Unemployment Reinsurance Scheme, but all of these schemes were considered strictly conditional on compliance with EU fiscal rules and the broader economic surveillance framework. The reflection paper also discussed the idea of a possible European Monetary Fund as an additional and autonomous fund to provide liquidity assistance mechanisms to Member States, similar to today's ESM, and possibly serve as the last resort common backstop of the Banking Union.[703] With regards to financing, the Commission suggested the use of existing instruments, such as the ESM after necessary legal changes, or even a wider EU budget based on national contributions or a share of VAT, or revenues from excises, levies or corporate taxes.

Ultimately, the Commission also discussed the idea, at a later stage of the deepening of EMU, of a Euro area Treasury. The new institution would then carry out central economic and fiscal surveillance tasks, the coordination of issuing a possible European safe asset, and the management of the macroeconomic stabilization function. Overall, this proposed new framework could potentially solve some of the aforementioned contradictions of the current structure and provide, in light of the examples of other federal system, a more effective economic govervance in terms of fiscal discipline, economic growth, and preservation of the irreversibility of the Euro. The proposal and its associated full risk sharing regime would generate an even higher expectation of financial bailouts and a tendency toward economic centralization at the EU level, with new funding and competences and less space for national economic policies.

[701] Five President Report (n. 360) 14-15.
[702] European Commission White Paper (n. 363). See also European Commission (n. 363).
[703] A similar idea was developed in D Gros and T Mayer, 'Towards a Euro(pean) Monetary Fund', CEPS Policy Brief No. 202 (2010). Available at SSRN: https://ssrn.com/abstract=1615478.

The second and third possible solutions would instead tackle, at the contracting stage, the misalignment of incentives of the current structure not through integration, but rather through market mechanisms. For these options, it is more relevant to consider the theoretical literature on enforceability under incomplete contracts, and more generally, the literature on the enforceability of contractual terms in a context where external enforcement is necessarily limited. In other words, it is necessary to understand what incentive compatible schemes are able to provide assurance of performance, both for specific contractual terms and for situations outside the scope of the incomplete contract.

This question brings us to a second strand of contract theory that relies on the role of self-enforcing mechanisms as an alternative method to assuring contractual performance when governments or any third parties cannot enforce the contract.[704] More specifically, under this strand of literature, self-enforcing mechanisms, such as reputation, market forces and the threat of business termination, are able to act as stong incentives for the contractual party to adhere to its commitment under the contract. This logic fits solidly in the context of sovereign debt. The economic literature on sovereign debt has also traditionally been directed toward self-enforcing agreements, where the incentives of participants are able to tackle international contracting problems where a "proper" court is absent or ineffective. This theory is also consistent with a stream of literature in the field of political economy of law concerning fiscal federalism.[705] According to the so-called 'second generation' fiscal federalism, the central component of a credible commitment to limited government is that these limits must be "self-enforcing". More clearly, this stream of literature believes that a limited or restricted government can be credibly achieved only if limits and restrictions, such as budget constraints, are designed or understood as an incentive-compatible arrangement (i.e. self-enforcing), based on the incentives of the political officials rather than external enforcing mechanisms. This idea is not new to the economic integration process. As some commentators have suggested, several of the social and economic institutions developed in most European countries after the Second World War can be thought of as self-enforcing.[706] For instance, the same EPU, as explained in the first chapter,

[704] B Klein and K Leffler, 'The Role of Market Forces in Assuring Contractual Performance', 89 *Journal of Political Economy* 4 (1981) 616.
[705] See B Weingast, 'The Economic Role of Political Institutions: Market-Preserving Federalism and Economic Development' 11 *Journal of Law, Economics & Organization* 1 (1995) 1-31; more recently B Weingast, 'Second Generation Fiscal Federalism: Implications for Decentralized Democratic Governance and Economic Development' 21 *Journal of Law, Economics, and Organization* 1 (2006).
[706] B Eichengreen (n. 17) 800.

mainly relied on self-enforcing mechanisms that were based on high incentives and binding rules.

Overall, contract theory, general economic theories on sovereign debt, and political economic of law, all agree from different standpoints that a self-enforcing arrangement constitutes a more effective enforcement structure in a setting where moral hazard is present and a proper external enforcement is necessarily limited or lacking completely. In the context of the EMU, there are two possible self-enforcing mechanisms.

Based on this theoretical foundation, a second alternative arrangement could be based on market discipline. Pressure from capital markets is widely believed to induce fiscal discipline through higher yields in governments bonds. During the early stages of the EMU process, this idea was prominently advanced by the Padoa-Schioppa Report, which maintained that capital market restraints on state finance would result in a more effective instrument long term than wide fiscal arrangements.[707] This idea was later supported by a group of economists who pointed out how *ex ante* coordination rules are usually subject to information, incentive and enforcement problems, and ultimately to transparency issues that make it difficult to have any form of public accountability.[708] In accordance with such suggestions, instead of creating a complex system of coordination, Member States should direct their efforts at approving the necessary structural reforms to achieve greater flexibility in the labor and goods markets, so as to eventually decrease economic interdependence among them and reduce the need for coordination markets in the first place.[709]

In other words, there is an argument for enforcement based on "moral hazard" and market forces as a better and more effective system.[710] In fact, monetary unification without coordination among decentralized fiscal authorities may actually reduce in certain cases the inflation bias towards public spending. Future expectation plays a vital role in financial markets as well as in macroeconomic theory. A high level of government debt creates the rising of sovereign risk premia, which in turn generates a negative effect on internal expectations. According to the traditional economic view, government spending is less expansionary in case

[707] Padoa-Schioppa Report (n. 181) 10.
[708] O Issing (n. 390) 356.
[709] O Issing (n. 390) 354-355.
[710] See also R Beetsmaa and A Bovenbergb, 'Monetary union without fiscal coordination may discipline policymakers', 45 *Journal of International Economics* 2 (1998) 239–258. O Sibert, 'Government finance in a common currency area', 11 *Journal of International Money and Finance* 6, 567-578 (1992).

of high-debt levels, since it induces expectations of high future taxes, discouraging consumption, investment, and output. Additionally, this weakens the short-term stimulative effect of a possible government spending increase.[711]

Nevertheless, having a system purely based on moral hazard and market discipline without the recourse to economic coordination could eventually be ineffective. First, market discipline is indeed crucial under the current structure of the EMU thanks to the no bailout clause, the prohibition of monetary budget financing, and the ban of government privileges in loan access. However, the Delors Report and later the drafters of the Maastricht Treaty and the SGP believed that market pressure alone could not enforce or induce fiscal discipline. As a result, market discipline was complemented with a wide system of coordination of economic policies. A notable member of the Delors Committee pointed out that financial markets had historically proven to be unsuccessful in steering fiscal discipline within the European settings.[712] The sovereign debt crisis proved these considerations to be correct. Market forces were indeed unable to price the various government bonds of European States according to the different economic fundamentals and to induce fiscal discipline as a result. This proved, once again, how the case for reliance on market discipline as an enforcement mechanism is quite weak.[713]

However, we also explained how this occurred mainly because investors' pricing of sovereign risk was affected by the expectation of bailouts. In other words, it was the failure of the system of economic coordination that induced market failures and not the other way around. In any case, it is important to underline that market discipline operates only as a complementary method. In this sense, it was pointed out recently that fiscal rules without market discipline are equally ineffective, for financial sanctions, for instance, can only be an effective deterrent if a country cannot pass on these costs to its partners in a subsequent bailout.[714] As a result, we understand that a possible alternative arrangement should certainly strengthen market discipline as a complementary self-enforcement mechanism, but market discipline cannot be considered the principal pillar of the new structure.

A third alternative arrangement is based on the threat of termination. The majority of the literature on self-enforcing agreements and on the sovereign debt point, in particular, sees the

[711] Ibid 12.
[712] See A Lamfalussy, 'Macro-coordination of fiscal policies in an economic and monetary union in Europe' (1989), in Delors Report (n. 161).
[713] D Gros and T Mayer (n. 706).
[714] M Dolls, C Fuest, F Heinemann, A Peichl, (n. 521) 10.

threat of termination of the business relationship as the most effective method of assuring that the discounted future expected profit stream exceeds the short term gain of non-performing.[715] In our present scenario, the threat of termination would steer financial discipline in two ways. First, it would strengthen and restore market discipline. The concrete possibility of a withdrawal or expulsion from the Monetary Union could potentially restore the correct perception of risks by capital markets. Capital markets would no longer be affected by bailout expectations, and prices of sovereign bonds would again reflect the different economic fundamentals as occurred before the establishment of the EMU. Second, the threat of termination would operate as a pure self-enforcment device based on the loss of the discounted future expected profit stream arising from the termination of the monetary union regime. Under this self-enforcing agreement, each Member State could unilaterally understand whether it would be more beneficial to remain in the union or to leave it in accordance with a cost and benefit exercise. This would resemble the cost and benefit analysis occurred during the phase leading to the introduction of the Euro.[716]

More specifically, the first possible costs of leaving the Euro would be in terms of trade effects. A large number of studies suggest that the common currency has been effective in reducing trade barriers associated with national borders and in increasing European trade based on the so-called Rose effect.[717] A second potential cost would be in terms of price and currency stability. We have explained before how the Eurozone has experienced a very stable inflation rate and an equally stable currency over the last fifteen years.[718] Crucially, with particular regard to a context of financial distress and unsustainable debt, a possible exit from the single currency could also imply a financial default. The leaving Member State would indeed be forced to replace Euro liabilities with the liabilities of the new currency, which would lose value

---

[715] See the early analysis in L Telser, 'Theory of Self-Enforcing Agreements', 53 *The Journal of Business* 1 (1980) 27-44.

[716] See for instance the famous research study of the European Commission (n. 255) 102.

[717] The Rose effect tends to measure, according to certain parameters, how much a country within a currency union trades more with currency members than with non-currency members: A Rose 'One Money, One Market: Estimating the Effect of Common Currencies on Trade', 30 *Economic Policy* 15 (2000) 9-45. A number of studies have later applied the techniques of Rose to the Eurozone and showed a significant trade increase. Among many see A Micco, E Stein, G Ordonez 'The Currency Union Effect on Trade: Early Evidence From EMU', 37 *Economic Policy* 18 (2003) 316-356. It is worth mentioning, however, that some other studies, based on the different border effect, disputed this evidence by showing how there has been no significant reduction of border-linked costs after the Euro's introduction. The border effect measures the integration of a country with its trade partners, and particularly how much trade within a country is higher than that country's average trade with its representative trade partner. See G Cafiso 'Rose Effect versus Border Effect: the Euro's Impact on Trade,' 43 *Applied Economics* 1 (2010) 1691-1702.

[718] For an overview of the costs and benefits see for R Beetsma and M Guiliodori, 'The macroeconomic costs and benefits of the EMU and other monetary unions: An overview of recent research', 48 *Journal of Economic Literature* 3 (2010) 603–641; See also P De Grauwe, (n. 3).

immediately and would easily result in the impossibility for the Member State to repay its government obligations. Such a potential default would then mean future exclusion from capital markets as an additional future expected loss to take into consideration.[719] Empirical studies on sovereign default are quite robust in showing the impact of defaults on the States' short and medium term ability to borrow again and on general economic growth.[720]

On the other side of the equation, the first benefit of a termination would be in terms of larger spending capacities outside the stringent budget constraints of the SGP. However, this larger spending would imply an additional cost in terms of higher interest rates on government bonds. Another major benefit would arise from regaining an independent monetary policy. The leaving Member State could again establish its own interest rates according to its optimal policy mix, while in terms of currency, the leaving Member State could let its national currency depreciate with potentially positive consequences for economic growth. In terms of public debt, a Member State outside the currency union could also potentially 'inflate away' its debt by seigniorage. Through seigniorage, it would sell government bonds to its own central bank, who would then immediately "monetize" the debt with new money emissions. The interests on these bonds would be returned to the fiscal authority, and with this excess of money creation the government would get new funding to spend for public policies.[721] A Eurozone Member State cannot force or convince the European central bank to purchase its own bonds through a seigniorage system. More specifically, even if the ECB decided to purchase additional Greek bonds, Greece would still pay interest on central bank holdings of its bonds and its seigniorage revenues would not increase.

[719] On this argument, among many see J Eaton and M Gersovitz, 'Debt with Potential Repudiation: Theoretical and Empirical Analysis' 48 *The Review of Economic Studies* 2 (1981) 289-309, K Kletzer and B Wright, Sovereign Debt as Intertemporal Barter, 90 *The American Economic Review* 3 (2000) 621-639.

[720] See for instance E Jorgensen and J Sachs, 'Default and Renegotiation of Latin American Foreign Bonds in the Interwar Period' *NBER Working Paper* No. 2636 (1988); P Lindert and P Morton, 'How Sovereign Debt Has Worked,' in J. Sachs (ed.) *Developing Country Debt and Economic Performance, Volume 1: The International Financial System* (Chicago, University of Chicago Press, 1989) 39-106.

[721] Seigniorage revenue is given by the product of the inflation rate and the inflation tax base. This inflation tax base reflects the purchasing power of the public's money holdings and is the level of real money balances (nominal money holdings divided by the price level). Monetary expansion causes the inflation rate to rise, but the revenue effects are partially offset as individuals attempt to quickly spend the extra money before it depreciates further. If people spend money faster than it is being printed, the rate of price increase comes to exceed the rate of money issuance. The government can buy real goods and services that the private sector produces with money that is (virtually) costless for the government to print. The real resources that the government acquires in this way equal its seigniorage revenue. The New Palgrave Dictionary of Economics (n. 490).

This costs and benefits analysis is largely theoretical, as there are practical problems to economically measuring all the effects. The general idea was, as recognized by the former prime minister of Greece, that the "expected additional benefits" of the Euro "both real and potential, are substantive and more than offset the short-term cost of adjustment to the new economic environment and the necessary further restructuring the economy".[722] However, practically speaking, it is not possible to know for certain the results of the costs and benefits analysis and to predict the consequences of a possible exit. Likewise, it is difficult to predict its implications in terms of economic and political instability, for instance, in case of debt seigniorage. Additionally, some of the literature notes that any solution based on a possible exit from the monetary union needs to take into consideration today's mutual interdependence, specifically in terms of incompatibility between frequent exchange rate adjustments or even floating exchange rates with the idea of the common market.[723]

Now, we must apply these considerations to our specific scenario. First and foremost, a self-enforcement mechanism based on termination would necessarily require an explicit provision under the Treaty. As we explained above, the actual legal framework does not allow single countries to leave the Euro area without breaching the Treaties or without leaving the EU tout court. A new Treaty provision allowing the exit from the EMU would be consistent with the principle of participation, which was among the core principles of the EMU foundational period. The Delors Committee explained that: "There is one Community, but not all the members have participated fully in all its aspects from the outset. A consensus on the final objectives of the Community, as well as participation in the same set of institutions, should be maintained, while allowing for a degree of flexibility concerning the date and conditions on which some member countries would join certain arrangements."[724] Some prominent commentators have clarified how the EMU is essentially a voluntary agreement: "In a sense it is an agreement between all the Member States that those who so wish will be bound by the rules and make use of institutions created under Community law".[725] Indeed, not all the eligible countries decided to participate to the common currency. We have explained how the UK, Denmark, and Sweden originally decided, for different reasons, not to join the monetary union.

[722] Speech given in January 2001 by the former prime minister Papantoniou available at <www.greekembassy.org>).
[723] See among many H Siekman (n. 141) 356.
[724] Delors Report (n. 161) 28.
[725] J Usher, *The Law of Money and Financial Services in the European Community* (London, Clarendon Press, 1994) 141.

This new provision allowing Eurozone Member States to leave the monetary union could potentially take two forms.[726] A first option could be a unilateral and/or negotiated withdrawal, similar to the one provided under Article 50 TEU. This would allow any Member State whose currency is the Euro to withdraw from the common currency through a notification followed by a negotiation process. Such a scenario evidently presents two disadvantages. First, a right to withdrawal dependent on a negotiation would necessarily feed market speculation.[727] This would then negatively affect the negotiation process and possibly produce negative externalities on all remaining Member States. Such a scenario could then imply the same speculative attacks we have discuessed with regards to the ERM.[728] Second, a voluntary option could nevertheless give rise to holdup problems as the leaving Member State could be tempted to use its right of withdrawal in order to force the other Member States to provide financial assistance. From a practical standpoint, such a withdrawal could be necessary regardless of our self-enforcing analysis. As noted by some commentators, Article 50 TEU does not consider the possibility that the leaving Member State is also part of the Eurozone.[729] A leaving scenario would thus involve managing the details surrounding the participation in the Economic and Monetary Union, such as the creation of a new currency; the refund of the ESCB contribution as well as foreign assets owned by the ECB; and the possible redenomination of all contracts in Euro.[730] As a result, in order to avoid market speculation, it would be more appropriate to address all the conditions upfront, at least in broader terms, instead of leaving them entirely to an ex post negotiation process.

A second option could be a suspension or an expulsion from the monetary union. These two possibilities could be combined, such that a first phase of suspension could eventually lead to an expulsion at a later stage. Under the Treaty, there exists a general right of suspension which allows the Council to temporarily suspend some of a Member State's rights for a "serious and persistent breach" of the principles mentioned under Article 6(1) TEU,[731] while there is no

---

[726] For an early overview of the different possibilities see P Athanassiou, (n. 550); For an economic analysis of the withdrawal option among many see C Proctor and G Thieffry, *Economic and Monetary Union: Thinking the Unthinkable -The Breakup of the Monetary Union* (London, Norton Rose 1998). For a legal analysis see D Meyer, 'Legal Options of a Withdrawal from the Euro and the Reassignment of Monetary Sovereignty' 25 *European Business Law Review* 5 (2014) 665–679.
[727] See on this point see the argument of M Maduro (n. 701) 10.
[728] For the two main models of speculative attacks, the Obstfeld model and the Barro Gordon model see D Gross and N Thygesen (n. 213) 196-201.
[729] P Athanassiou, (n. 550) 28-31.
[730] See C Proctor and G Thieffry (n. 729) 7-8.
[731] See Article 7(2) and (3) TEU.

provision allowing the expulsion of any Member State from the EU. In the literature, a number of scholars have considered this possibility as legally inconceivable,[732] while others have maintained that the Treaty does not expressly prohibit such eventuality.[733]

Nevertheless, as with the case for withdrawal, both options would require an explicit Treaty amendment, specifying both the economic benchmarks that would trigger the suspension or expulsion from the EMU as well as the economic conditions for the aftermath. For the latter, we refer to the considerations expressed above. In this sense, according to many commentators, the leaving Member State should be allowed to introduce capital controls as well as a brief bank holiday combined with a longer period of restrictions on financial transfers abroad in order to avoid widespread capital flights.[734] In connection with the former, such benchmarks could be structuraly similar to those provided by the SGP or the Fiscal Compact. They should, however, take into consideration many other economic factors, such as unemployment rates, and a larger safety margin with respect to the present indicators so as to allow the Member State to correct its public finances in a reasonable timeframe and flexibility for efficient spending.

Furthermore, two elements need to be emphasized. First, based on the above considerations, to be effective and self-enforcing, such a provision should be automatic. This would be consistent with the original Weigel plan for the SGP based on automatic fines on Member States in breach of the fiscal rules. Additionally, such an alternative arrangement would necessarily imply the cancellation of the OMT program and the removal, or else its use for different means, of the ESM. Second, the provision should be drafted so to facilitate self-enforcement. Contract theory explains that it is possible to build a self-enforcing mechanism so that termination will never be taken into consideration as a feasible choice for the Member State. In particular, B. Klein has tried to integrate the literature on self-enforcement mentioned above within the context of incomplete contracts. The aim was to draft contract terms in order to facilitate self-

---

[732] Among many see the analysis in A Lowrey, 'Could Greece Get Kicked Out of the European Union? No, FP Explainer (Mar. 23, 2010), available at http://foreignpolicy.com/2010/03/23/could-greece-get-kicked-out-of-the-european-union/; also S Peers, 'Is Temporary Grexit Possible? EMU as Hotel California', July 11, 2015, EU Law Analysis Blog available at http://eulawanalysis.blogspot.co.Uk/2015/07/is-temporary-grex-it-legally-possible.html.

[733] J Blocher, M Gulati, L Helfer, 'Can Greece be expelled from the Eurozone? Toward a default Rule on expulsion from International organizations' in F Allen, E Carletti, J Gray and M Gulati (eds), *Filling the Gaps in Governance: the Case of Europe*, (Fiesole, European University Institute, 2016) 129.

[734] H Scott, 'When the Euro Falls Apart – A sequel', Harvard Law School Public Law & Legal Theory Working Paper Series Paper No. 12-16 (2012) 12-17.

enforcement.[735] He argued that, in the context incomplete contracts, contract terms may supplement the self-enforcing mechanism to create certain economic conditions where self-enforcement is always the optimal preference.[736] In particular, contract terms can operate on the left side of the equation, by reducing short-term gains, or on the right side of the equation, by increasing the discounted future expected profit.

In our specific case, this could be achieved by reducing the short-term gains mentioned above. For instance, the Treaty provision could make it mandatory for the Member State to remain for a number of years within the exchange rate mechanism, the ERM II, under the condition that no devaluation can occur on the Member State's initiative. Ultimately, in order to partially avoid the economic and legal risks and difficulties of restoring a Member State's old currency,[737] the leaving Member State could still be allowed under the Treaty to continue using the Euro through a consensual Euro-ization without participating in the governance structure and decision-making process.[738] This framework could potentially solve the aforementioned contradictions of the current structure, with particular regards to the enduring contradiction between fiscal rules and the principle of national sovereignty as well as the conflict between bailout expectations and the plain language of the Treaty.

Some prominent economists have also pointed out that a solution based on possible defaults could be able to adjust the European economic governance as it occurred in the US example.[739] More specifically, it is argued that the federal decision in 1841 to 1842 to let eight US states to default on their debts rather than bail them out, created a critical precedent to eliminate state-level moral hazard, and ever since, no bailout of a single state has occurred. As a result, it could represent a more effective economic govervance system in terms of fiscal discipline and economic growth, but not in terms of preserving the irreversibility of the Euro.

---

[735] B Klein, 'The Role of Incomplete Contracts in Self-enforcing Relationships" Revued' *Economie Industrielle* (2000) 67–80.

[736] Ibid 75.

[737] Regarding the practical economic conditions for this exit options see the analysis and some of the suggestions in R Bootle, *Leaving the Euro: A practical guide* (London, Capital Economics Limited, 2012); E Dor, 'Leaving the Euro zone: a user's guide' IESEG School of Management, Working Paper Series (2011) available at http://my.ieseg.fr/bienvenue/DownloadDoc.asp?Fich=1046781054_2011-ECO-06_Dor.pdf; C Proctor, 'The future of the Euro - what happens if a Member State leaves?' 17 European Business Law Review 4 (2006).

[738] Discussing the Euroization option is P Athanassiou, (n. 550) 41-43.

[739] J Frankel, 'The Future of the Currency Union' KS Working Paper No. RWP13-015 (2013) Available at https://ssrn.com/abstract=2326719 or http://dx.doi.org/10.2139/ssrn.2326719.

However, it is worth mentioning that none of these possibilities of termination have been formally discussed at the EU level. Nevertheless, the general idea has not been officially ruled out. Most notably, the President of the Bundesbank recently affirmed: “No doubt can be allowed to arise concerning the character of the euro as a stable currency and its continued existence”. At the same time, he argued: “If the central bank were obliged to guarantee that member states remain in the euro zone at all costs, it could come into conflict with its key mission of maintaining price stability. I also don't see how it's possible to fundamentally rule out that a sovereign member state might decide to leave the monetary union.”[740]

[740] Interview with Bundesbank President, Der Spiegel August 29, 2012 available at http://www.spiegel.de/international/europe/spiegel-interview-with-bundesbank-president-jens-weidmann-a-852285-2.html.

2.1 – EFFICIENCY CONCERNS

Up to this point, we have carried out an effectiveness assessment of the current structure, and we have analyzed and compared possible alternative institutional arrangements. The different alternative arrangements will now be examined and compared under an institutional comparative analysis in order to assess their potential efficiency. Effectiveness and, by comparison, efficiency are two different measures. Effectiveness, as we have explained, concerns the degree of compliance or achievement of objectives, while efficiency refers, as we will develop in this section, to the concept of minimizing transaction costs.[741] The two elements go hand in hand, as an effective rule must nevertheless also pursue an efficient outcome, which was recognized by O. Williamson, who maintained that transaction costs economics and agency theory complement each other.[742]

The efficiency criterion, to identify and assess the content of the law, traditionally belongs to law and economics literature. In our context, efficiency considerations play an important role for two main reasons. First, economic analysts of law have been largely silent in connection to the debt ceiling discussion or the Eurozone crisis, and this notwithstanding the fact that the legal profession (i.e. lawyers, judges, academia) was deeply involved in the financial crisis itself through practices and regulations.[743] Second, the concept of efficiency was one of basic elements considered under the original establishment of the architecture of the economic and monetary union. We have seen that the same idea of a common market specifically rests on efficiency-driven concerns, in terms of static and dynamic efficiency. Economic growth and social progress on the one hand, and efficiency concerns on the other hand, were in fact the underlying assumptions and objectives of the Treaty of Rome[744]. Additionally, a correct assessment of the body of law governing the European Economic and Monetary Union is

[741] For an early and different analysis see P Artus, 'Is the Stability Pact an Efficient Agreement?' mimeo, Caisse des Dépôts et Consignations (1997).

[742] For an analysis of the differences between agency theory and transaction costs economics see O Williamson, 'Corporate Finance and Corporate Governance', 43 The Journal of Finance , Papers and Proceedings of the Forty-Seventh Annual Meeting of the American Finance Association, Chicago, Illinois, December 28-30, 1987 (1988) 567-591.

[743] "The legal profession was deeply involved in the creation of the complex financial instruments that crashed and, of course, in the creation, un-creation, and administration of the regulatory laws and institutions governing finance. Yet about these instruments and practices and regulations—the Federal Reserve Act, for example, or the debt ceiling, or the Eurozone—economic analysts of law have been largely silent" R Posner, 'The Future of Law and Economics: Essays by Ten Law School Scholars', University of Chicago Law School, (2011) available at https://www.law.uchicago.edu/news/future-law-and-economics-essays-ten-law-school-scholars.

[744] The preambles of the Treaty listed many economic and social objective. For further reading on the scope of the Treaty see O De Schutter, 'The Balance Between Economic and Social Objectives in the European Treaties', Revue française des affaires sociales 5, (2006) 119-143.

subject to complex macroeconomic assumptions, which, in turn, necessarily bring economic thought into the study of law.

The concept of efficiency is thus the basic unit for the economic analysis of law, and for a long time it was generally defined as the ability to produce more at a lower cost. The ECSC Treaty made reference to this definition by affirming that "the Community must progressively establish conditions which will in themselves assure the most rational distribution of production at the highest possible level of productivity […]".[745] Over time, different schools of economic analysis of the law have interpreted "efficiency" in different ways, and according to different economic philosophies and perspectives.[746] In our context, we will consider efficiency in terms of minimizing transaction costs. This reflects what O. Williamson later would explain, that economic institutions of capitalism have the main purpose and effects of economizing on transaction costs.[747] However, as it is known, a clear-cut definition of transaction costs does not exist[748], but this is not so important in our context. Rather, what is important is how we intend and define transaction costs in this particular analysis. Very persuasive and relevant here is the definition provided by economists Furuborn and Richter, who defined transaction costs with reference to political transaction costs as the "array of costs associated with the running and adjusting of the institutional framework of a policy".[749]

Transaction costs are crucial because they were among the principal concerns in connection with the establishment of the monetary union. For instance, we saw in the first chapter that the EPU and the ECC had been conceived and drafted with the purpose of minimizing transaction costs. The EPU minimized trade distortions, while the EEC minimized transaction costs by abolishing trade restrictions among European states. Moreover, the creation of a common currency itself was considered for transaction costs purposes. On this point, R. Mundel, without citing the term, clearly recognized this element when he explained that "the costs of currency

---

[745] Article 2 ECSC Treaty.

[746] For a survey on this point in connection with the different school see: F Parisi, 'Positive, Normative and Functional Schools in Law and Economics' 18 European Journal of Law and Economics 1 (2004).

[747] O Williamson (n. 694) 17.

[748] There is not a clear and widespread accepted definition of the term. In its original formulation, Coase refers to transaction costs as "the cost of using the price mechanism" or "the cost of carrying out a transaction by means of an exchange on the open market." (Coase 1960) A broader definition was made by Kenneth Arrow who defined them as"'the costs of running the economic system" (Arrow, 1969). More recently, other authors provided a more legally-oriented definition by defining 'the costs associated with the transfer, capture and protection of rights (Yoram Barzel 1997). For a more complete coverage see M Klaes, 'The history of the concept of transaction costs: neglected aspects.' 22 *Journal of the History of Economic Thought* 2 (2000) 191-216.

[749] E Furubotn and R Richter, *Institutions and Economic Theory - The Contribution of the New Institutional Economics 2nd Edition* (Ann Arbor, The University of Michigan Press, 2005) 51.

conversion are always present, they loom exceptionally large under inconvertibility or flexible exchange rates." Transaction costs are also important because they provide the key to understanding alternative forms of economic organization and contractual arrangement, as in our case. What is vital is the cost of conducting transactions in one organizational or contractual form relative to others. In other words, what matters is not the absolute amount of transaction costs, but the relative amount of transaction costs associated with different organizational or contractual choices. This is also because transaction costs are not directly measured. Certain proxies, such as uncertainty, transaction frequency, asset specificity, opportunism, and so on, are used instead, which are believed to affect the cost of transactions.[750] Approaching the subject from a transaction costs perspective is thus useful to better understand the amount of political discretion that each govervance system allows in connection with the internal decision of the Member State concerning its sovereign debt.[751]

TCE is precisely concerned with identifying the trade-off between autonomy and cooperation, and this reflects the present trade-off and balance between fiscal centralization and fiscal autonomy of Member States within a macroeconomic context. This was recognized in the first major appraisal of monetary union, when the Commission explained: "To supply the adequate mix of autonomy, discipline and cooperation is the challenge the fiscal regime of the Community has to meet".[752] Given these considerations, a Transaction Cost Economics methodology approach applied to the different institutional arrangements of the EMU is key to understanding the distinctive strengths and weaknesses of the various alternatives.

Transaction Cost Economics has been further developed in the context of private law.[753] However, because many problems can be viewed as a contracting problem and can be investigated in transaction cost economizing terms, the potential scope of transaction cost economics is very broad.[754] For instance, TCE was also applied to the public sector where the transactions are defined, from a contractual point of view, as "probity transactions", since they

[750] See for instance H Shelanski and P Klein, 'Empirical Research in Transaction Cost Economics: A Review and Assessment' 11 *Journal of Law, Economics, and Organization* 2 (1995) 335-61.

[751] With regards to the different internal decisions see K Oosterlinck, 'Are "No Bailout" and "No Deebt Restructuring" in the EMU Compatible? A Historical Perspective', in F Allen, E Carletti, J Gray and M Gulati eds (n. 736).

[752] European Commission (n. 255) 102.

[753] S. Grundmann, 'chapter 17' in S Grundmann, H Micklitz, M Renner (eds.) *Grand Theories of Private Law*', (forthcoming).

[754] O Williamson, 'Public and Private Bureaucracies: A Transaction Cost Economic Perspective' 15 *The Journal of Law, Economics, & Organization* 1 (1999) 313–314.

are long-term and incomplete in character.[755] In our context, the relationship between the Member State and the EU is certainly a probity transaction, as TCE applies to the public sector, but the different categories we will use are those adopted with a private governance approach.

The different institutional arrangements outlined in the previous section can be, to a certain extent, compared to the modes of private governance designed by Williamson. In particular, he distinguishes three structural modes of institutional governance: (i) market, (ii) hierarchy, and (iii) hybrid. The key attributes in which the three modes differ are: incentive intensity, administrative controls, dispute-settling mechanisms, and adaptability.[756] The hierarchic mode relates to the establishment of an enduring authority regime between the owner of an enterprise and the management and employees, and where the owner directs the latter's operation. Hierarchy could correspond to the idea, suggested by the Five President Report and by the Commission, of a unified Euro Area Treasury with a large common budget. The new structure of governance would indeed result in an enduring authority regime between the EU and the Member States in economic matters. The new EU treasury would be responsible for economic and fiscal surveillance, management of the larger EU budgets, and possibly oversight or coordination of the issuance of Eurobonds.

This first option would imply a European joint intervention as part of national sovereignty up to the establishment of a proper economic and fiscal union. According to Williamson, a hierarchical structure of governance usually implies low-powered incentives. In our case, however, a fiscal union would on the contrary provide high-powered efficiency incentives (i.e. the incentives of Member States to comply) arising from the Euro budget. We explained how this larger budget would both serve as a macroeconomic stabilization system to address possible asymmetric shocks, and as a source for positive incentives by linking any possible transfer to compliance with the broad EU governance framework and with the required structural reforms. As a result, this first system could therefore be more effective to address all the problems of

[755] In this context, Williamson distinguishes three modes of public governance in connection with probity transactions: (i) full privatization, which represents a situation where the public sector is contracting out to private institutions; (ii) regulation, which represents a situation where public sector is contracting out to private institutions but maintaining a strong oversight; and (iii) public agency, which represents a situation where there is no contracting out and the tasks are perfomed directly by state organs. These three categories of the public sector do not correspond with their respective private law categories because of the long term and incomplete character of the probity transactions Ibid 315; D Ruiter, 'Is Transaction Cost Economics Applicable to Public Governance?' 20 *European Journal of Law and Economics* 2 (2005) 287–303.
[756] O Williamson (n. 694).

negative externalities and free riding that we have faced in recent years, and would also lead, as TCE demonstrates, to a strong cooperative adaptability of the Member States.

There are, however, significant economic shortcomings to this first proposal. According to TCE, this new system of governance would imply strong administrative controls and thus higher costs in terms of bureaucracy. Additionally, the plan implies a tendency toward economic centralization at the EU level, with new funding and competences and less space for national economic policies, hence in TCE terminology, weak autonomy of the Member States. In this sense, a number of commentators suggested that such an idea would significantly conflict with the fact that countries have divergent tastes regarding fiscal policies.[757] Specifically, it was pointed out how Member States feel "reluctant to mutualize fiscal resources or delegate decisions over national fiscal policies to the Commission and the European Parliament", since public finance and public spending "is intimately bound up with the details of each nation's culture and history".[758] A fully developed fiscal union would not olny require a significant technical effort to surrender autonomy in making economic policy decisions, but it would also require additional steps towards a complementary political union.[759]

On the other side of the spectrum rests the second and third governance schemes based on self-enforcing mechanisms. Both institutional arrangements present certain features akin to the market mode and others more akin to the hybrid mode. On the one hand, similar to the hybrid mode, they both represent an enduring exchange regime between entities regulating probity transactions. Both governance schemes also represent a relational contract concerning budgetary and economic policies between Member States and the European Union. On the other hand, similar to the market mode, both schemes rely on market mechanisms. The second alternative arrangement entirely based on market discipline is certainly more comparable to the market mode. As a result, it combines weak administrative control, hence lower costs of bureaucracy, with high-powered efficiency incentives leading to strong autonomous adaptability.

Additionally, this type of system would operate without the recourse to economic coordination, and thus without the need for hard budget constraints. Recent literature strongly supports this

[757] B Eichengreen, C Wyplosz, 'Minimal Conditions for the Survival of the Euro' 51 *Intereconomics - Review of European Economic Policy* 1 (2016) 24-28.
[758] Ibid 26.
[759] P De Grauwe, 'How to embed the Eurozone in a political union' VoxEU.org e-Book, 17 June 2010, (2010).

idea by maintaining that hard budget constraints are not always optimal because they can provide excessive incentives for high effort, and thus discourage investment that is socially efficient. In other words, a hard budget constraint can imply the opposite kind of inefficiency that emerges under a soft budget constraint, where the common pool problem can give rise to low effort and overinvestment.[760] From an efficiency and transaction costs perspective, this second system would therefore represent an optimal scenario in the context of the Eurozone. It would be certainly be more consistent with the fact that Member States have heterogeneuos fiscal policies, and it would combine low transaction costs with more budgetary flexibility allowed by the soft budget constraints, which could, in turn, encourage long-term efficient investments, such as investments directed towards research and education.

The third alternative arrangement based on the threat of termination, with specific reference to the possibility of suspension or expulsion from the monetary union, would represent a middle ground between the two systems outlined above. It would combine semi-strong administrative controls, thus medium administrative costs, with high-powered efficiency incentives. The alternative system would still require the economic benchmarks and institutions for monitoring and supervision as those provided by the SGP or the Fiscal Compact. The supervision process and its benchmarks would, however, be less detailed and invasive in the Member State's internal decision-making procedure because it would rely on self-enforcement.

On the other hand, precisely because such exit provisions would be automatic and drafted so as to facilitate self-enforcement, this alternative would imply as the market mode high-powered efficiency incentives. The combination of the two would lead to semi-strong autonomous and semi-strong cooperative adaptability. This combination could potentially provide an optimal trade-off between economic advantages of autonomy in connection with national economic policies, and economic advantages of integration in connection with economic coordination. This is because it implies a return to a model of national control of public finance as some strongly suggested.[761] This renationalization of fiscal policy would be consistent with the fact that fiscal policy has strong allocation and redistribution dimensions, which need to reflect national political preferences.[762] Additionally, such renationalization would be optimal also

760 B Besfamille and M Lockwood, 'Bailouts in Federations: Is a Hard Budget Constraint Always Best?' 49 *International Economic Review* 2 (2008) 577-593.
761 B Eichengreen and C Wyplosz (n. 760).
762 A Alesina and G Tabellini 'Bureaucrats or Politicians? Part I: A Single Policy Task', 97 *American Economic Review* 1 (2007) 169-179; also E Maskin and J Tirole, 'The Politician and the Judge: Accountability in Government', 94

where the combination of explosive growth in external government debt and taxes raised to the fiscal limit lead to a standoff. In such cases, in the absence of a federal government that can provide unlimited fiscal assistance to avoid a vicious cycle of fiscal perversity, a possible termination of the monetary union would ultimately be the only option available. Harsh conclusions arising from this exit could potentially be mitigated, as some suggested, with the removal of inherited debt overhangs.[763] Economic integration in the form of economic coordination would still play a significant role and could operate more effectively after the elimination of bailout expectations.

2.2 – LEGITIMACY CONCERNS

Any law implies some underlying social science. The European economic union is no exception, for it is embedded with certain economic theory. More specifically, as we have explained, the European economic constitution is subject to macroeconomic assumptions and ordoliberal ideas.[764] Therefore, the assessment carried out in the previous sections has been primarily economically oriented. Nevertheless, we also have to keep in mind that the unit of analysis still remains a legal system that cannot be assessed in strictly economic terms. As a result, any possible assessment cannot refrain from taking into account "justice", which is often considered the ultimate purpose of the law.[765] This is consistent with a specific strand of literature within the law and economics movement that believes that efficiency and justice are two side of the same coin.[766] In contrast with the other strand based on wealth maximization led by R. Posner, G. Calabresi claims that increased wealth cannot lead to a just society unless justice is also considered. According to Calabresi, "There is no trade-off between efficiency and justice, but instead that efficiency and distribution are ingredients of justice, which is a goal of a different order than either of these ingredients […] justice should be a veto on the pursuit

American Economic Review 4 (2004) 1034-1054. Both papers point to the conclusion that, albeit technical, fiscal policies are intrinsically redistributive and should therefore be made by elected representatives.

[763] B Eichengreen and C Wyplosz (n. 760).

[764] In connection with the original design of Maastricht see W Sauter (n. 370); more recently, in connection with the newly enacted reform see K Tuori and K Tuori, (n. 366).

[765] On the principle of justice and its different features in the field of law, see the well known work of J Rawls*, A Theory of Justice* (Cambridge, Mass, Belknap Press, 2005).

[766] G Calabresi, 'An Exchange: About Law and Economics: A Letter to Ronald Dworkin", 8 *Hofstra Law Review* 553 (1980).

of efficiency".[767] A similar approach is taken by the German ordoliberal school, which considers the dialogue between law and economics a dialogue between equal partners.[768]

Based on these considerations, in our case no effective and efficient institutional arrangement of economic governance can prevail or be accepted, unless the question of justice is also considered. However, as rules are directed toward states and not at individuals and within a complex quasi-federal system, justice should be more appropriately replaced with the term "legitimacy". This does not represent a mere theoretical exercise; because the EU lacks a robust democratic legitimacy of a nationstate, legitimacy is crucial for the popular and social acceptance of its economic institutions and policies.[769] This claim is also supported by the recent increased judicial involvement in the EMU by a number of European Courts.[770] As a result, in this section we will turn our attention to the question of legitimacy as the last of the criteria, in order to ultimately carry out an overall balancing exercise between economic effectiveness and efficiency, and legitimacy.

The term "legitimacy", as was the case with the term "efficiency", is largely indeterminate and needs to be defined. In the context of the European integration process, one of the most widely recognized definitions is provided by F. Scharpf. He distinguishes between input legitimacy, which refers to the degree of participation of the people in the decision-making process, and output legitimacy, which refers to the ability of institutions to deliver policies on behalf of the people.[771] Both types of legitimacy coincide with the long-standing problem of democratic deficit and accountability in the context of the European integration process.[772] A third interesting type of legitimacy was coined by J. Weiler, "mission legitimacy", which refers to the "foundational commitments of a particular state or political system, or the ideals for which it stands".[773]

---

[767] Ibid 558.
[768] S. Grundmann, (n. 369).
[769] J Weiler '60 Years since the First European Community: Reflections on Messianism' 22 *European Journal of International Law* 303 (2002).
[770] For a general survey see F Fabbrini, 'the eurocrisis and the courts judicial review and the political process in comparative perspective', 32 *Berkeley J of Intl L* 64 (2014).
[771] F Scharpf, 'Legitimacy Intermediation in the Multilevel European Policy', *MPIfG, Discussion Papers* (2012). In connection with the EMU and its system of governance see F Scharpf, 'Monetary Union, Fiscal Crisis and the Preemption of Democracy' *MPIfG Discussion Paper* (2011).
[772] See among many A Moravcsik, 'In Defense of the 'Democratic Deficit': Reassessing Legitimacy in the European Union', CES Working Paper No. 92 (2001); J Habermas, *The Crisis of the European Union. A Response* (Cambridge, Polity Press, 2012).
[773] G de Búrca, 'Europe's Raison d'être', NYU Law School public law & legal theory research paper series working paper NO. 13-09 (2013).

All three types of legitimacy play a significant role in the context of the economic union. First and foremost, input and output legitimacy are particularly relevant in connection with the principle of fiscal discipline, of which the system of coordination and fiscal rules has wide implications in the national sovereign sphere of Member States.[774] This is especially true after the recent set of reforms which, as we have seen, significantly increase the national implications. With regards to economic policy coordination, for instance, the new annual cycle of the European Semester has been highly criticized for allowing national budgets to be presented and discussed at the EU level before any activity is carried out at the national parliamentary level.[775] This affects, to a large extent, the degree of participation of national parliaments and the resulting input legitimacy of the system. More importantly, the reformed system of fiscal rules has constrained the budgetary prerogatives and powers of national parliaments with more strength and more visibility. For instance, many different legitimacy issues have to be raised in connection with the Fiscal Compact, concerning the relationship between constitutional law and its budgetary rules and requirements.[776]

For the same reasons, the new procedure of reverse qualified majority rule arising out of the Six Pack has been highly questioned.[777] More generally, it is the new constitutional balance between the EU and national sovereignty of Member States emerging from the entire reform that is controversial in terms of both input and output legitimacy.[778] We have seen how the entire direction of the reform accentuates centralization of the economic decision-making process while it undermines, at the same time, parliamentary scrutiny. This is provided by the rise of executive control via the European Council, the power of the "troika", and the new role of the ECB in the economic governance and its involvement in the sovereign debt crisis. In this sense, the ECB represents, in the absence of an equally effective European treasury, the "ideal dictator", as the only agent capable of taking decisive action.[779] This concept has also been

[774] M Dawson and F De Witte, 'Constitutional Balance in the EU after the Euro-Crisis', 76 *The Modern Law Review* 5 (2013) 817–844; A Hinarejos, *The Euro Area Crisis in Constitutional Perspective* (Oxford Oxford University Press 2015).

[775] On the legitimacy of the European Semester see M Hallerberg, B Marzinotto, G Wolff, 'How Effective and Legitimate is the European Semester? The increasing role of the European Parliament', *Bruegel Working Paper* 9 (2011); A Dukes, "Democratic Legitimacy and Accountability: The European Semester and the Irish Budget", *Institute of International and European Affairs* (2013).

[776] R Baratta, 'Legal Issues for the "Fiscal Compact": Searching for a Mature Democratic Governance of the Euro' in B de Witte, A Héritier and A Trechsel (eds), *The Euro Crisis and the State of the European Democracy* (Florence, European University Institute, 2013).

[777] See for this argument W. Van Aken, L. Artige, (n. 645).

[778] For this argument see M Dawson and F De Witte, (n. 777).

[779] W Streeck, 'Heller, Schmitt and the Euro', 21 European Law Journal 3 (2015) 361–370. This problem of legitimacy of the ECB actions was in fact among the main concerns in many interviews and speeches of the ECB

raised in the context of the OMT ruling of the German Constitutional Court by acknowledging that "the independence granted to the European Central Bank leads to a noticeable reduction in the level of democratic legitimation of its actions and should therefore give rise to restrictive interpretation and to particularly strict judicial review of the mandate of the European Central Bank."[780]

These questions of legitimacy concerning the principle of fiscal discipline and its system of coordination and fiscal rules have been mainly discussed in the literature. However, the questions of legitimacy concerning the measures of financial and monetary assistance have instead been tackled by a number of national and European courts.[781] As we anticipated, these measures created a broader system of risk sharing in order to preserve the Euro. At the same time, this new regime could be considered a possible amendment of the original structure of the European economic constitution, and accordingly, a possible infringement of the power and prerogatives of national parliament or of the current structure of the EU treaties.

In connection with these measures, the German Federal Constitutional Court (BVerfG) was among the most active and critical of all courts. In particular, during the peak of the sovereign debt crisis, the BVerfG was called to issue a temporary injunction against the financial aid loan to Greece of 2010 for its possible violation of the *Bundestag*'s budget autonomy. The Court rejected the issue of temporary injunction,[782] but eventually admitted the constitutional complaints insofar as they satisfied the strict requirements for showing the violation of a fundamental right, more specifically the violation of Article 38.1 of the Basic Law, as the fundamental right to participate in the democratic self-government of the people, together with the principle of democracy under Article 20 of the Basic Law and protected by the eternity

---

President. In one interview interview with the Süddeutsche Zeitung on the specific question as to whether "he speaks as the Chancellor of Europe?" Draghi replied, "I am communicating this message as the President of the ECB to all stakeholders, citizens, businesses and markets. Investors need a long-term vision because they undertake long-term commitments. For them, it is very important that our leaders and governments are determined to keep the euro irreversible. So, if I say this, I am saying what our political leaders are fundamentally saying." "So you are covering up the failure of politics?" Draghi replied: "Again, I am saying it because it is important to do so. Markets should know that the euro is irreversible. That helps them to properly price euro area assets and it helps us in the conduct of our monetary policy."

[780] BVerfG, Case No. 2 BvR 2728/13, 2 BvR 2729/13, 2 BvR 2730/13, 2 BvR 2731/13, 2 BvE 13/13. Press Release No. 34/2016 of 21 June 2016.

[781] Among many see Estonia Supreme Court, Constitutional Case No. 3-4-1-6-12, judgment of 12 July 2012. English translation is available at https://www.riigikohus.ee/en/constitutional-judgment-3-4-1-6-12; Fr. Cons. C., Décision n° 2012-653 DC, judgment of 9 August 2012. An English translation available at http://www.conseil-constitutionnel.fr/conseil-constitutionnel/english/case-law/decision/decision-no-2012-653-dc-of-9-august-2012.115501.html; Pt. Const. Ct., *Acórdão* N° 353/2012, judgment of 5 July 2012.

[782] See BVerfG, Case No. 2 BVR 987/10, May 7, 2010, 125 BVERFGE 385 (Ger.); BVerfG Case No. 2 BVR 1099/10, Jun. 9, 2010, 126 BVERFGE 158 (Ger.).

clause of Article 79(3).[783] In this decision, the Court clarified that these measures did not erode the German Bundestag's right to decide on the budget in a constitutionally impermissible manner, as they did not involve a burden on present or future federal budgets with disproportionately great commitments.

However, the Court also clarified that a limit still existed. More specifically, the Court strongly emphasized that "the *Bundestag* may not consent to an intergovernmentally or supranationally agreed automatic guarantee or performance which is not subject to strict requirements and whose effects are not limited, which – once it has been set in motion – is removed from the *Bundestag*'s control and influence." As a result, the Court set the legitimacy conditions for such present or future measure of risk sharing regime by affirming that "The *Bundestag* must specifically approve every large-scale measure of aid of the Federal Government taken in a spirit of solidarity and involving public expenditure on the international or European Union level [...] in addition it must be ensured that sufficient parliamentary influence will continue in existence on the manner in which the funds made available are dealt with". Therefore, in this decision, the Court, building on the cornerstones of its traditional arguments in the context of the European integration process, defined the boundaries of the German commitment around a number of rights which the Bundestag necessarily would retain, as the one to be informed, its involvement in the day-to-day operation of any financial measure, and more importantly its express approval.[784]

In the following cases of 2012, the German Court was specifically called to assess the constitutionality of the newly established EFSF and ESM. In the first case, the Court reviewed the legal position of the Bundestag members as well as the overall budgetary responsibility of the German Bundestag in connection with the EFSF.[785] The applicants submitted a claim against the German participation to the EFSF, because it violated the principle of democracy by allocating the exercise of rights of participation and information of the German Bundestag, for matters of particular urgency, to a body consisting of nine members of the budgetary committee. The Court upheld the claim, as it represented a disproportionate restriction of the rights of members of the Bundestag. More specifically, it expressly affirmed that only if the

[783] BVerfG, Case No. 2 BvR 987/10 - paras. (1-142) An English translation available at https://www.bundesverfassungsgericht.de/SharedDocs/Entscheidungen/EN/2011/09/rs20110907_2bvr098710en.html.
[784] See for a critical analysis and an overview of these decisions S Schmidt, 'Sense of Deja Vu: The FCC's Preliminary European Stability Mechanism Verdict', 14 *German Law Journal* 1 (2013) 11.
[785] BVerfG, Case No. 2 BVE 8/11 - paras. (1-162).

bond purchase occurred in the secondary market would there exist the reason of urgency and secrecy to justify the recourse to a special committee.[786]

A second legal battle concerned the involvement of the Bundestag in the negotiation of the ESM as well as the Euro Plus Pact. The Court once again emphasized the full involvement of the Bundestag by affirming that the government needs to provide "early and comprehensive information" of its intention to the Bundestag as soon as the government negotiates with third parties.[787] A third legal proceeding directly challenged the German ratification of three main legal instruments arising from the crisis: the amendment of Article 136 TFEU, the Treaty establishing the ESM, and the Fiscal Compact.[788] The Court was called to decide on a temporary injunction albeit submitting the ratification. The crucial point of the proceeding was whether these instruments created an unlimited financial obligation for Germany. In its decision, the Court rejected the claims for an injunction by maintaining that the overall budgetary autonomy of the Bundestag was not prejudiced by the signing of these instruments.

However, it allowed the ratification on two conditions already established in its precedents. First, the Bundestag and the Bundesrat would need to be sufficiently informed. Second, "every large-scale federal aid measure" would need to be approved by the Bundestag. The Court thus excluded an interpretation of the ESM according to which it was allegedly possible to establish payment obligations for Germany that exceeded the maximum limit expressly fixed by its Treaty without a prior agreement of the German representative. It was pointed out that the judgment saw a return to substantial openness regarding the future development of the Monetary Union against the backdrop of eternity clause of the Basic Law as a promising judicial realignment.[789]

The Court reaffirmed all the conditions developed over the course of these decisions in the following judgment,[790] but it did not address the central issue of whether the Eurozone rescue measures were prohibited as a possible bailout. On this, the European Court of Justice was

[786] For a critical analysis of the last decision see H Deters, 'National constitutional jurisprudence in a post-national Europe: The ESM ruling of the German Federal Constitutional Court and the disavowal of conflict', 20 *European Law Journal* 2 (2014) 204–218.
[787] BVerfG, Case No. 2 BVE 4/11, Jun. 19, 2012 (Ger.).
[788] BVerfG, Case No. 2 BvR 1390/12 et al., Sept. 12, 2012 (Ger.)
[789] M Wendel, 'Judicial Restraint and the Return to Openness: The Decision of the German Federal Constitutional Court on the ESM and the Fiscal Treaty of 12 September 2012', 14 *German Law Journal* 21 (2013).
[790] BVerfG, Case No. 2 BvR 1390/12 - paras. (1-245); english translation provided by the Court and available at http://www.bundesverfassungsgericht.de/SharedDocs/Entscheidungen/EN/2014/03/rs20140318_2bvr139012en.html.

called to decide on a preliminary reference from the Irish Supreme Court with particular regards to the Decision 2011/199 which amended the TFEU by adding a third paragraph in Article 136 TFEU. According to the claimant, the decision represented an unlawful amendment of the Treaty, and created financial obligations incompatible with the Treaties, particularly about the prohibition of monetary financing and the no-bailout clause.[791] The case was centered on two main issues. The first question was essentially procedural, as the Court was asked to verify that the procedural rules laid down in Article 48(6) TFEU for adopting a simplified revision of the Treaty were followed. Moreover, the Court had to verify whether the amendment concerned solely provisions of Part Three of the Treaty as required for a simplified decision. The Court clarified that the decision could not be considered as affecting or increasing the Union's competence in matters of monetary policies or economic policies because the amendment was merely designed to confirm that the Member States were entitled to conclude the ESM Treaty and to ensure its compliance with EU law. As a result, the Court found that the conditions for the validity of the Decision had been met, including the fact that the ESM Treaty could be concluded and ratified before the entry into force of the decision.[792]

The second major question concerned the compatibility of the ESM Treaty with the EU Treaty and particularly with the prohibition of monetary financing and the no-bailout clause. With regards to the first compatibility, the ECJ rejected the violation first, by interpreting the prohibition as addressed to the ECB and central banks rather than directly to Member States; and second, by noting that the funds provided by the ESM might be derived from financial instruments prohibited by Article 123 TFEU. As for the second compatibility, the ECJ held that Article 125 TFEU had the purpose of prohibiting financial aid that reduces the incentive of a Member State to carry out sound budgetary policy. In the view of the Court, the ESM does not reduce such incentives because any financial support is subject to strict conditionality and it is only granted in case of limited cases of emergency, which can prejudice the stability of the Eurozone. Furthermore, the Court added that the purchase of government bonds on the primary markets or even on the secondary markets would not make the ESM responsible for the debt of

[791] See Case C-370/12 Pringle v. Government of Ireland, Ireland and the Attorney General, judgment of 27 Nov. 2012; for a critical analysis B De Witte and T Beukers, 'The Court of Justice approves the creation of the European Stability Mechanism outside the EU legal order: Pringle' 50 *Common Market Law Review* 3 (2013) 805–848; P Craig 'Pringle and Use of EU Institutions outside the EU Legal Framework: Foundations, Procedure and Substance' 9 *European Constitutional Law Review* 2 (2013) 263-284.

[792] P Van Malleghem, 'Pringle: A Paradigm Shift in the European Union's Monetary Constitution', 14 *German Law Journal* 1 (2013).

a Member State. The financial assistance would still have the effect of creating new debt for the beneficiary state.

These legal challenges have been raised once again in connection with the last of these financial measures: the OMT program. The questions were very similar to the one raised in connection with the ESM since, as explained by the judges of the German Constitutional Court, the substance of the two programs is in fact 'functionally equivalent'. The claimants ultimately challenged, *inter alias*, the constitutionality of the participation of the German Bundesbank in the implementation of the OMT decision, and the omission by the German Government to bring an action for annulment before the European Court of Justice concerning the OMT program.[793]

The German Constitutional Court upheld some of the legal arguments, and as a result, questioned the legality of the OMT program under both German and EU law. First, the BVerfG challenged the compatibility of the OMT within the scope of the mandate of the ECB under the Treaty (Articles 119 TFEU and 127(1) and (2) TFEU) as well as under the ECB statute (Articles 17 to 24 of Protocol (No 4) on the Statute of the ESCB and of the ECB). According to the Court, the OMT could be considered an economic policy measure rather than a monetary policy measure. More specifically, based on four aspects of the program (conditionality, selectivity, parallelism and circumvention), the Court maintained that the OMT could constitute an *ultra vires act* in breach of the powers attributed to the ECB.

Second, according to the BVerfG, the OMT might have circumvented the prohibition of monetary financing under Article 123(1) TFEU. The Court pointed out various technical features of the program, such as the pari passu treatment and the possible unlimited purchase, to show that high financial risks would be shared among the Member States, and, accordingly, this could constitute a substantial circumvention of the prohibition laid down in Article 123(1) TFEU. As a result, the Court, for the first time in its history, requested a preliminary ruling under Article 267 TFEU from the ECJ, concerning the compatibility of the OMT decision with the TFEU.[794] In particular, the two legal questions outlined above were raised before the ECJ. The first question concerned the possible infringement of the monetary policy mandate of the

[793] BVerfG, Case No. 2 BvR 2728/13, English translation provided by the Court and available at http://www.bundesverfassungsgericht.de/SharedDocs/Entscheidungen/EN/2014/01/rs20140114_2bvr272813en.html.

[794] For a different analysis of the case and of the decision, see the articles of special issue of the German Law Journal (15 German Law Journal 2 2014) to the OMT decision of the German Federal Consitutional Court. In particular see *inter alias* U Di Fabio, 'Karlsruhe Makes a Referral' 15 *German Law Journal* 2 (2014).

ECB through the OMT program. The second question concerned the compatibility of the OMT program with the prohibition of monetary financing enshrined in Article 123 (1) of the TFEU.[795]

The ECJ issued its final ruling in June 2015, which substantially upheld the arguments of the Advocate General.[796] Concerning the first question, the Court, similar to the Advocate General, affirmed that any bond buying measure needs to be proportional to the objectives of the monetary policy and, that, in this sense, the economic and monetary reasoning provided by the ECB for the adoption of the program were sound. The emergency economic situation and the broken monetary transmission on the one hand and the fact that the program was conditioned and limited on the other hand, were crucial in concluding that the OMT program did not infringe upon the principle of proportionality and the mandate of the ECB under the Treaty and the Statute.

Regarding the second question, the Court acknowledged that according to Article 123(1) TFEU, not only the purchase of government bonds on secondary markets but also other type of purchases having the same equivalent effect are prohibited. According to the Court, sufficient safeguards must be built into the implementation of the program to avoid the prohibition of such monetary financing. However, the Court observed that such safeguards were present in the draft decision and guidelines of the ECB where a minimum period is observed between the issue of a security on the primary market and its purchase on the secondary market, and that no prior announcement will be made concerning any decision to carry out government bond purchases. Ultimately, the Court interpreted Articles 119 TFEU, 123(1) TFEU and 127(1) and (2) TFEU, as well as Articles 17 to 24 of Protocol (No 4) on the Statute of the ESCB and of the ECB, as permitting the ESCB to adopt a program for the purchase of government bonds on secondary markets, such as the OMT program.

The case eventually went back to the BVerfG for a final decision on the constitutionality of the measure. The Court, in its judgement on June 2016, substantially recognized both interpretations provided by the ECJ, and, and as a result, rejected the constitutional claims.[797] The Court, however, particularly stressed the importance of the features adopted by the Court

[795] BVerfG, Case No. 2 BvR 2728/13 - paras. (1-24) (English version). See more generally Editorial Comments, 'An unintended side-effect of Draghi's bazooka: An opportunity to establish a more balanced relationship between the ECJ and Member States' highest courts' 51 *Common Market Law Review* 1 (2014).
[796] Case C-62/14 Peter Gauweiler and Others v Deutscher Bundestag, ECLI:EU:C:2015:400 [2015].
[797] BVerfG, Case No. 2 BvR 2728/13, 2 BvR 2729/13, 2 BvR 2730/13, 2 BvR 2731/13, 2 BvE 13/13. Press Release No. 34/2016 of 21 June 2016; english translation provided by the Court and available at https://www.bundesverfassungsgericht.de/SharedDocs/Pressemitteilungen/EN/2016/bvg16-034.html.

of Justice to support the legality of the program, and expressly made any implementation of the program by the German Bundesbank subject to the respect of six conditions: (i) the bond purchases must not be announced by the ECB; (ii) the volume of the purchases must be limited from the outset; (iii) there must be a minimum period between the issue of the government bonds and their purchase by the ESCB that is defined from the outset and prevents the issuing conditions from being distorted; (iv) the ESCB must only purchase government bonds of Member States that have bond market access enabling the funding of such bonds; (v) only in exceptional cases must purchased bonds be held until maturity and (vi) purchases must be restricted or ceased and purchased bonds must be remarketed should continuing the intervention become unnecessary. It is important to note that all these conditions were clearly present in the decision of the ECJ but they were mostly indirect "conditions" for the legality of the program. The BVerfG essentially made explicit what was implicit in the ECJ decision.

The decision in Gauweiler is significant for many aspects of EU law. The connection between national courts and the ECJ under the preliminary reference procedure is one of them.[798] The decision is mostly significant in respect to the different interpretation of the power of the ECB between the ECJ and the German Constitutional Court. What is important to underline here is not the different interpretative standpoints of the two courts, where the ECJ, on the one hand, was more monetarily oriented, considering the OMT strictly linked to the objective of monetary policy transmission, while the BVerfG was more economically oriented, in terms of the impact of OMT on interest rate spreads[799]. What is important instead is the underlying reasoning behind these different decisions. In particular, as pointed out by other authors, the difference is essentially based on two different perceptions of the independence of the ECB.[800] The two courts, in this sense, significantly differs where the BVerfG is less deferent to the judgment of the ECB and strictly applies its power of judicial review, particularly in case of reviewing non-standard measures; while the ECJ explicitly practices judicial restraint in reviewing actions and decisions of the ECB. There is much evidence of these different practices. Ultimately, these two rulings reflect two different visions of the European economic constitution: a constitutional tension between national and supranational economic interests that have not been settled yet.[801]

---

798 See especially P Craig. and M Markakis, 'Gauweiler and the Legality of Outright Monetary Transactions' 41 *European Law Review* 1 (2016).

799 Ibid.

800 V Borger, 'Outright Monetary Transactions and the stability mandate of the ECB: Gauweiler' 53 *Common Market Law Review* 2 (2016).

801 See on this point, D Adamski, 'Economic constitution of the Euro area after the Gauweiler preliminary ruling' 52 *Common Market Law Review* 6 (2015), 1485.

From all the considerations expressed above, we understand that both the measures imposing fiscal discipline as well as those preserving the irreversibility of the Euro present many questions of legitimacy. These questions refer to the possible violation of national constitutional rights as well as to the possible infringement of the EU Treaty. In order to respond more generally to these issues and ensure democratic legitimacy and accountability of the current economic union, we saw that from a judicial standpoint, national courts and the ECJ insisted on the budgetary prerogatives of national parliaments. From a legislative side, the EU also recently moved in this direction through a larger involvement of the European Parliament and of national parliaments in the European economic governance process.[802] Already the Lisbon Treaty significantly strengthened the powers of the European Parliament, as well as of the national parliament, in connection with the EU legislative process. However, the Treaty did not provide an equal increase of powers in the area of economic governance. The Four President Report urged to complete the process by involving both the European Parliament and national parliaments on the recommendations adopted in the context of the European Semester.[803] The following Five President Report developed this concept more extensively by suggesting in particular the extension of European Parliament cooperation with the Eurogroup and the extension of the plenary debate on the AGS both before and after it is issued by the Commission, as well as on CSR. It also suggested a more systematic interaction and consultation between the Commission and national parliaments concerning CSRs, national budgets, and NRPs.[804]

Parliamentary control is certainly critical in strengthening democratic legitimacy, but it alone is not sufficient. First, it would not tackle the accountability issue, as the decision related to economic policies would still be hidden within the multilevel decision process. Second, this approach would not deal with the output legitimacy issue. In this sense, it was prominently pointed out that the entire economic governance can be considered a disaster from this point of view, with the rising rates of unemployment, massive real-wage cuts, and rising social inequality.[805] This was already recognized by Hirschman, who generally opposed the prescriptions of orthodox monetary policies in the postwar economies of Western Europe for being “politically naïve, socially explosive, and economically counterproductive from any long run point of view”.[806] Moreover, the progressive strengthening of this guidance and surveillance

[802] European Commission (n. 669).
[803] Four President Report (n. 352) 16.
[804] Five President Report (n. 360) 17-18.
[805] F Scharpf, (n. 774) 36.
[806] A Hirschman (n. 29) 5.

system has significantly armed the so-called ‘European Social Model’.[807] This brings us to the third question of mission legitimacy as the politics of austerity failed in terms of economic perspective, but also in undermining one of the main EU’s raison d’être. These policies have prevented Europe from offering a third alternative between laissez-faire capitalism and managed socialism.[808]

Of the three alternative arrangements outlined in the previous chapter, only the second and third alternatives based on market mechanism would truly improve both input and output legitimacy, while respecting at the same time the prerogatives of democratically elected governments. On the one hand, input-oriented democratic legitimacy requires the possibility of politically meaningful choices, thus excluding situations of external enforcement as under the present structure or under rigid centralization according to the first alternative arrangement. Both the second and third alternative arrangements would imply a return to a model of national decision making and control of public finance. On the other hand, output legitimacy requires more economic flexibility in order to avoid the negative effect of pro-cyclical policies, which ultimately impede the ability of institutions to deliver policies on behalf of the people. Both the second and third alternative arrangements provide such flexibility through market mechanism and self-enforcement.

The third alternative governance arrangement would also have a solid legal basis anchored on the principle established in the famous *Maastricht Urteil* decision of the German Constitutional Court.[809] In its decision, the Court for the first time held its right for *ultra vires* control over the European integration process in order to ultimately assess whether the transfer of power or loss of influence from the Federal Parliament to the European Union complied with the principle of democracy. In this view, the Court evaluated the EMU and stressed the idea that monetary union represented a community of stability (“*Stabilitdtsgemeinschaft*”) anchored on the respect of both monetary and fiscal discipline.[810] On the basis of this concept, the Court clarified that

[807] F Scharpf, ‘The European Social Model: Coping with the Challenges of Diversity’, 40 *Journal of Common Market Studies* 40 (2002) 645-670; C Kilpatrick and B De Witte ‘Social Rights in Times of Crisis in the Eurozone: The Role of Fundamental Rights’ Challenges’, EUI Working Paper LAW 2014/05 (2014).
[808] G de Búrca (n. 776).
[809] BVerfG, Case No. 89, 155 of 12 October 1993; english translation provided by the Court and available at: http://www.bverfg.de/en/decisions/rs20120912_2bvr139012en.html. A first commentary concerning the EMU aspects of this decision was written by R Smits, ‘A Single Currency for Europe and the Karlsruhe Court’ 1 Legal Issues of European Integration (1994) 115–33.
[810] J Baquero Cruz, ‘The Legacy of the Maastricht-Urteil and the Pluralistic Movement’ 14 European Law Journal 4 (2008) 389–422.

the Treaty did not create an unconditional and irreversible process regardless of the decision-making power of the German parliament. According to the Court, Member States were still "the Masters of the Treaties", and as a result, if the Treaty failed to offer sufficient guarantees for the maintainance of stability, Germany could be authorized to withdraw from the Community. In the literature, it was pointed out that the importance of the decision goes beyond EMU, for it provides for a doctrine based on the democracy requirement for the legitimacy of the participation of Germany in European integration proccess.[811] The same argument came into play in the recent decision *Lisbon Urteil* of the German Constitutional Court. [812] In particular, the Court found that the EU, as designed by the Lisbon Treaty, is not a federal state, and that constitutional safeguards of national identity clearly exist under EU law. While pronouncing in favor of the constitutionality of the Treaty, the Court insisted on German active participation so as to retain sufficient political, economic, cultural, and social prerogatives for the sake of preserving democracy.

Ultimately, these alternative institutional arrangements would also be able to restore the mission legitimacy of the EMU: the EU's capacity to provide its Member States and citizens with collective power and coordinated problem-solving capabilities, and to offer an alternative socio-economic model to what exists today.

---

[811] R Lastra and J Louis (n. 71) 15.

[812] BVerfG, Case No. 2 BvE 2/08 of 30 June 2009; english translation provided by the Court and available at: http://www.bverfg.de/en/decisions/rs20120912_2bvr139012en.html.

CONCLUSION

From the historical overview of the first chapter, we see that the system of European monetary and economic coordination has developed over time in parallel to the growing economic interdependence among the Member States. In its initial phase, monetary and economic coordination followed two different paths. With the EEC Treaty, European states adopted a regional approach, whereas with the European Payment Union, they adopted a more international approach. It is interesting to note that both instruments were conceived and drafted for the purpose of minimizing transaction costs. Additionally, we understand that coordination of economic and monetary policies was much more effective and efficient under the EPU than under the EEC. We argued that one of the main reasons for this was its self-enforcing nature, based on a mix of high incentives and binding rules.

The second phase saw the implementation of the Treaty of Rome. In this period, the regional approach became dominant, while the discourse moved to the dispute between the monetarist and the economist schools. The different proposals, from the Marjolin report up to the Werner report, did not take a resolute position between the two schools but rather followed a parallel approach, with both approaches pursued at the same time. This phase also saw the first disconnection between economic and monetary policies with the establishment of the Exchange Monetary System. The system was able to promote monetary stability for a certain time, but it was unable to convince the financial markets of its inner stability and permanent nature. As a result, the system broke down under a series of speculative attacks in the financial markets. These events, together with the adoption of the single market program in 1986, led to the establishment of the EMU.

The EMU, primarily based on the new Delors Report, adopted a different approach than the previous proposals had. On the one hand, monetary policies became centralized, through a process of progressive monetary integration up to the adoption of the single currency. On the other hand, economic policies remained decentralized within a system of convergence criteria and a framework of coordination and assessment of short-term and medium-term economic developments. The system was complemented with a separate agreement, the Stability and Growth Pact, as an additional safeguard for fiscal discipline. The crisis dramatically reshaped the entire economic governance of the Euro area, for it exposed the ineffectiveness of this system to promote fiscal discipline and consolidation. As a result, the EU approved, through a number of different legal measures, a reformed structure of economic governance.

From this historical overview we understand that two themes are always present in the EMU integration process. First, the role played by European institutions to solve coordination problems and to induce or enforce credible commitments. Second, the role of European institutions in minimizing transactions costs. While this first issue is related to the concept of effectiveness, the second element deals with the concept of efficiency. Both elements are crucial in the development of the economic and monetary union and they have been taken into consideration when examining alternative institutional arrangements.

In the second chapter we saw that the actual structure of the EMU is essentially based on two main common principles: fiscal discipline and the irreversibility of the Euro. This has not been reversed by the recent institutional amendments following the sovereign debt crisis. Fiscal discipline, as the requirement to maintain a balanced budget and a sustainable level of public debt, represents one of the core principles arising out of the legal and economic framework of the Monetary Union. We explained that before the recent reform of governance, fiscal discipline was carried out under a system of soft form of economic policy coordination. Peer pressure was the central element in connection with the marcoeconomic dialogue, as well as with the convergence criteria under the Treaty and the budget constraints under the SGP. Fiscal discipline was essentially carried out through self-commitment and peer pressure, pushing toward structural reforms and fiscal adjustments in the shadow of the procedure. After the sovereign debt crisis, the EU departed from such a soft approach and moved toward a higher level of fiscal of coordination towards fiscal disicpline. The macroeconomic dialogue was revised to a more stringent *ex-ante* guidance and control. The recent reform also greatly reinforced the system of budget constraints and external enforcement. In the last few years, however, we also attend to a slightly reverse approach in order to provide some sort of flexibility given the harsh economic context. In this sense, the Commission decided to put a greater emphasis on flexibility and social issues than before.

The irreversibility of the Euro represents the second core principle arising out of the legal and economic framework of the Monetary Union. It was enshrined in the Maastricht Treaty and was interpreted not only in support of the idea that the entire monetary union process cannot be reversed, but also that each single country is not allowed to leave the monetary union once it enters under any circumstances. As a matter of fact, we explained that there is no legal provision allowing the exit from the EMU. The irreversibility of the Euro was, for a long time, a merely theoretical and legal concept. The sovereign debt crisis changed this perception, however, and showed that the plain language of the Treaties was not able to demonstrate to the financial markets the unconditional and irrevocable commitment by the Member States to the preservation of the monetary union. In his London speech, the ECB President clarified that only concrete actions could have demonstrated such commitment and anticipated some of the concrete measures that followed. First, the ECB adopted its Outright Monetary Transactions program (OMT) for the purchase of sovereign bonds of Member States under financial distress with more flexibility than previous programs. Additionally, the Member States of the Eurozone created a mechanism of financial assistance, the European Stability Mechanism (ESM), which could provide direct funding to Member States and banks facing financial difficulties. Both programs of financial and monetary assistance created a new system of risk sharing, although under the conditionality requirement, which represents the trade-off between financial assistance and public reforms of fiscal consolidation. In this sense, they are considered as having amended the original structure of the European economic constitution, according to which only the national level carried out redistributive policies, while the supranational level mainly pursued economic efficiency and undistorted completion. This new framework of risk sharing is also considered as paving the way for the possible new role of the ECB as lender of last resort (LOLR).

The definition of these two pillars is functional to the normative assessment of the last chapter for many reasons. First, as a reference point, in order to test the effectiveness of both the current and the alternative regimes. Second, this two principles allow us to better clarify the conflict between the two, as well as the core foundamental problems affecting the operation of the EMU. As a result, in the last chapter, we have then turn our attention to evaluate the current legal structure of the European Monetary Union in order to assess and understand its success, and explore possible alternative institutional designs which could be more effective in achieving its objectives and, at the same time, be potentially more efficient and legittimate.

First and foremost, in our effectiveness assessment we have pointed out how both the old system, as well as the revised system of governance, has been rather ineffective to promote fiscal discipline in particular. More specifically, while it is true that, after the recent reforms, to some extend national ownership increased and the Euro was ultimately preserved, fiscal discipline and consolidation at large is still lacking. We pointed to empirical data on public debt and consolidation, but also to economic growth that is among the main objectives of the system of governance. Austerity measures have critically worsened the economic situation in the aggregate and the ratio on which deficit and debt are calculated. As a result, we argued that the problem rests in the basic structure of the system. The sovereign debt crisis in particular revealed a number of dramatic contradictions in its fundamental structure, which, despite its recent reform, is clearly dated as it reflects late 80s' conventional wisdom, while economic and political conditions have changed considerably since that time. First and foremost, the crisis underlined the enduring conflict between intergovernmentalism and functionalism within the Economic and Monetary Union. This translates into the conflict between the need to ensure coordination and considency between monetary and budgetary policy within the current structure of the EMU, where monetary policies are delegated to a supranational institution while fiscal policies rest in the hands of Member States. Second, the current structure of the EMU is internally inconsistent, because it generated, both before and after the crisis, an expectation of bailouts despite the plain and clear language of the Treaty. The crisis therefore revealed an internal tension and inconsistency between the two common principles, fiscal discipline on the one hand and irreversibility of the Euro on the other hand. This tension significantly increased after the recent reform, as the new framework of risk sharing significantly fosters such bailout expectations. While the Maastricht approach had given equal weight to fiscal rules and market discipline, the reformed design reacted by weakening market discipline.

This brings us to the third and more fundamental contradiction of this system, the contradiction between its regime of fiscal rules and the principle of national sovereignty. We saw that budget constraints did not work because policies contrary to these fiscal rules are usually spending policies, which may hold popular support and are in the interest of government officials to pursue. In the same way, external enforcement and direct sanctions in a context of sovereign states and, especially in the area of economic policy-making, are also ineffective. Overall, we argued that the current Economic Union's structure is indeed unfit to equally preserve the irreversibility of the Euro and at the same time induce fiscal discipline and economic growth.

To respond to this contradiction, and to design a more effective system, we maintained that the fundamental challenge to meet is addressing the problem posed by the lack of positive incentives or by the misalignment of incentives in the current structure. The reform, in particular, failed to address the lack of spontaneous enforcement, and accordingly, the lack of *ex ante* incentives for Member States not to breach the rules in the first place. Incentive compatible rules are in fact limited in presence in the current legislation. The current incentives under the system are indeed not automatic and the amount of funds available to incentivize Member States is not clearly sufficient given the limited EU budget.

We therefore relied on a theoretical framework that is able to capture game theoretical aspects within a contractual setting: contract theory. According to contract theory, agreements like the SGP or the Fiscal Compact present two distinctive features: they are incomplete, and they are long-term in nature. These two contractual features were fundamental to our analysis.

A first possible solution to tackle the lack of incentives could be through fiscal integration and centralized control, which, in certain cases, the optimal allocation of ownership and control. A wider European budget would certainly imply a more effective system for fiscal discipline and serve as an automatic fiscal stabilizer. Both the Four President Report and the Five President Report went in this direction by suggesting the need for a common macroeconomic stabilization system, and discussed the idea of a European treasury, responsible for the necessary assessments of national budgets.

A second and third possible solution would instead tackle, at the contracting stage, the misalignment of incentives of the current structure, not through integration, but rather through market mechanisms. Both contract theory, general economic theories on sovereign debt and political economic of law all agree from different standpoints that a self-enforcing arrangement constitutes a more effective enforcing structure in a setting where moral hazard is present and a proper external enforcement is necessarily limited or lacking completely. In the context of the EMU, there are two possible self-enforcing mechanisms. A second alternative arrangement is based on market discipline. However, we noted that having a system purely based on moral hazard and market discipline without the recourse to economic coordination could eventually be ineffective as revealed by the sovereign debt crisis. Additionally, market discipline operates only as a complementary method.

A third alternative arrangement is based on the threat of termination. The majority of the literature on self-enforcing agreements and on the sovereign debt, in particular, sees the threat of termination of the business relationship as the most effective self-enforcing device in similar cases. It would strengthen and restore market discipline, the threat of termination would operate as a pure self-enforcing devise based on the loss of the discounted future expected profit stream arising from the termination of the monetary union regime. Under such an agreement, each Member State could unilaterally understand, as a costs and benefits analysis, whether it would be more beneficial to remain in the union or to leave it.

We presented two forms of self-enforcing devices based on termination. A first option could be a unilateral and/or negotiated withdrawal from the EMU, similar to the one provided under Article 50 TEU. A second option could be suspension or expulsion from the monetary union. Both options would require an explicit Treaty amendment, as elaborated on before. We pointed out that, in order to be effective, the possible suspension or expulsion from the monetary union would need to be automatic and drafted so as to facilitate self-enforcement. Contract theory gave us support in the explanation that it is possible to build self-enforcing mechanisms so that termination is never an optimal solution for the Member State. In this sense, contract terms can operate on the left side of the equation, thus by reducing short-term gains, or on the right side of the equation, by increasing the discounted future expected profit. We mentioned the possibility, in our scenario, to reduce the short-term gains by making it mandatory for the Member State to remain for a number of years within the exchange rate mechanism, the ERM II, under the condition that no devaluation can occur on the Member State's initiative.

In the next sections, we evaluated the different alternatives outlined before according to both efficiency and legitimacy standpoints. First, we employed Transaction Cost Economics to identify and understand their distinctive strengths and weaknesses in terms of efficiency, by comparison to the private governance modes designed by TCE literature. More specifically, we suggested that hierarchy could correspond to the first alternative arrangement involving strong cooperative adaptability of the Member States, but also strong administrative controls and thus higher costs in terms of bureaucracy. This arrangement would also imply a tendency toward economic centralization at the EU level, which would significantly conflict with the fact that countries have heterogeneuos tastes regarding fiscal policies. Alternately, with features of the market and of the hybrid mode, the second and third governance schemes represent a relational contract concerning budgetary and economic policies between Member States and the European Union. The second alternative arrangement combines weak administrative control, hence lower costs of burocracy, with high-powered efficiency incentives, leading to a strong autonomous adaptability. From an efficiency and transaction costs perspective, this second system would represent an optimal scenario in the context of the Eurozone. The third alternative arrangement would combine semi-strong administrative control, thus medium administrative costs, with high-powered efficiency incentives. The combination of the two would lead to semi-strong autonomous and semi-strong cooperative adaptability. This combination could potentially provide an optimal trade off between economic advantages of autonomy in connection with national economic policies, and economic advantages of integration in connection with economic coordination.

From a legitimacy standpoint, we pointed out that of the three different alternative arrangements outlined in the previous chapter, only the second and third alternative based on market mechanism would truly improve both the input and the output legitimacy while respecting the prerogatives of democratically elected governments. On the one hand, input-oriented democratic legitimacy requires the possibility of politically meaningful choices, thus excluding the situation of external enforcement as under the present structure, or under rigid centralization according to the first alternative arrangment. Both the second and third alternative arrangements imply a return to a model of national decision-making and control of public finance. On the other hand, output legitimacy requires more economic flexibility in order to avoid the negative effect of pro-cyclical policies, which ultimately impede the ability of institutions to deliver policies on behalf of the people. Both the second and third alternative arrangements provide such flexibility through market mechanisms and self-enforcement.

Ultimately, we can conclude that the first two alternatives present relevant shortcomings. Centralization of fiscal policies as the model recently proposed by the Five President Report and the Commission could solve the effectiveness problem through a larger EU budget and increased binding powers. At the same time, it is rather inefficient from a transaction standpoint and impractical from both a political standpoint and a legitimacy standpoint. This alternative scenario would make sense only is Member States were able to develop homogeneity of preferences as the optimal currency area theory explains, thus once the integration process is complemented with the necessary steps for a political union.

The second alternative arrangement purely based on market discipline would be very efficient from a transaction costs standpoint and it would be able to improve both the input and the output legitimacy while respecting the prerogatives of democratically elected governments. However, we also pointed out that it would fail the effectiveness test as it failed the EMS before.

The third alternative governance arrangement based on the withdrawal or expulsion from the Monetary Union seems to be the only arrangement able to be both effective and efficient, and flexible enough to respect the budgetary prerogatives and power of Member States. The third alternative would also have solid legal basis anchored on the foundational principle of participation as outlined by the German Constitutional Court, Ultimately, we pointed out that this alternative institutional arrangement would not only imply a better input and output legitimacy, but it would also be able to restore the mission legitimacy of the EMU. If the EU is able to solve the present constitutional and economic crisis through an alternative system of coordination, it could also show, through its new problem-solving capability, a possible and alternative socio-economic model to those existing today.

LIST OF THE MAIN ABBREVIATIONS

AGS – Annual Growth Survey

AMR – Alert Mechanism Report

BEPG - Broad Economic Policy Guidelines

BVerfG – German Federal Constitutional Court

CAP – Common Agricultural Policy

CSR – Country Specific Reccomandations

ECB – European Central Bank

ECJ – European Court of Justice

ECSC – European Coal and Steel Community

EDP – Excessive Deficit Procedure

EEC – European Economic Community

EFB – European Fiscal Board

EFTA – European Free Trade Area

EIP – Excessive Imbalance Procedure

EMS – European Monetary System

EMU – European Monetary Union

EPU – European Payment Union

ERM – Exchange Rate Mechanism

ES – European Semester

ESM – European Stability Mechanism

IDR – In-depth review

IMF – International Monetary Fund

LOLR – Lender of Last Resort

MIP – Macroeconomic Imbalance Procedure

MSP – Multilateral Surveillance Procedure

MTO – Medium Term Objective

NRP – National Reform Program

OCA – Optimal Currency Area

OMC – Open Method of Coordination

OMT – Outright Monetary Transactions

SCP – Stability and Convergence Programs

SGP – Stability and Growth Pact

SMP – Securities Market Program

TCE – Transaction Cost Economics

TEU – Treaty on the European Union

TFEU – Treaty on the Functioning of the European Union

BIBLIOGRAPHY

Litterature (alphabetical order)

V Acharya, I Drechsler, and P Schnabl, 'A Pyrrhic Victory? - Bank bailouts and sovereign credit risk' NBER Working Paper, 17136 (2012) available at http://pages.stern.nyu.edu/~sternfin/vacharya/public_html/pdfs/ADS_4april2013.pdf.

D Adamski, 'Economic constitution of the Euro area after the Gauweiler preliminary ruling' 52 Common Market Law Review 6 (2015).

J Ainslie, D Price, Schuman or Monnet? the real Architect of Europe (Regina, Bron Communications, 2003).

A Alesina and G Tabellini, 'Rules and discretion with non-coordinated monetary and fiscal policies', 25 Economic Inquiry 4 (1987) 619-630.

A Alesina and G Tabellini 'Bureaucrats or Politicians? Part I: A Single Policy Task', 97 American Economic Review 1 (2007) 169-179.

C Allsopp and M Artis, 'The assessment: EMU four years on' 19 Oxford Review of Economic Policy 1 (2003) 1-29.

C Altavilla, D Giannone and M Lenza, 'The Financial and Macroeconomic Effects of the OMT Announcements' CSEF working paper 32 (2014).

K Armstrong, 'The Lisbon Agenda and Europe 2020: From the Governance of Coordination to the Coordination of Governance', in P Copeland, D Papadimitriou (eds), The EU's Lisbon Strategy: Evaluating Success, Understanding Failure (Basingstoke, Palgrave Macmillan, 2012).

F Amtenbrink, J De Haan, C.H.M. Sleijben, 'Stability and Growth Pact: Placebo or Panacea?' 8 European Business Law Review 9 (1997) 202-210.

F Amtenbrink and J De Haan, 'Reforming the stability and growth pact', 31 European Law Review 3 (2006) 402-413.

D Andrews, 'The Committee of Central Bank Governors as a source of rules' 10 Journal of European Public Policy 6 (2003).

E Apel, European Monetary Integration 1958 – 2000 (London and New York, Routledge, 2005).

E Apel, Central Banking Systems Compared: The ECB, The Pre-Euro Bundesbank and the Federal Reserve System (London, Taylor & Francis Ltd, 2007).

M Artis and B Winkler, 'The Stability Pact: Safeguarding the Credibility of the European Central Bank' National Institute Economic Review No. 163 (1998) 87-98.

M Artis and A Buti, 'Close-to-Balance or in Surplus': A Policy-Maker's Guide to the Implementation of the Stability and Growth Pact' 38 JCMS 4 (2000) 563–591.

P Artus, 'Is the Stability Pact an Efficient Agreement?' mimeo, Caisse des Dépôts et Consignations (1997).

P Athanassiou, 'Withdrawal and expulsion from the EU and EMU — Some Reflections' ECB Legal Working Paper Series 10 (December 2009).

M Attinasi et al., 'What Explains the Surge in Euro Area Sovereign Spreads During the Financial Crisis of 2007–2009?' ECB Working Paper (2009).

H Audretsch, 'The E.E.C. and E.F.T.A. Two Solutions Regarding Balance of Payments Difficulties' 4 Common Market Law Review 4 (1967).

B Auguste, The Economics of International Payments Unions and Clearing Houses - Theory and Measurement (Oxford and New York, Palgrave Macmillan UK St. Martin's Press in association with St. Antony's College, 1997).

M Bahmani, H Harvey, S W Hegerty, 'Empirical tests of the Marshall-Lerner condition: a literature review', 40 Journal of Economic Studies 3 (2013).

J Baquero Cruz, 'The Legacy of the Maastricht-Urteil and the Pluralistic Movement' 14 European Law Journal 4 (2008) 389–422.

D Balaam and M Veseth, Introduction to International Political Economy, 4th edition (Upper Saddle River, New Jersey, Prentice Hall, 2008).

B Balassa, 'Towards a theory of economic integration' 1 Kyklos (1961) 1–17.

B Balassa, 'Trade Creation and Trade Diversion in the European Common Market' 77 The Economic Journal (1967) 1-21.

B Balassa, 'Trade Creation and Trade Diversion in the European Common Market: An Appraisal of the Evidence,' 42 Manchester School of Economic & Social Studies 2 (1974) 93-135.

R Baldwin and Venables, 'Regional Economic Integration', in G Grossman and K Rogoff (eds) Handbook of International Economics: Vol. III (Amsterdam, North-Holland, 1995).

R Baldwin C Wyplosz, The Economics of European Integration (London, McGraw-Hill, 2004).

R Baratta, 'Legal Issues for the "Fiscal Compact": Searching for a Mature Democratic Governance of the Euro' in B de Witte, A Héritier and A Trechsel (eds), The Euro Crisis and the State of the European Democracy (Florence, European University Institute, 2013).

T Bayoumi and P Masson, 'Fiscal flows in the United States and Canada: Lessons for monetary union in Europe' 39 European Economic Review 2 (1995) 253-274.

T Bayoumi and B Eichengreen, 'Ever Closer to Heaven? An Optimum-Currency-Area Index for European Countries' in P De Grauwe (ed.) The Political Economy of Monetary Union (London, Elgar, 2001).

R Beetsma and H Uhlig, 'An analysis of the 'Stability Pact' CEPR Discussion Paper 1669 (1997).

R Beetsmaa and A Bovenbergb, 'Monetary union without fiscal coordination may discipline policymakers', 45 Journal of International Economics 2 (1998) 239–258.

R Beetsma and M Giuliodori, 'The Macroeconomic Costs and Benefits of the EMU and Other Monetary Unions: An Overview of Recent Research' 48 Journal of Economic Literature (2010) 603–641.

R Beetsma, 'The Stability and Growth Pact in a model with politically induced deficit biases' in A Hughes Hallett, M. Hutchison, S E Hougaard Jensen (eds.) 189-215.

R Beetsma and M Guiliodori, 'The macroeconomic costs and benefits of the EMU and other monetary unions: An overview of recent research', 48 Journal of Economic Literature 3 (2010) 603–641.

I Begg, 'Hard and soft economic policy coordination under EMU: problems, paradoxes and prospects' Center for European Studies 103 Working Paper Series (2003) 3 available at https://sites.fas.harvard.edu/~ces/publications/docs/pdfs/BeggHardEMU.pdf.

S Bekker, 'The EU's Stricter Economic Governance: A Step Towards More Binding Coordination of Social Policies?' ReflecT Discussion Paper No. 13/001; Tilburg Law School Research Paper No. 01/2013, available at https://ssrn.com/abstract=2229161.

S Bekker and I Palinkas, 'The impact of the financial crisis on EU economic governance: A struggle between hard and soft law and expansion of the EU competences?', 17 Tilburg Law Review 2 (2012), 360-366.

F Bergsten and J. Kirkegaard 'The Coming Resolution of the European Crisis: An Update' Petersen Institute, Policy Brief PB12-18 (2012).

O Bernal et al., 'Observing bailout expectations during a total eclipse of the sun' Dulbea Working Paper 9 (2009).

B Besfamille and M Lockwood, 'Bailouts in Federations: Is a Hard Budget Constraint Always Best?' 49 International Economic Review 2 (2008) 577-593.

L Besselink and J H Reestman, 'Editorial: The Fiscal Compact and the European Constitutions: "Europe Speaking German"', 8 European Const. Law Review 1 (2012) 1-7.

J Blocher, M Gulati, L Helfer, 'Can Greece be expelled from the Eurozone? Toward a default Rule on expulsion from International organizations' in F Allen, E Carletti, J Gray and M Gulati (eds), Filling the Gaps in Governance: the Case of Europe, (Fiesole, European University Institute, 2016) 129.

M Bordo, A Markiewicz, L Jonung, 'A Fiscal Union for the Euro: Some Lessons from History' 59 CESifo Economic Studies 3 (2013) 449-488.

E Borensztein and U Panizza, 'Do Sovereign Defaults Hurt Exporters?' 21 Open Economies Review 3 (2010) 393-412.

V Borger, 'Outright Monetary Transactions and the stability mandate of the ECB: Gauweiler' 53 Common Market Law Review 2 (2016).

R Bootle, Leaving the Euro: A practical guide (London, Capital Economics Limited, 2012);

G Braakman, 'Monetary Evolutions and the Common Agricultural Policy' 15 Common Market Law Review 2 (1978).

J Broz and J Frieden, 'The political economy of exchange rates' in in B Weingast and D Wittman (Eds) The Oxford Handbook of Political Economy (Oxford, Oxford University Press 2006).

A Brunila, M Buti, D Franco, The Stability and Growth Pact: the architecture of fiscal policy in EMU (New York, Palgrave Macmillan, 2001).

J Buchanan and G Tullock, Calculus of Consent (Ann Arbor, University of Michigan Press, 1962) represents the first relevant work on incentives and constraints concerning public finance. For a recent analysis in connection with the EMU see R Beetsma (n. 474).

J Buchanan and R Wagner, Democracy in Deficit: The Political Legacy of Lord Keynes (Ney York, Academic Press, 1977).

W Buiter, G Corsetti, N Roubini 'Excessive deficits: Sense and Nonsense in the Treaty of Maastricht', 16 Economic Policy 8 (1993) 57–100.

J Bulow and K Rogoff 'Sovereign Debt: Is to Forgive to Forget?' 79 American Economic Review 1 (1989) 43-5

A Busca, 'The thin red line between the omt decision and the banking union' in S Grundmann, H Micklitz (eds.) Banking Union and Constitution, (Hart, forthcoming).

G Cafiso 'Rose Effect versus Border Effect: the Euro's Impact on Trade,' 43 Applied Economics 1 (2010) 1691-1702.

G Calabresi, 'An Exchange: About Law and Economics: A Letter to Ronald Dworkin", 8 Hofstra Law Review 553 (1980).

L Calmfors and S Wren-Lewis, 'What should fiscal councils do?' 26 Economic Policy 68 (2011) 649-695.

G Carli, 'From the European Payments Union to the European Monetary System', in R Cooper, P Kenen, J Braga de Macedo and Y van Ypersele (eds) The International Monetary System under Flexible Exchange Rates: Global, Regional, and National (Cambridge, Mass, Ballinger, 1981).

A Casale, A Giovannini et al., 'The Implications for the EU and National Budgets of the Use of EU Instruments for Macro-Financial Stability', CEPS Working Documents 64 (2012) available at http://aei.pitt.edu/36439/1/Instruments_for_Macro-Financial_Stability.pdf.

D Chalmers, 'The European Redistributive State and a European Law of Struggle', 18 European Law Journal 5 (2012) 677-678.

F Chaltiel, 'Le Pacte de stabilite, entre exigences juridiques et pragmatisme politique', 481 Revue du marche commun et de l'Union Européenne (2004) 509-514.

A Chiti and P Teixeira, 'The constitutional implications of the European responses to the financial and public debt crisis', 50 Common Market Law Review 3 (2013), 683–708.

B. Cœuré, 'Completing Europe's Economic and Monetary Union, Palestinian Public Finance Institute Ramallah (23 September 2012) available at http://www.ecb.europa.eu/press/key/date/2012/html/sp120923.en.html.

B Cœuré, speech at the workshop on "Fiscal councils, central banks and sound public finances", Frankfurt am Main, 27 January 2016 available at https://www.ecb.europa.eu/press/key/date/2016/html/sp160127.en.html.

B. Cohen, 'The European Monetary System: An Outsider's View', Princeton Essays in International Finance n. 142 (1981).

S Collignon, 'Economic Policy Co-ordination in EMU: Institutional and Political Requirements' Center for European Studies (2001).

R Cooper, 'Economic Interdependence and Coordination of Economic Policies', in R W Jones and P B Kenen (eds), Handbook of International Economics, vol. II (Amsterdam, ElsevierScience Publishers, 1985) 1195-1234.

V Constâncio, Speech at the 18th Annual Central Bank and Investment Authority Seminar organised by Commerzbank (Berlin, 16 October 2014) available at https://www.ecb.europa.eu/press/key/date/2014/html/sp141016.en.html.

G Corsetti et al. 'The Time is Short and the Need Great: New Institutions and New Policies for a Workable', CEPR Monitoring the Eurozone, November (2014).

D Costello and J Fischer (eds.), 'Scoreboard for the surveillance of macroeconomic imbalances', in European Economy. Occasional Papers, No. 92 (2012), available at: http://ec.europa.eu/economy_finance/publications/occasional_paper/2012/op92_en.htm.

C Cottarelli, 'European Fiscal Union: A Vision for the Long Run' 149 Swiss Journal of Economics and Statistics 2 (2013) 167-174;

P Craig, 'The Stability, Coordination and Governance Treaty: principle, politics and pragmatism' 37 European Law Review 3 (2012) 231-248.

P Craig 'Pringle and Use of EU Institutions outside the EU Legal Framework: Foundations, Procedure and Substance' 9 European Constitutional Law Review 2 (2013) 263-284.

P Craig. and M Markakis, 'Gauweiler and the Legality of Outright Monetary Transactions' 41 European Law Review 1 (2016).

A Cukierman and A Meltzer, 'A Political Theory of Government debt and Deficits in a Neo-Ricardian Framework', 79 American Economic Review 4 (1989) 353-98.

K Dam, 'The European Common Market in Agriculture' 67 Columbia Law Review 209 (1967).

Z Darvas, 'Fiscal Federalism in Crisis: Lessons for Europe from the US' Bruegel Policy Contribution (2010).

M Dawson and F De Witte, 'Constitutional Balance in the EU after the Euro-Crisis', 76 The Modern Law Review 5 (2013) 817–844.

G De Burca, 'The constitutional challenge of new governance in the European Union', 28 European Law Review 6 (2003) 814-839.

G de Búrca, 'Europe's Raison d'être', NYU Law School public law & legal theory research paper series working paper NO. 13-09 (2013).

H Deters, 'National constitutional jurisprudence in a post-national Europe: The ESM ruling of the German Federal Constitutional Court and the disavowal of conflict', 20 European Law Journal 2 (2014) 204–218.

P De Grauwe, Economics of monetary union, 6th edn (Oxford, Oxford University Press, 2005).

De Grauwe, 'How to embed the Eurozone in a political union' VoxEU.org e-Book, 17 June 2010, (2010).

P De Grauwe, 'The European Central Bank: Lender of Last Resort in the Government Bond Markets' 59 CESifo Economic Studies 520 (2013).

A De Gregorio Merino, 'Legal developments in the economic and monetary union during the debt crisis: the mechanism of financial assistance', 49 Common Market Law Review 5 (2012) 1613-1645.

J De Larosière, 'The High Level Group on financial supervision in the EU' (the De Larosière Report) published on 25 February 2009.

S Deroose, D Hodson, J Kuhlmann, 'The Broad Economic Policy Guidelines: Before and After the Re-launch of the Lisbon Strategy', 46 JCMS 4 (2008) 827–848.

O De Schutter, 'The Balance Between Economic and Social Objectives in the European Treaties', Revue française des affaires sociales 5, (2006) 119-143.

A De Streel, 'EU Fiscal Governance and the Effectiveness of its Reform' in M. Adams, F. Fabbrini and P. Larouche (eds), Constitutionalization of European Budgetary Constraints: Comparative and Interdisciplinary Perspectives (Londo, Hart, 2014).

M Dewatripont and E Maskin, Credit and Efficiency in Centralized and Decentralized Economies, 62 Review of Economic Studies 4 (1995) 541-555.

B De Witte and T Beukers, 'The Court of Justice approves the creation of the European Stability Mechanism outside the EU legal order: Pringle' 50 Common Market Law Review 3 (2013) 805–848;

W Diebold, The Shuman Plan: A Study in Economic Cooperation 1950-1959 (New York, Praeger, 1959).

U Di Fabio, 'Karlsruhe Makes a Referral' 15 German Law Journal 2 (2014).

A Dixit and L Lambertini, ‘Monetary–Fiscal Policy Interactions and Commitment versus Discretion in a Monetary Union’ 45 European Economic Review 4 (2001) 977–87.

A Dixit and L Lambertini, ‘Symbiosis of Monetary and Fiscal Policies in a Monetary Union’ 60 Journal of International Economics 2 (2003) 235–247.

M Dolls, C Fuest, F Heinemann, and A Peichl, ‘Reconciling Insurance with Market Discipline: A Blueprint for a European Fiscal Union’ ZEW Centre for Economic Research, Discussion Paper No. 15-044 (2015).

E Dor, ‘Leaving the Euro zone: a user’s guide’ IESEG School of Management, Working Paper Series (2011) available at http://my.ieseg.fr/bienvenue/DownloadDoc.asp?Fich=1046781054_2011-ECO-06_Dor.pdf;

R Dornbusch, ‘Debt and monetary policy: the policy issues’ NBER working paper 5573 (1996).

L Drake, T Mills, ‘Trends and Cycles in Euro Area Real GDP’ 42 Applied Economics 11 (2010) 1397-1401

K Dyson and K Featherstone, The Road to Maastricht. Negotiating Economic and Monetary Union (Oxford, Oxford University Press, 1999).

A Dukes, “Democratic Legitimacy and Accountability: The European Semester and the Irish Budget”, Institute of International and European Affairs (2013).

S Dullina and U Guerot, ‘The Long Shadow of Ordo-Liberalism: Germany's Approach to the Euro Crisis’ European Council on Foreign Relations’, Policy Brief No.49 (2012).

S N Durlauf, L E Blume, The New Palgrave Dictionary of Economics (London, Palgrave Macmillan, 2016).

J Eaton and M Gersovitz, ‘Debt with Potential Repudiation: Theoretical and Empirical Analysis’ 48 The Review of Economic Studies 2 (1981) 289-309.

Editorial comments, ‘Whither the Stability and Growth Pact?’ 41 Common Market Law Review 5 (2004) 1198.

Editorial Comments, ‘An unintended side-effect of Draghi’s bazooka: An opportunity to establish a more balanced relationship between the ECJ and Member States’ highest courts’ 51 Common Market Law Review 1 (2014).

T Eger, H Schafer, Research handbook of the economics of European Union Law, (Northhampton, Edward Elgar, 2014).

G Erber, ‘The German Current Account Surplus and Krugman’s and Wolff’s Critique’, German Institute for Economic Research Working Paper series (2013).

B Eichengreen and C Wyplosz ‘The Unstable EMS’, Brookings Papers on Economic Activity 1, (1993).

B Eichengreen and T Bayoumi, ‘The political economy of fiscal restrictions: Implications for Europe from the United States’ 38 European Economic Review 3 (1994) 783-791.

B Eichengreen, ‘The European Payments Union: An Efficient Mechanism for Rebuilding Europe's Trade?’, in B Eichengreen (ed.) Europe's Postwar Recovery (Cambridge, Cambridge University Press, 1995).

B. Eichengreen, ‘Saving Europe's automatic stabilisers’ 159 National Institute Economic Review (1996) 92-98.

B Eichengreen and C Wyplosz “The Stability Pact: more than a minor nuisance?” 13 Economic Policy 26 (1998) 65-113.

B Eichengreen, J Frieden, The Political Economy of European Monetary Integration, 2nd edn, (Westview Press, 2000).

B Eichengreen and J Braga de Macedo, 'The European Payments Union: History and Implications for the Evolution of the International Financial Architecture' (2001) OECD Development Centre Paris 25.

B Eichengreen, 'European Integration', in B Weingast and D Wittman (Eds) The Oxford Handbook of Political Economy (Oxford, Oxford University Press 2006).

B Eichengreen, C Wyplosz, 'Minimal Conditions for the Survival of the Euro' 51 Intereconomics - Review of European Economic Policy 1 (2016) 24-28.

L Einaudi, Lo scrittoio del presidente (1948-1955) (Torino, Einaudi Editore, 1956).

M Evers, 'Federal fiscal transfer rules in monetary unions', 56 European Economic Review 3 (2012) 507–525.

F Fabbrini, 'the eurocrisis and the courts judicial review and the political process in comparative perspective', 32 Berkeley J of Intl L 64 (2014).

M Feldstein, 'The political economy of the European Economic and Monetary Union: Political Source of an Economic Liability', 11 The Journal of Economic Perspectives, 4 (1997).

R Fisher, W Ury, B Patton, Getting to Yes: Negotiating Agreement Without Giving in (New York, N.Y: Penguin Books, 1991).

J Fleming, 'Domestic financial policies under fixed and floating exchange rates' 9 IMF Staff Papers (1962) 369–379.

M Friedman, 'A Monetary and Fiscal Framework for Economic Stability', (1948) 38 The American Economic Review 3, 245.

M Friedman, 'The Case for Flexible Exchange Rates' in Essays in Positive Economics (Chicago, University of Chicago Press, 1953).

M Friedman, 'The European Community: Friend or Foe of the Market Economy' Paper for Mont Pèlerin Society Meeting, (1982).

J Frankel, 'The Future of the Currency Union' KS Working Paper No. RWP13-015 (2013) Available at https://ssrn.com/abstract=2326719 or http://dx.doi.org/10.2139/ssrn.2326719.

M Fratzscher, F Giavazzi, R Portes, B Weder di Mauro, C Wyplosz, 'A Call for support for the European Central Bank's OMT Programme' 19 July 2013, available at https://berlinoeconomicus.diw.de/monetarypolicy/a-call-for-support-for-the-european-central-banks-omt-programme/.

J Furth, 'The European Monetary Agreement', Board of Governors of the Federal Reserve System Division of International Finance, Review of Foreign Developments (September 6 1955).

E Furubotn and R Richter, Institutions and Economic Theory - The Contribution of the New Institutional Economics 2nd Edition (Ann Arbor, The University of Michigan Press, 2005).

C Gerner-Beuerle, E Kucuk, E Schuster, 'Law Meets Economics in the German Federal Constitutional Court: Outright Monetary Transactions on Trial' 15 German Law Journal 281 (2014).

D Giannone, M Lenza, L Reichlin, 'Business Cycle in the Euro Area', A Alesina (ed.) Europe and the Euro (Chicago, The University of Chicago Press, 2010) 141-167.

M Gilbert, 'The gold-standard system: conditions of equilibrium and the price of gold in B Eichengreen' in M Flandreu (ed) The Gold Standard in theory and history (New York/London, Routledge, 1997).

J. González-Páramo, 'The European Central Bank and the policy of enhanced credit support', Speech at the Conference organised by Cámara de Comercio de Málaga and University of Málaga, Málaga, 18 June 2010. Available at https://www.ecb.europa.eu/press/key/date/2010/html/sp100618_2.en.html.

D Gros and N Thygesen, European Monetary Integration: From the European Monetary System to European Monetary Union (London, Longman, 1992) 480.

D Gros, T Mayer, A Ubide, 'The Nine Lives of the Stability Pact' Special report by the CEPS Macroeconomic Policy Group (2004) available at http://library.coleurop.be/pdf/9%20Lives%20of%20SGP%20standard1.pdf.

D Gros and T Mayer, 'Towards a Euro(pean) Monetary Fund', CEPS Policy Brief No. 202 (2010). Available at SSRN: https://ssrn.com/abstract=1615478.

D Gros and A Giovannini, 'The "Relative" Importance of EMU Macroeconomic Imbalances in the Macroeconomic Imbalance Procedure', 14 Documenti IAI, (2014).

S Grossman and O Hart, 'An Analysis of the Principal-Agent Problem', 51 Econometrica 1 (1983) 7-45.

S Grossman and O Hart 'The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration" 94 Journal of Political Economy 4 (1986) 691-719.

S Grundmann, 'The Concept of the Private Law Society: After 50 Years of European and European Business Law' 16 European Review of Private Law 4 (2008) 553–581.

S. Grundmann, 'chapter 17' in S Grundmann, H Micklitz, M Renner (eds.) Grand Theories of Private Law', (forthcoming).

Guest Editorial, 'The no-bailout clause and rescue package' 47 Common Market Law Review 4 (2010) 971-986.

B Haar, 'Financial Regulation in the EU – Cross-Border Capital Flows, Systemic Risk and the European Banking Union as Reference Points for EU Financial Market Integration', SAFE Working Paper No. 57 (2014) 33, Available at SSRN: https://ssrn.com/abstract=2459361.

J Habermas, The Crisis of the European Union. A Response (Cambridge, Polity Press, 2012).

H Hahn, 'The stability pact for european monetary union: Compliance with deficit limit as a constant legal duty', 35 Common Market Law Review 1 (1998) 77-100.

J Hagen, A Hughes Hallett, R Strauch, 'Budgetary consolidation in EMU' European Commission Economic Papers 148 (2001).

M Hallerberg, B Marzinotto, G Wolff, 'How Effective and Legitimate is the European Semester? The increasing role of the European Parliament', Bruegel Working Paper 9 (2011).

A Hansen and H Perloff, State and Local Finance in the National Economy (New York, Norton, 1944).

O Hart 'Incomplete Contracts and the Theory of the Firm' 4 Journal of Law, Economics, and Organization 1 (1988).

O Hart, Firms, Contracts, and Financial Structure (New York, Oxford University Press, 1995).

K Head and T Mayer, 'Non-Europe: The Magnitude and Causes of Market Fragmentation in the EU' 136 Review of World Economics 2 (2000).

M Heipertz, 'The Stability and Growth Pact – Not the Best but Better than Nothing. Reviewing the Debate on Fiscal Policy in Europe's Monetary Union' MPIfG Working Paper 03/10 (2003).

M Heipertz and A Verdun, Ruling Europe: The Politics of the Stability and Growth Pact (Cambridge, Cambridge University Press, 2010).

A Heise, 'European economic governance: what is it, where are we and where do we go?' 3 International Journal of Public Policy, 1 (2008) 1-19.

K Heppke-Falk and G Wolff, 'Moral hazard and bail-out in fiscal federations: evidence for the German Länder' Discussion Paper Series 1 Economic Studies Deutsche Bundesbank (2007).

J Herbst, 'Observations on the Right to Withdraw from the European Union: Who are the "Masters of the Treaties"?', 6 German Law Journal 1 (2005).

M Herdegen, 'Price stability and budgetary restraints in the Economic and Monetary Union: The law as guardian of economic wisdom', 35 Common Market Law Review 1 (1998) 9-32.

B Higgins, 'Was the ERM Crisis Inevitable?' 78 Federal Reserve Bank of Kansas City Economic Review 4 (1993).

A Hinarejos, The Euro Area Crisis in Constitutional Perspective (Oxford Oxford University Press 2015).

A Hirschman 'Three Uses of Political Economy in Analyzing European Integration' in Trespassing: Economics to Politics and Beyond (Cambridge U.K., Cambridge Univ Press, 1981).

A Hirschman, Rival views of market society and other recent essays (New York, Viking, 1986)

A Hirschman, Proposta per una Autorità Monetaria Europea, in L Meldolesi (ed.) A. Hirschman, Tre continenti. Economia politica e sviluppo della democrazia in Europa, Stati Uniti e America Latina (Torino, Einaudi, 1990).

A Hirschman, 'Fifty Years After the Marshall Plan: Two Posthumous Memoirs and Some Personal Recollections' in A Hirschman (ed.) Crossing boundaries: selected writings (New York, Zone Books, 1998).

A Hirschman, 'The Essential Hirschman', J Adelman (ed) (Princeton, Princeton University Press, 2013).

D Hodson, Governing the Euro Area in GoodTimes and Bad (Oxford, Oxford Scholarship Online, 2011).

D Hodson, 'Policy-Making under Economic and Monetary Union, Crisis, Change, and Continuity' in H Wallace, M Pollack, A Young (eds) Policy-making in the European Union (Oxford, Oxford University Press, 2015).

O W Holmes Jr, 'The path of the law' (1897) 10 Harvard Law Review 457, 469.

T. Humphrey, 'Lender of last resort: the concept in history' 75 Economic Review 8 (1989).

R Inman, 'Do Balanced Budget Rules Work? U.S. Experience and Possible Lessons for the EMU' NBER Working Paper 5838 (1996).

O Issing, V Gaspar, I Angeloni and O Tristani, Monetary policy in the euro area: strategy and decision-making at the European Central Bank, (Cambridge, Cambridge University Press, 2001).

O Issing, 'On Macroeconomic Policy Co-ordination in EMU' 40 JCMS 2 (2002) 345–58

H James, Making the European Monetary Union (Cambridge, MA., Harvard University Press, 2012).

L H Janssen, Free Trade, Protection and Customs Union (Leiden, H. E. Stenfert Kroese, 1961).

C Joerges, 'What is left of the European Economic Constitution?' Eui working paper Law 13, (2004).

E Jorgensen and J Sachs, 'Default and Renegotiation of Latin American Foreign Bonds in the Interwar Period' NBER Working Paper No. 2636 (1988).

G Kaminsky and S Schmukler, 'Short-Run Pain, Long-Run Gain: The Effects of Financial Liberalization' NBER Working Paper No. 9787 (2003).

H Kempf, H Von Thadden, 'On Policy Interactions among Nations: When Do Cooperation and Commitment Matter?' European Central Bank Working Paper 880 (2008).

J M Keynes, 'Tract on Monetary Reform', in Royal Economic Society ed. Collected Writings of John Maynard Keynes, vol. 4 (London, Macmillan for the Royal Economic Society, 1971).

C Kilpatrick and B De Witte 'Social Rights in Times of Crisis in the Eurozone: The Role of Fundamental Rights' Challenges', EUI Working Paper LAW 2014/05 (2014).

M Klaes, 'The history of the concept of transaction costs: neglected aspects.' 22 Journal of the History of Economic Thought 2 (2000) 191-216.

B Klein and K Leffler, 'The Role of Market Forces in Assuring Contractual Performance', 89 Journal of Political Economy 4 (1981).

B Klein, 'The Role of Incomplete Contracts in Self-enforcing Relationships" Revued' Economie Industrielle (2000) 67–80.

K Kletzer and B Wright, Sovereign Debt as Intertemporal Barter, 90 The American Economic Review 3 (2000) 621-639.

A Kocharov (ed.) 'Another Legal Monster? An EUI Debate on the Fiscal Compact Treaty', EUI Working paper LAW 2012/09 (2012).

J Kornai, 'Hard and Soft budget constraint', 25 Acta Oeconomica 3 (1980).

L B Krause, 'European Economic Integration and the United States', American Economic Review, Papers and Proceedings, (1963).

D Kruse, Monetary Integration in Western Europe (London, Butterworths, 1980).

A Lamfalussy, 'Intra-European Trade, and the Competitive Position of the E.E.C' Transactions of The Manchester Statistical Society, (Manchester, Manchester University Press, 1963).

A Lamfalussy, 'Macro-coordination of fiscal policies in an economic and monetary union in Europe' (1989), in Delors Report.

P Lane, 'The European Sovereign Debt Crisis' 26 Journal of Economic Perspectives 3 (2012) 49-68.

R Lastra, and J Louis, 'European Economic and Monetary Union: History, Trends, and Prospects - Yearbook of European Law' 136 Queen Mary School of Law Legal Studies Research (2013) 7, available at SSRN: https://ssrn.com/abstract=2244764.

P Lindert and P Morton, 'How Sovereign Debt Has Worked,' in J. Sachs (ed.) Developing Country Debt and Economic Performance, Volume 1: The International Financial System (Chicago, University of Chicago Press, 1989) 39-106.

J Louis, 'A monetary Union for tomorrow?' 26 Common Market Law Review 2 (1989) 301-326.

J Louis, From the European Monetary System to Monetary Union 2nd edn (Luxembourg, OPEC, 1990).

J Louis, 'The economic and monetary union: law and institutions', 41 Common Market Law Review 2 (2004) 575-608.

J Louis, 'The review of the Stability and Growth Pact' 43 Common Market Law Review 1 (2006) 85–106.

J Louis, 'L'Union Europeenne et sa Monnaie', Commentaire J Megret, chapter III (Brussels, Editions de l'Universite´ de Bruxelles Collection: Institut d'Etudes Europe´ennes, 2009).

J Louis, 'The unexpected revision of the Lisbon Treaty and the establishment of a European Stability Mechanism', in Ashiagbor, Countouris and Lianos (Eds.), The European Union after the Treaty of Lisbon (CUP, 2012) 298-319.

M Maduro, 'A new governance for the European union and The Euro: democracy and justice' RSCAS Policy Paper 11 (2012).

I Maes and I Pasotti, 'The European Payments Union and the origins of Triffin's regional approach towards international monetary integration', (2016) NBB Working Paper No. 301 available at https://www.nbb.be/doc/ts/publications/wp/wp301en.pdf.

I Maes, 'The ascent of the European Commission as an actor in the monetary integration process in the 1960s' 53 Scottish Journal of Political Economy 2 (2006).

G Majone, Regulating Europe (New York, Routledge, 1996).

G Majone, Dilemmas of European Integration: The Ambiguities and Pitfalls of Integration by Stealth (Oxford, Oxford University Press, 2005).

S Marks and M Saltmarsh, 'Will EU's New Independent Fiscal Board Turn into a Commission Committee?' MNI Euro Insight (2016).

M Massa, 'Discretion, Sustainability, Responsibility in the Constitutional Case Law on Social Rights', Quaderni costituzionali, Rivista italiana di diritto costituzionale 1 (2017) 73-96.

E Maskin and J Tirole, 'The Politician and the Judge: Accountability in Government', 94 American Economic Review 4 (2004) 1034-1054.

K McNamara, The Currency of Ideas: Monetary Politics in the European Union (Ithaca NY, Cornell University Press, 1988).

Y Mersch, 'Monetary policy in the euro area: scope, principles and limits' Keynote speech at the Natixis Meeting of Chief Economists (Paris, 23 June 2016).

D Meyer, 'Legal Options of a Withdrawal from the Euro and the Reassignment of Monetary Sovereignty' 25 European Business Law Review 5 (2014) 665–679.

A Micco, E Stein, G Ordonez 'The Currency Union Effect on Trade: Early Evidence From EMU', 37 Economic Policy 18 (2003) 316-356.

K Mitchener and M Weidenmier, 'Supersanctions and Sovereign Debt Repayment', NBER Working Paper No. 11472 (2005).

F Mongelli, 'European Economic and Monetary Integration, and the Optimum Currency Area Theory', Economic Papers n. 302 (2008).

A Moravcsik, The Choice for Europe: Social Purpose and State Power from Messina to Maastricht (Ithaca, NY, Cornell University Press, 1998).

A Moravcsik, 'In Defense of the 'Democratic Deficit': Reassessing Legitimacy in the European Union', CES Working Paper No. 92 (2001).

R Morris, H Ongena, L Schuknecht, 'The reform and implementation of the Stability and Growth Pact' ECB Occasional Paper, No. 47 (2006).

J. Mortensen, Federalism vs. Co-ordination: Macroeconomic Policy in the European Community (Brussels, Centre for European Policy Studies, 1990).

J Mortensen, 'Economic Policy Coordination in the Economic and Monetary Union: from Maastricht via the SGP to the Fiscal Pact' CEPS Working Documents No. 381 (2013) 4. Available at http://aei.pitt.edu/43184/1/WD381_JM_Economic_Policy_Coordination.pdf.

R Mundell, 'A Theory of Optimum Currency Areas', 51 American Economic Review 4 (1961) 657–665.

R Mundell, 'Capital mobility and stabilization policy under fixed and flexible exchange rates' 29 Canadian Journal of Economic and Political Science 4 (1963) 475–485.

R Mundell, Balance of Payments, in D L Sills (ed.), International Encyclopedia of the Social Sciences, Vol. 8. (USA, Crowell Collier and Macmillan, 1968).

D Murswiek, 'ECB, ECJ, Democracy, and the Federal Constitutional Court: Notes on the Federal Constitutional Court's Referral Order from 14 January 2014', 15 German Law Journal 2 (2014).

C Nerlich and W H Reuter, 'The design of national fiscal frameworks and their budgetary impact', ECB Working Paper Series, No 1588 (2013).

M Obstfeld, J Shambaugh and A Taylor, 'The Trilemma in History: Tradeoffs among Exchange Rates, Monetary Policies, and Capital Mobility' 87 Review of Economics and Statistics 2 (2005) 423–438.

P Oslington, 'Contextual History, Practitioner History, and Classic Status: Reading Jacob Viner's The Customs Union Issue' 35 Journal of the History of Economic Thought 4 (2013) 491-515.

K Oosterlinck, 'Are "No Bailout" and "No Deebt Restructuring" in the EMU Compatible? A Historical Perspective', in F Allen, E Carletti, J Gray and M Gulati eds.

T Padoa-Schioppa et al, Efficiency, Stability and Equity (Oxford: Oxford University Press, 1987).

F Parisi, 'Positive, Normative and Functional Schools in Law and Economics' 18 European Journal of Law and Economics 1 (2004).

J Pelkmans, European Integration: Methods and economics analysis, 2nd edn (Harlow UK, Prentice Hall, 2001).

S Peers, 'The Stability Treaty: Permanent Austerity or Gesture Politics?' 8 European Constitutional Law Review, 3 (2012) 404-441.

S Peers, 'Is Temporary Grexit Possible? EMU as Hotel California', July 11, 2015, EU Law Analysis Blog available at http://eulawanalysis.blogspot.co.Uk/2015/07/is-temporary-grex-it-legally-possible.html.

T Persson and G Tabellini, Political Economics: Explaining Economic Policy (Cambridge, MIT Press, 2000).

J Pipkorn, 'Legal Arrangements in the Treaty of Maastricht for the Effectiveness of the EMU', 31 Common Market Law Review 2 (1994) 263-291.

J Pisani-Ferry, V Virhiälä, G Wolff, 'Options for a Euro-Area fiscal capacity', Bruegel Policy Contribution 01, (2013).

K Pöhl, 'The Further Development of the European Monetary System' Collection of Papers. Committee for the Study of Economic and Monetary Union (Luxembourg, 1989) 129-156.

R Portes, ‘EMS and EMU After the Fall’ The World Economy 19 (1993) 1-16.

R Posner, ‘The Future of Law and Economics: Essays by Ten Law School Scholars’, University of Chicago Law School, (2011) available at https://www.law.uchicago.edu/news/future-law-and-economics-essays-ten-law-school-scholars.

J Poterba, ‘Budget Institutions and Fiscal Policy in the U.S. States’ 86 American Economic Review 2 (1996) 395—400.

P Praet, ‘The ECB and its role as lender of last resort during the crisis’, speech at the committee on Capital Markets Regulation conference on The lender of last resort – an international perspective (Washington DC, 10 February 2016) available at https://www.ecb.europa.eu/press/key/date/2016/html/sp160210.en.html.

C Proctor and G Thieffry, Economic and Monetary Union: Thinking the Unthinkable -The Breakup of the Monetary Union (London, Norton Rose 1998).

C Proctor, ‘The future of the Euro - what happens if a Member State leaves?’ 17 European Business Law Review 4 (2006).

Y Qian and R Gérard, Federalism and the Soft Budget Constraint. 88 American Economic Review 5 (1998) available at https://ssrn.com/abstract=149988.

J Rattso, ‘Fiscal Federation or Confederation in the European Union: The Challenge of the Common Pool Problem’ Working paper (2003).

J Rawls, A Theory of Justice (Cambridge, Mass, Belknap Press, 2005).

C Reinhart and K Rogoff, ‘The Aftermath of Financial Crises’ 99 American Economic Review 2 (2009) 466-470.

C Reinhart, K Rogoff, ‘Growth in a Time of Debt,’ 100 American Economic Review 2 (2010) 573-78.

J Rey, ‘The European Monetary System’, 17 Common Market Law Review 7 (1980).

D. Ricardo, The Principles of Political Economy and Taxation (London, J.M. Dent & Sons., 1912).

A Rose, ‘Explaining Exchange Rate Volatility: An Empirical Analysis of "The Holy Trinity" of Monetary Independence, Fixed Exchange Rates, and Capital Mobility’ 15 Journal of International Money and Finance 6 (1996) 925-945.

A Rose ‘One Money, One Market: Estimating the Effect of Common Currencies on Trade’, 30 Economic Policy 15 (2000) 9-45.

S Rose, ‘Do Fiscal Rules Dampen the Political Business Cycle’ 128 Public Choice (2006) 407-431.

M Ruffert, ‘The European debt crisis and European Union law’, 48 Common Market Law Review 6 (2011) 1777–1806.

A Rugina, ‘Critical analysis of the Barre-Plan’ 8 Intereconomics 1 (1978).

T Sadeh and A Verdun ‘Explaining Europe's Monetary Union: A Survey of the Literature’, 11 International Studies Review 2 (2009) 277-301.

W Sauter, ‘The Economic Constitution of the European Union’, 4 Columbia Journal of European Law 27 (1998) 43–56.

F Scharpf, ‘The European Social Model: Coping with the Challenges of Diversity’, 40 Journal of Common Market Studies 40 (2002) 645-670.

F Scharpf, ‘Monetary Union, Fiscal Crisis and the Preemption of Democracy’ MPIfG Discussion Paper (2011).

F Scharpf, ‘Legitimacy Intermediation in the Multilevel European Policy’, MPIfG, Discussion Papers (2012).

H. Schmidt, ‘Wenn Stabilita¨t zum Fetisch wird’ DIE ZEIT, Nr.12, 17.3.2005.

S Schmidt, ‘Sense of Deja Vu: The FCC's Preliminary European Stability Mechanism Verdict’, 14 German Law Journal 1 (2013).

S Schwarcz, ‘Systemic Risk’, 97 Georgetown Law Journal 193 (2008).

M Schwarz, ‘A memorandum of misunderstanding – the doomed road of the European Stability Mechanism and a possible way out: enhanced cooperation’,51 Common Market Law Review 2 (2014) 389–424.

H Scott, ‘When the Euro Falls Apart – A sequel’, Harvard Law School Public Law & Legal Theory Working Paper Series Paper No. 12-16 (2012) 12-17.

H Shelanski and P Klein, ‘Empirical Research in Transaction Cost Economics: A Review and Assessment’ 11 Journal of Law, Economics, and Organization 2 (1995) 335-61.

O Sibert, ‘Government finance in a common currency area’, 11 Journal of International Money and Finance 6, 567-578 (1992).

R Smits, ‘A Single Currency for Europe and the Karlsruhe Court’ 1 Legal Issues of European Integration (1994) 115–33.

F. Snyder, ‘EMU Revisited Are we Making a Constitution? What Constitution are we Making?’ EUI Working Paper Law No. 98/6 (1998) available at http://cadmus.eui.eu/bitstream/id/942/BS-EMUWOR-FS.pdf/

H Spruyt, ‘Unbundling sovereignty rights through incomplete contracting: Empowering European Transnational network beyond the States’, in D King, P Le Gales (Eds) Reconfiguring European States in crisis (New York, Oxford University Press, 2017).

A. Steinbach, Economic Policy Coordination in the Euro Area, (Routledge: London, New York, 2014).

J Stiglitz, ‘Can the Euro Be Saved? An Analysis of the Future of the Currency Union’, Rivista di Politica Economica 3 (2014).

W Streeck, ‘Heller, Schmitt and the Euro’, 21 European Law Journal 3 (2015) 361–370.

A Szász, ‘The Monetary Union Debate’ 7 Common Market Law Review 4 (1970).

Y Suzuki, Centralization, ìDecentralization and Incentive Problems in Eurozone Financial Governance: A Contract Theory Analysis’ Tokyo Center for Economic Research (TCER) Paper No. E-72 (2014) available at https://ssrn.com/abstract=2397562.

G Tabellini and C Wyplosz ‘Supply-side Reforms in Europe: Can the Lisbon Strategy be Repaired?’ 1 Swedish Economic Policy Review 13 (2006) 101-56.

L Telser, ‘Theory of Self-Enforcing Agreements’, 53 The Journal of Business 1 (1980) 27-44.

N Thygesen, ‘The Delors Report and European Economic and Monetary Union’ 65 International Affairs 4 (1989) 639

N Thygesen, ’Fiscal institutions in EMU and the Stability Pact’ in A Hughes Hallett, M. Hutchison, S E Hougaard Jensen (eds.), Fiscal aspects of European monetary integration (New York, Cambridge University Press, 1999).

N Thygesen, ‘Peer Pressure as Part of Surveillance by International Institutions’ OECD, Paris (2002) available at http://www.oecd.org/dataoecd/11/30/1935112.pdf

J Trichet, ‘State of the Union: The Financial Crisis and the ECB’s Response between 2007 and 2009’ 48 Journal of Common Market Studies 7 (2010).

R Triffin, Europe and the Money Muddle: From Bilateralism to Near-Convertibility, 1947-1956 (New Heaven/London: Yale University Press, 1947).

R Triffin, ‘The Unresolved Problem of Financing European Trade. IMF Memorandum’ in R Triffin (ed) The World Money Maze: National Currencies in International Payments (New Heaven and London: Yale University Press, 1947).

R Triffin, Gold and the Dollar Crisis (New Heaven, CT, Yale University Press 1960).

G Toniolo, ‘Europe's Golden Age, 1950-1973: Speculations from a Long-Run Perspective’, 51 The Economic History Review 2 (1998).

K Tuori and K Tuori, The Eurozone Crisis - A Constitutional Analysis (Cambridge, Cambridge University Press, 2014).

H Ungerer, A Concise History of European Monetary Integration: From EPU to EMU (Santa Barbara CA., Praeger, 1997).

J Usher, The Law of Money and Financial Services in the European Community (London, Clarendon Press, 1994).

J Usher, EC Agricultural Law, 2nd edn (Oxford, Oxford University Press, 2001).

W Van Aken and L Artige, ‘A Comparative Analysis of Reverse Majority Voting: The WTO's Dispute Settlement Mechanism, the EU Anti-Dumping Policy and the Reinforced SGP and Fiscal Compact’ EUSA Thirteenth Biennial Conference, Baltimore, Maryland, USA (May 9-11, 2013). Available at http://ssrn.com/abstract=2202787.

P Van Malleghem, ‘Pringle: A Paradigm Shift in the European Union’s Monetary Constitution’, 14 German Law Journal 1 (2013).

A Verdun, ‘The Role of the Delors Committee in the Creation of EMU: An Epistemic Community?’ EUI Working Paper RSC No 98/44 (1998) available at http://cadmus.eui.eu/bitstream/handle/1814/1596/98_44t.htm?sequence=1&isAllowed=y.

J Vinal, ‘European Monetary Integration: A narrow or a wide EU’ 40 European Economic Review 1103 (1996).

J Viner, The customs union issue (New York, Carnegie Endowment for International Peace, 1950).

J. Viner, ‘’The Most-Favored-Nation Clause’’ 61 Journal of Political Economy 2-17, (1931).

J Von Hagen, ‘Currency Union and Fiscal Union: A Perspective From Fiscal Federalism’, in: P Masson and M Taylor (eds.).

J Von Hagen, ‘A note on the empirical effectiveness of formal fiscal restraints’ 44 Journal of Public Economics 2 (1991) 199-210.

H Wagner, ‘Is harmonization of legal rules an appropriate target? Lessons from the global financial crisis’ 33 European Journal of Law and Economics 3 (2012) 541–564.

G Weil (Ed), A Handbook on the European Economic Community (New York, Praeger, 1965)

J Weiler, 'Alternative to Withdrawal from an International Organization: The case of the European Economic Community', 20 Israel Law Review 2 (1985).

J Weiler, 'The Transformation of Europe' 100 Yale Law Journal 2403 (1991), 2410.

J Weiler '60 Years since the First European Community: Reflections on Messianism' 22 European Journal of International Law 303 (2002).

B Weingast, 'The Economic Role of Political Institutions: Market-Preserving Federalism and Economic Development' 11 Journal of Law, Economics & Organization 1 (1995) 1-31.

B Weingast, 'Second Generation Fiscal Federalism: Implications for Decentralized Democratic Governance and Economic Development' 21 Journal of Law, Economics, and Organization 1 (2006).

M Wendel, 'Judicial Restraint and the Return to Openness: The Decision of the German Federal Constitutional Court on the ESM and the Fiscal Treaty of 12 September 2012', 14 German Law Journal 21 (2013).

P Wenneras, 'Sanctions against member states under article 260 Tfeu: alive, but not kicking?' 49 Common Market Law Review 1 (2012) 145–176.

J Williamson, 'EMS and EMU After the Fall: A Comment' The World Economy 16 (1993).

O Williamson, The Economic Institutions of Capitalism (London-New York, The Free Press, 1985).

O Williamson, 'Corporate Finance and Corporate Governance', 43 The Journal of Finance , Papers and Proceedings of the Forty-Seventh Annual Meeting of the American Finance Association, Chicago, Illinois, December 28-30, 1987 (1988) 567-591.

O Williamson, 'Public and Private Bureaucracies: A Transaction Cost Economic Perspective' 15 The Journal of Law, Economics, & Organization 1 (1999) 313–314.

M Wolf, 'Can One Have Balance of Payments Crises in a Currency Union?' 16 February 2012, Financial Times.

G Wolff, 'A budget for Europe's monetary union', Bruegel Policy Contribution 22 (2012).

C Wyplosz, 'Economic Policy Coordination in EMU: Strategies and Institutions' German-French Economic Forum in Bonn, January 12, (1999).

C Wyplosz, 'European Monetary Union: the dark sides of a major success', 46 Economic Policy 21 (2006) 207-261.

C Wyplosz, 'Multilateral Surveillance' directorate general for internal policies policy department a: economic and scientific policies economic and monetary affair (2010), Available at http://www.europarl.europa.eu/activities/committees/studies.do?language=EN.

C Wyplosz, The failure of the Lisbon strategy, VOX, CEPR's Policy Portal (12 January 2010), available at http://www.voxeu.org/article/failure-lisbon-strategy.

A Zareh et al. 'Making the most of the European Fiscal Board', ZEW policy brief, No. 3 (2017).

J Zeh, 'Recht auf Austritt', 2 Zeitschrift für Europarechtliche Studien (2004).

J Zeitlin, 'The Open Method of Co-ordination and the Governance of the Lisbon Strategy', 46 JCMS 2 (2008) 436-446.

BIBLIOGRAPHY

Table of legislation (Chronological Order)

Committee for European Economic Co-operation, General Report, Paris, September 21 1947 (U.S. Department of State Pubblications 2930).

Accord sur l'établissement d'une Union européenne des paiements-Agreement for the establishment of a European payements union. Paris: Organisation européenne de coopération économique, 1950. 50 p. (EPU agreement).

R. Schuman, The Schuman Declaration – 9 May 1950, available at: http://europa.eu/about-eu/basic-information/symbols/europe-day/schuman-declaration/index_en.htm.

Treaty Establishing the European Coal and Steel Community, Apr. 18, 1951, 261 U.N.T.S. 140 (ECSC Treaty).

Joint Declaration of the Ministers signatory to the Treaty establishing the European Coal and Steel Pool (18 April 1951).

Treaty Establishing the European Atomic Energy Community, Mar. 25, 1957, 298 U.N.T.S. 167 (Euratom Treaty).

Treaty Establishing the European Economic Community, Mar. 25, 1957, 298 U.N.T.S. 11, (EEC Treaty).

Accord monétaire européen et protocoles additionnels (5 août 1955-27 juin 1958) (EMA agreement).

EEC Council Decision of 9 March 1960 on Coordination of the Conjunctural Policies of the Member States, OJ 9.5.1960 L31/764.

First Capital Directive Council OJ 12.7.60 L921/60.

Memorandum of the Commission on the Action Programme of the Community for the Second Stage. (Marjolin Memorandum) COM (62) 300 final, 24 October 1962.

Second Capital Directive Council Directive OJ 22.1.63 L62/63.

Commission Communication, Brussels, 30.9.1964 COM(64)400.

Council Decision of 8 May 1964 on Co-operation between the Central Banks of the Member States of the EEC, OJ L77/1206.

Council Decision of 8 May 1964 on Co-operation between Member States in the Field of International Monetary Relations, OJ 21.51964 L77/1207.

Declaration of 8 May 1964 of the representatives of the Governments of the Member States of the European Economic Community, meeting within the Council, on the prior consultations between Member States in the event of changes in the exchange-rate parities of their currencies, OJ 22.5.1964 L78/1226.

Council Decision of 15 April 1964 establishing a Medium-term Economic Policy Committee OJ 22.4.1964 L64/1029.

Council Decision of 8 May 1964 on Cooperation between the Competent Government Departments of Member States in the Field of Budgetary Policy, OJ 21.5.1964 L77/1205.

Commission Communication, memorandum to the Council on the co-ordination of economic policies and monetary co-operation within the Community, Brussels, 12 February 1969, COM (69) 150 final, (First Barre Plan).

Council Decision of 17 July 1969 on co-ordination of the short-term economic policies of the Member States (69/227/EEC) - OJ L 183, 25.7.1969.

Council Decision of 16 February 1970 concerning the appropriate procedures for the prior consultations provided for in the Council Decision of 17 July 1969.

EEC Commission memorandum to the Council on the preparation of a plan for the phased establishment of an economic and monetary union. (Second Barre Plan) COM (70) 300 final, 4.03.1970.

Decision of the Council of 6 march 1970 regarding the procedure in the matter of economic and monetary cooperation, OJ L 59, 14.3.1970.

P. Werner, (1970) Report to the Council and the Commission on the realization by stages of Economic and Monetary Union in the Community (Werner Report) OJ C 136, 11.11.1970.

The "Summit Conference" at the Hague Statements made by the Heads of State or Government on 2 December 1969, OJ C 136, 11.11.1970.

Council of the Resolution and the three decisions on 22 March 1971: Resolution of the Council and of the Representatives of the Governments of the Member States of 22 March 1971 on the attainment by stages of economic and monetary union in the Community OJ C 28, 27.3.1971.

Council Decision of 22 March 1971 on the strengthening of the coordination of short-term economic policies of the Member States of the European Economic Community OJ L 73, 27.3.1971.

Council Decision of 22 March 1971 on the strengthening of cooperation between the central banks of the Member States of the European Economic Community OJ L 73, 27.3.1971.

Council Decision of 22 March 1971 setting up machinery for medium-term financial assistance OJ L 73, 27.3.1971.

Commission communication to the Council on the progress achieved in the first stage of economic and monetary union, Brussels, 19.4.1973, COM(73)570 final.

Council Decision of 18 February 1974 setting up an Economic Policy Committee OJ L 63, 5.3.1974.

Decision of the Representatives of the Governments of the Member States on the provisional location of the European Monetary Cooperation Fund (EMCF) in Luxembourg (Decision 73/208/EEC) - OJ L 207, 28.7.73.

Council Resolution of 18 February 1974 on short-term monetary support. OJ C 20, 5.3.1974.

Council Decision 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 (74/120/EEC) - OJ L 63, 5.3.1974.

Report of the Study Group on the Role of Public Finance in European Integration Studies: Economic and Fiscal Series A13 (vol. I), Brussels (1977) EC Commission, doc. II/10/77. (MacDougall Report).

Resolution of the European Council on the establishment of the European Monetary System (EMS) and related matters of 5 December 1978.

Council Decision 78/1041/EEC of 21 December 1978 - OJ L 379, 30.12.1979.

Single European Act, 1987 O.J. L 169/1, (SEA).

European Council in Hannover, Conclusion of the Precidency, EC Bulletin, No 6-1988, p. 22.

Padoa-Schioppa report on "Efficiency, stability and equity: A strategy for the evolution of the economic system of the European Community" EC Bulletin, No 4-1987, p. 7 (“Padoa-Schioppa Report”).

Council Directive 88/361, OJ 8.7.88 L178/5 - EC Bulletin, No 6/1988, p. 24.

EC Commission, Research on the Cost of Non-Europe. Office for Official Publications of the European Communities (Luxembourg, 1988).

European Council in Madrid, Conclusion of the Precidency, EC Bulletin, No 6-1989, p. 11.

European Council in Strasbourg. EC Bulletin, No 12-1989.

Council Decision 90/142 on the Committee of Central Bank Governors of the Member States, OJ 24.3.1990 L78/25.

Council Decision 90/141 on the progressive convergence of economic policies and performance during stage one of economic and monetary union, OJ 24.3.1990 L78/23.

EEC Commission (1990) “One Market, One Money” 44 European Economy. p. 46.

Council Decision 91/136/EEC of 13 March 1991on a Community loan in favour of Greece OJ L 66/22.

Council Decision 91/136/EEC of 13 March 1991 on a Community loan in favour of Italy OJ L 66/36.

Treaty on European Union (Maastricht text), July 29, 1992, 1992 O.J. C 191/1 (Treaty of Maastricht or EC Treaty).

Council Regulation (EC)No 3603/93 of 13 Dec. 1993 specifying definitions for the application of the prohibitions referred to in Articles 104 and 104b(l) of the Treaty, O.J. 1993, L 332/1.

European Council in Bruxelles, Conclusion of the Precidency, EC Bulletin No 10-1993, p. 8.

Council Recommendation 94/7/EC of 22 December 1993 on the broad guidelines of the economic policies of the Member States and of the Community, OJ L 7/9.

Commission Green Paper on the practical arrangements for the introduction of the single currency, EU Bulletin, No 5-1995, point 1.3.7, p. 12.

Commission Communication, the impact of currency fluctuations on the internal market, Brussels, 31.10.1995 COM (9S) 503 final.

Council Regulation (EC) No 1103/97 of 17 June 1997 on certain provisions relating to the introduction of the euro, O. J. 1997 L 162/1.

European Council Resolution on the Stability and Growth Pact (Amsterdam, 17 June 1997) OJ C 236/1.

Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, OJ L 209/1.

Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure, OJ L 209/6.

European Council in Amsterdam, Conclusion of the Precidency, EU Bulletin 6-1997, point I.27. OJ C 236, 2.8.1997.

Decision of the Council of the European Union meeting in the composition of the Head of States and Government of 3 May 1998, O.L J 139, 11 May 1998, p. 30.

Council Recommendation 98/454/EC of 6 July 1998 on the broad guidelines of the economic policies of the Member States and of the Community OJ L 200/34.

Council Recommendation 2003/555/EC of 26 June 2003 on the broad guidelines of the economic policies of the Member States and the Community (for the 2003-2005 period) OJ L 195/1.

Commission Recommendation to the Council on an Excessive Deficit Procedure for France Commission Press Room, IP/30/1420 Brussels, 21 October 2003.

Commission Recommendation to the Council on an Excessive Deficit Procedure for Germany Commission Press Room IP/03/1560 Brussels, 18 November 2003.

Commission Communication on strengthening economic governance and clarifying the implementation of the Stability and Growth Pact, Brussels, 3.9.2004 COM (2004) 581 Final.

Council Regulation (EC) No. 1055/2005 of 27 June 2005 amending Regulation (EC) No. 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, O.J. 2005, L 174/1;

Council Regulation (EC) No. 1056 of 27 June 2005 amending Regulation (EC) No. 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure, O.J. 2005, L 174/5.

Council Recommendation 2005/601/EC of 12 July 2005 on the broad economic policy guidelines of the Member States and the Community (2005-2008) OJ L 205/28.

Council Regulation (EC) n. 1084/2006 of 11 July 2006 establishing a Cohesion Fund and repealing Regulation (EC) No 1164/94, OJ L210/79.

Council Recommendation 2007/209/EC of 27 March 2007 on the 2007 update of the broad guidelines for the economic policies of the Member States and the Community and on the implementation of Member States' employment policies OJ L 92/23.

Council Recommendation 2008/390/EC of 14 May 2008 on the broad economic policy guidelines for the Member States and the Community (2008-2010) OJ L 137/13.

Commission Communication on a European Economic Recovery Plan, Brussels, 26 November 2008 COM (2008) 800.

Commission Communication on "EMU@10: successes and challenges after 10 years of Economic and Monetary Union" 7 May 2008 - IP/08/716.

Commission Communication on European financial supervision, Brussels, 27 May 2009 COM (2009) 252.

Commission Proposal on “Regulation of the European Parliament and of The Council on Community macro prudential oversight of the financial system and establishing a European Systemic Risk Board”, 23 September, COM(2009) 499.

The European Parliament report (INI) on “Improving the economic governance and stability framework of the Union, in particular in the euro area”, 2009 (Feio Report) avalaible on EP Legislative Observatory under: http://www.europarl.europa.eu/oeil/FindByProcnum.do?lang=2&procnum=INI/2010/2099.

Report of the Commission of 8 Jan. 2010 on Greek Government deficit and debt statistics, COM(2010) 1 final.

Joint statement by European Commission, European Central Bank and Presidency of the Eurogroup on Greece, IP/10/446, 23 April 2010.

Commission Communication on reinforcing economic policy coordination, Brussels, 12.5.2010 COM (2010) 250 final.

ECB Decision of 14 May 2010 on establishing a securities markets programme, [2010] OJ L 124/8.

Commission Communication, proposal for a Regulation of the European Parliament and of the Council - on the effective enforcement of budgetary surveillance in the Euro area, Brussels, 29.9.2010, COM (2010) 524 final.

Council Decision (2010/320/EU) of 10 May 2010, O.J. 2010, L 145/6, amended by Council Decision (2010/486/EU) of 14 Sept. 2010, O.J. 2010, L 241/12.

Regulation 407/2010, O. J. 2010, L 189/1 (EFSM Regulation);

Council Recommendation of 13 July 2010 on broad guidelines for economic policies of the Member States and of the Union OJ L191/28.

Council Decision 2010/707/EU of 21 October 2010 on guidelines for the employment policies of the Member States OJ L308/46.

Directive 2010/78/EU of 24 November 2010, [2010] OJ L 331/120.

European Council, Presidency Conclusions of 24-25 March 2011, EUCO10/1/11 of 20 April 2011, Annex 1.

European Council, Statement by the heads of State or Government of the euro area and EU institutions of 21 July 2011, available at www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/123978.pdf

European Council Conclusions of 24-25 March 2011, EUCO 10/1/11 REV1.

Treaty Establishing the European Stability Mechanism (ESM Treaty) (2011) OJ L91/1.

Council Decision of 25 March 2011 amending Article 136 of the Treaty on the Functioning of the European Union with regard to a stability mechanism for Member States whose currency is the Euro, O.J. 2011, L 91/1.

Regulation (EU) No 1174/2011 of the European Parliament and of the Council of 16 November 2011 on enforcement measures to correct excessive macroeconomic imbalances in the Euro area, OJ L 306/8.

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, OJ L 306/12.

Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances, OJ L 306/25.

European Council, Statement by the Euro area heads of state or government, (the so called "December 2011 statement"), 9 December 2011 available at https://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/126658.pdf.

Treaty on Stability, Coordination and Governance in the Economic and Monetary Union of 2 March 2012 - not published in the Official Journal (also known as the fiscal compact) available at https://www.consilium.europa.eu/media/20399/st00tscg26_en12.pdf

Council Decision 2012/156/EU of 13 March 2012 suspending commitments from the Cohesion Fund for Hungary with effect from 1 January 2013 (2012) OJ L78/19.

Council Decision 2012/323/EU of 22 June 2012 lifting the suspension of commitments from the Cohesion Fund for Hungary (2012) OJ L165/46.

Commission Communication, Common principles on national fiscal correction mechanisms Brussels, 20.6.2012 COM (2012) 342 final.

European Council Conclusions of 28-29 June 2012, EUCO 76/12.

ECB, Technical features of Outright Monetary Transactions, Press Release of 6 September 2012 available at https://www.ecb.europa.eu/press/pr/date/2012/html/pr120906_1.en.html.

H. Van Rompuy, J. M. Barroso, J. C. Juncker, M. Draghi (2012) 'Towards a genuine Economic and Monetary Union', Brussels: European Council (Four President Report of the 5 December 2012) available at http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ec/134069.pdf.

Commission Communication, Interim Progress Report on the implementation of Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States Brussels, 14.12.2012 COM(2012) 761 final.

European Council Conclusions of 19-20 December 2013, EUCO 217/13.

Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (2012) O.J L 287/63.

Commission Communication, Towards a Deep and Genuine Economic and Monetary Union The introduction of a Convergence and Competitiveness Instrument, Brussels, 20.3.2013 COM(2013) 165 final.

Regulation (EU) No 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area, OJ L 140/11.

Regulation (EU) No 472/2013 of the European Parliament and of the Council of 21 May 2013 on the strengthening of economic and budgetary surveillance of Member States in the Euro area experiencing or threatened with serious difficulties with respect to their financial stability, OJ L 140/1.

Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006, OJ L 347/320.

European Council Conclusions of 19-20 December 2013, EUCO 217/13.

European Parliament, 'Ratification requirements and present situation in the member states: Article 136 TFEU, ESM, Fiscal Stability Treaty (January 2014)' Policy Department of 15 January 2014, available at http://www.europarl.europa.eu/meetdocs/2009_2014/documents/afco/dv/2013-06-12_pe462455-v16_/2013-06-12_pe462455-v16_en.pdf.

Regulation (EU) No 806/2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund (2014) OJ L 225/1.

Commission Communication, results of in-depth reviews under Regulation (EU) No 1176/2011 on the prevention and correction of macroeconomic imbalances Brussels, 5.3.2014, COM (2014) 150 final.

Decision ECB/2014/40 of the European Central Bank of 15 October 2014 on the implementation of the third Covered Bond Purchase Programme, OJ L 335/22.

Decision ECB/2014/45 of the European Central Bank of 19 November 2014 on the implementation of the asset-backed securities purchase programme OJ L 1/4.

Commission Communication, Economic governance review Report on the application of Regulations (EU) n° 1173/2011, 1174/2011, 1175/2011, 1176/2011, 1177/2011, 472/2013 and 473/2013", Brussels, COM (2014) 0905 final, available at http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1485161865423&uri=CELEX:52014DC0905.

Decision ECB/2015/10 of the European Central Bank of 4 March 2015 on a secondary markets public sector asset purchase programme OJ L 121/20.

Report by J Juncker in close cooperation with D Tusk J. Dijsselbloem M Draghi and M Schulz Completing Europe's Economic and Monetary Union. (Five President Report, 2015) available at https://ec.europa.eu/commission/sites/beta-political/files/5-presidents-report_en.pdf.

Commission Communication on making the best use of the flexibility within the existing rules of the stability and growth pact, Brussels, 13.1.2015 COM (2015) 12 final.

Council Recommendation (EU) 2015/1184 of 14 July 2015 on broad guidelines for the economic policies of the Member States and of the European Union OJ L 192/27.

Council Decision (EU) 2015/1848 of 5 October 2015 on guidelines for the employment policies of the Member States for 2015 OJ L 268/28.

Commission Decision (EU) 2015/1937 of 21 October 2015 establishing an independent advisory European Fiscal Board, OJ L 282/37.

European Commission, on steps towards Completing Economic and Monetary Union, Brussels COM (2015) 600 final, 21 October.

EU Commission, European structural and investment funds 2014-2020: Official texts and commentaries, November 2015 available at http://ec.europa.eu/regional_policy/sources/docgener/guides/blue_book/blueguide_en.pdf.

Commission Decision (EU) 2016/221 of 12 February 2016 amending Decision (EU) 2015/1937 establishing an independent advisory European Fiscal Board. OJ L 40/15.

Commision Communication, Annual Growth Survey 2017, Brussels, 16.11.2016 COM (2016) 725 final.

Commission Communication, Towards a positive fiscal stance for the euro area, Brussels, 16.11.2016 COM (2016) 727 final.

Commission Communication, the Fiscal Compact: Taking Stock, Brussels, 22.2.2017, COM (2017) C1200 final.

Commission Report presented under Article 8 of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, Brussels, 22.2.2017 C(2017) 1201 final, available at https://ec.europa.eu/info/sites/info/files/c20171201_en.pdf.

European Commission, white Paper on the future of Europe, Brussels, COM (2017) 2025 of 1 March 2017.

Council Recommendation of 21 March 2017 on the economic policy of the euro area, OJ C 92/1.

Council of the European Union Brussels, Revised Specifications on the implementation of the Stability and Growth Pact and Guidelines on the format and content of Stability and Convergence Programmes (Code of Conduct of the Stability and Growth Pact), 18 May 2017 (OR. en) 9344/17 ECOFIN 423 UEM 170.

European Commission, reflection paper on the deepening of the Economic and Monetary Union, Brussels, COM (2017) 291 of 31 May 2017.

Commission Communication, Alert Mechanism Report 2017, Brussels, 22.11.2017, COM (2017) 771 final.

Commission Communication, Country Report Italy 2018, Including an In-Depth Review on the prevention and correction of macroeconomic imbalances, Brussels, 7.3.2018, SWD(2018) 210 final.

Table of Case Law (Chronological Order)

BVerfG, Case No. 89, 155 of 12 October 1993; english translation provided by the Court and available at: http://www.bverfg.de/en/decisions/rs20120912_2bvr139012en.html.

Judgment of the Court of 13 July 2004, Commission of the European Communities v Council of the European Union. ECLI:EU:C:2004: 436.

BVerfG, Case No. 2 BvE 2/08 of 30 June 2009; english translation provided by the Court and available at: http://www.bverfg.de/en/decisions/rs20120912_2bvr139012en.html.

BVerfG, Case No. 2 BVR 987/10, May 7, 2010, English translation available at https://www.bundesverfassungsgericht.de/SharedDocs/Entscheidungen/EN/2011/09/rs20110907_2bvr098710en.html.

BVerfG, Case No. 2 BVE 4/11, Jun. 19, 2012 (Ger.).

Pt. Const. Ct., Acórdão N° 353/2012, judgment of 5 July 2012.

Estonia Supreme Court, Constitutional Case No. 3-4-1-6-12, judgment of 12 July 2012. English translation is available at https://www.riigikohus.ee/en/constitutional-judgment-3-4-1-6-12;

Fr. Cons. C., Décision n° 2012-653 DC, judgment of 9 August 2012. An English translation available at http://www.conseil-constitutionnel.fr/conseil-constitutionnel/english/case-law/decision/decision-no-2012-653-dc-of-9-august-2012.115501.html;

BVerfG, Case No. 2 BvR 1390/12 - paras. (1-245); english translation provided by the Court and available at http://www.bundesverfassungsgericht.de/SharedDocs/Entscheidungen/EN/2014/03/rs20140318_2bvr139012en.html.

BVerfG, Case No. 2 BvR 2728/13, English translation provided by the Court and available at http://www.bundesverfassungsgericht.de/SharedDocs/Entscheidungen/EN/2014/01/rs20140114_2bvr272813en.html.

Case C-370/12 Pringle v. Government of Ireland, Ireland and the Attorney General, judgment of 27 Nov. 2012.

BVerfG, Case No. 2 BvR 2728/13, 2 BvR 2729/13, 2 BvR 2730/13, 2 BvR 2731/13, 2 BvE 13/13. Press Release No. 34/2016 of 21 June 2016.

Case C-62/14 Peter Gauweiler and Others v Deutscher Bundestag, ECLI:EU:C:2015:400 [2015].

BVerfG, Case No. 2 BvR 2728/13, 2 BvR 2729/13, 2 BvR 2730/13, 2 BvR 2731/13, 2 BvE 13/13. Press Release No. 34/2016 of 21 June 2016; english translation provided by the Court and available at https://www.bundesverfassungsgericht.de/SharedDocs/Pressemitteilungen/EN/2016/bvg16-034.html.

Decision of the Italian Constitutional Court n. 275/2016.