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The transformation of the euro: law, contract, solidarity

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3 | Committing to stability

1 INTRODUCTION

In November 1995 the German Finance Minister Theo Waigel tabled a proposal for a *Stabilitätspakt für Europa*. In its preamble he argued:

‘The monetary union must be committed to stability from the beginning. All participants in the final stage have the same interest in this. They form a community of solidarity in the sense that the stability of the European currency will be reliably and permanently secured through strict budgetary discipline in all the participating countries.’¹

Waigel’s words captured the very essence of how the members of the currency union had to relate to one another, except for the fact that this was not an ambition to be realised with his pact but a political and legal reality due to the entry into force of the Treaty of Maastricht two years earlier, on 1 November 1993. By signing and ratifying this Treaty the member states had changed their Founding Contract and had jointly committed themselves to a currency union geared towards price stability. As a result, the solidarity they were bound to display was largely negative in kind; the actions each state had to perform in the interest of the collective mainly focused on its own condition, especially in the area of fiscal policy where each had to maintain budgetary discipline. For Waigel, however, these arrangements did not go far enough and that is why he pleaded for a stability pact only two years after the Treaty had entered into force.

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- This chapter contains and/or builds on previously published work by the author. See especially Vestert Borger, ‘How the Debt Crisis Exposes the Development of Solidarity in the Euro Area’ (2013) 9 *EuConst* 7; Stefaan Van den Bogaert and Vestert Borger, ‘Twenty Years After Maastricht: The Coming of Age of the EMU?’ in Maartje de Visser and Anne Pieter van der Mei (eds), *The Treaty on European Union 1993-2013: Reflections from Maastricht* (Intersentia 2013) 451; Stefaan Van den Bogaert and Vestert Borger, ‘Differentiated integration in EMU’ in Bruno De Witte, Andrea Ott and Ellen Vos (eds), *Between Flexibility and Disintegration: The Trajectory of Differentiation in EU Law* (Edward Elgar 2017) 209.

- 1 Theo Waigel, *Stabilitätspakt für Europa: Finanzpolitik in der dritten Stufe der WWU* (Bundesministeriums der Finanzen, 10 November 1995), translation obtained from <www.cvce.eu> accessed 13 March 2017. See also Jean-Victor Louis, ‘Managing Public Finances. Lessons and Perspectives for the EU and the Euro Area’ (Vortrag an der Humboldt-Universität zu Berlin, 15 December 2011) 7-8.

This chapter examines the single currency's original stability set-up. Thorough knowledge about this set-up is crucial to understand *how* the debt crisis could strike at the heart of the currency union when it erupted late in 2009 and *why* this necessitated a transformation of the euro. The chapter starts with a concise discussion of the history of European monetary integration. Clearly, this study is not the first to give such a description. In fact, they abound.² Yet, treatment of this history is justified as it not only helps to explain when and why the member states succeeded in creating a single currency, but also the rationale behind its legal set-up.

The discussion draws on the works of various disciplines, including those of integration theorists. It refrains, however, from defending a particular theory or model.³ Its ambition is more modest as it simply differentiates between two sorts of motives – one economic, the other political – and shows how both have been important drivers of monetary integration. Each of them inspired Europe's first attempt to create a currency union, started by its political leaders in The Hague in 1969, but each was lacking in urgency to have it succeed. Both, however, suddenly gained in importance during the 1980s, even to such an extent that the European Council dared to undertake a second attempt at its meeting in Hannover in June 1988. And this time both motives were sufficiently pressing, as the member states agreed on the creation of a single currency by 1999 at the latest when they signed the Treaty of Maastricht on 7 February 1992.

Economically, this move was inspired by rising capital mobility and the importance of exchange rate stability for the internal market, the combination of which made it increasingly difficult for states to pursue a monetary policy of their own. In fact, most of them had already lost much of their autonomy under the European Monetary System in which they had to closely follow the policy of the *Bundesbank* in order to have monetary stability. But political considerations were crucial too. The fall of the Berlin Wall in November 1989 provided critical incentives, in particular to Germany and France, to speed up plans for a currency union that had already been set in motion.

2 Some very thorough analyses, from various disciplines and viewpoints, are provided by Tommaso Padoa-Schioppa, *The Road to Monetary Union in Europe: The Emperor, the Kings, and the Genies* (OUP 1994); Daniel Gros and Niels Thygesen, *European Monetary Integration: From the European Monetary System to Economic and Monetary Union* (2nd edn, Longman 1999); André Szász, *The Road to European Monetary Union* (Macmillan Press 1999); Kenneth Dyson and Kevin Featherstone, *The Road to Maastricht: Negotiating Economic and Monetary Union* (OUP 2003).

3 For an overview of the different theoretical explanations of why Europe managed to attain economic and monetary union see Tal Sadeh and Amy Verdun, 'Explaining Europe's Monetary Union: A Survey of the Literature' (2009) 11 *International Studies Review* 277.

Attention then shifts to the legal set-up of the single currency, in particular its *internal policy* dimension.⁴ The economic and political forces behind the currency union's creation have also exercised great influence on its set-up. Cooperation in the European Monetary System stimulated a convergence of economic preferences among states, characterised by a shift away from 'Keynesian' to 'monetarist' thinking and a corresponding increase in importance of price stability as an objective. Moreover, price stability was greatly valued by Germany, which wanted to ensure that a single currency would be 'at least as stable as the D-Mark'.⁵ Given its anchor position in the European Monetary System, the German government was able to strongly push for this during the treaty negotiations on monetary union. And afterwards it sought further stability guarantees at the level of secondary law.

As a result of these dynamics, the single currency's original set-up institutionalised a 'stability' or 'sound money' paradigm. Characteristic of this paradigm was that it granted overriding importance to price stability as a policy goal and argued for a privileged position of the central bank in achieving this. Its influence was most notably evident at the level of aims and principles and in the constitutional position of the European Central Bank. But it also shaped the single currency's economic foundations, in particular the Union's limited competences in this area and its focus on fiscal prudence. It even informed the rules governing accession.

Throughout its discussion of this original set-up the chapter refers to the provisions that are currently laid down in the Union Treaties, unless consideration of the former EC Treaty is explicitly warranted.⁶ It discusses secondary law in its pre-crisis form.

2 CALLING FOR MONETARY UNION

2.1 The Hague, 1-2 December 1969

As early as 1950, several years before the creation of the Coal and Steel Community, Jacques Rueff, French economist and former judge at the European

4 For analyses of the legal framework governing the external aspects of monetary union see eg René Smits, *The European Central Bank: Institutional Aspects* (Kluwer Law International 1997) 365-484; Chiara Zilioli and Martin Selmayr, 'The External Relations of the Euro Area: Legal Aspects' (1999) 36 CML Rev 273.

5 See in this regard text to n 156 (ch 3).

6 For a discussion of the changes introduced by the Lisbon Treaty in the area of economic and monetary policy see René Smits, 'The European Constitution and EMU: An Appraisal' (2005) 42 CML Rev 425 (analysing the provisions in the Constitution for Europe that have largely been reproduced by the Lisbon Treaty); Fabian Amtenbrink and Johan W van de Gronden, 'Economisch recht en het Verdrag van Lissabon II: Europese Economische en Monetaire Unie' (2008) 56 SEW 389.

Court of Justice, declared: '*L'Europe se fera par la monnaie ou ne se fera pas*' (Europe will be created through the currency, or it will not be created).⁷ With the benefit of hindsight one can say these words bore a prophetic character. The desire to unite Europe monetarily has inspired the integration process since its inception. Admittedly, the original EEC Treaty contained only modest provisions on economic and monetary cooperation, mainly focusing on the coordination of national economic policies and obliging member states to treat their exchange rate policies 'as a matter of common interest'.⁸ Yet, this modesty can be explained by the fact that during the early years of European integration, monetary cooperation was not primarily a European, but a global affair.⁹ In 1944 the allied states, notably the United States and Great Britain, had established the Bretton Woods system with the aim to achieve monetary stability as soon as the Second World War came to an end. The system was inspired by a desire to return to the stable monetary relations that had characterised the international order in the 19th century when the Gold Standard was effective.¹⁰ It formed a 'semi-gold standard',¹¹ administered by the International Monetary Fund, with the dollar operating as an 'anchor currency' being tied to gold at \$35 an ounce.¹² The other currencies were pegged to the dollar and the parities around which they could 'pivot' within margins of one percent were 'fixed' but 'adjustable'.¹³

The Bretton Woods system disguised the importance of money for European integration as long as it operated quite successfully, but as soon as the first cracks in the system emerged in the 1960s,¹⁴ European initiatives at intensifying monetary cooperation appeared. They were modest at first, focusing on the establishment of policy bodies like the Committee of Central Bank

7 Jacques Rueff, '*L'Europe se fera par la monnaie ou ne se fera pas*' (1950) 4 *Synthèse* 267 (as cited in Christopher S Chivvis, *The Monetary Conservative: Jacques Rueff and Twentieth-century Free Market Thought* (Northern Illinois University Press 2010) 142, 209 (fn 40)).

8 Arts 6, 103-109 and 145 EEC.

9 Loukas Tsoukalis, *The Politics and Economics of European Monetary Integration* (George Allen & Unwin 1977) 52; Smits, *The European Central Bank* (n 4) 10-11; Michele Chang, *Monetary Integration in the European Union* (Palgrave Macmillan 2009) 15; Rosa M Lastra and Jean-Victor Louis, 'European Economic and Monetary Union: History, Trends, and Prospects' (2013) 32 *YEL* 57, 63.

10 Chang (n 9) 15-16.

11 Smits, *The European Central Bank* (n 4) 11.

12 Harold James, *International Monetary Cooperation Since Bretton Woods* (IMF and OUP 1996) 66. See also Chang (n 9) 16.

13 Chang (n 9) 16-17. See also Szász, *The Road* (n 2) 16. For an overview of the legal regime governing the system see Joseph Gold, *Legal and Institutional Aspects of the International Monetary System: Selected Essays* (IMF 1979).

14 For an elaborate discussion of the events that contributed to the system's demise, notably increased capital mobility, increasing rigidity of the exchange rates and a 'loose', inward looking US monetary policy see James (n 12) 205-227.

Governors,¹⁵ and closer cooperation and consultation in the economic and monetary sphere.¹⁶ But the more the Bretton Woods engine sputtered, the more European cooperation intensified. By the time the system collapsed in August 1971 when President Nixon let the world know he was 'closing the gold window', meaning that the United States was no longer prepared to exchange dollars for gold,¹⁷ Europe had already voiced its desire to achieve monetary union.

This desire was expressed by the heads of state and government at a summit in The Hague in December 1969. When studying the declaration they adopted at this summit, it is striking how closely European integration and money are related. First the leaders stress their belief that a 'Europe composed of states which.....are united in their essential interests' and 'assured in its internal cohesion' is vital for peace and prosperity.¹⁸ Then they call for a plan to achieve economic and monetary union in stages.¹⁹

Why were they prepared to take this bold move? First of all, there were economic motives. The gradual establishment of the internal market was causing greater trade interdependence among their national economies, which made them vulnerable to exchange rate fluctuations. When the Bretton Woods system began to show signs of decline, this interdependence provided the member states with a strong incentive to strengthen their own efforts to create monetary stability.²⁰ International monetary disturbances also created problems for the Community's agricultural policy.²¹ This policy was based on Community-wide prices for a range of agricultural products. Exchange rate fluctuations negatively affected its operation; whenever a state's currency

15 Council Decision 64/300/EEC of 8 May 1964 on cooperation between the central banks of the Member States of the European Economic Community [1964] OJ 77/1206.

16 See, for example, Council Decision 64/301/EEC of 8 May 1964 on cooperation between Member States in the field of international monetary relations [1964] OJ 77/1207; Declaration 64/306/EEC 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 the Member States in the event of changes in the exchange-rate parities of their currencies [1964] OJ 78/1226. For an overview of the major decisions and events in the run up to the creation of monetary union see Commission, 'Towards economic and monetary union (EMU): A chronology of major decisions, recommendations or declarations in this field' (European Economy Occasional Papers No 13, 2005).

17 James (n 12) 218-219. See also Chang (n 9) 24.

18 Final communiqué of the meeting of Heads of State or Government, The Hague, 1-2 December 1969, para 4.

19 Final communiqué of the meeting of Heads of State or Government, The Hague, 1-2 December 1969, para 8.

20 Tsoukalis (n 9) 58; Szász, *The Road* (n 2) 20; Chang (n 9) 21-22.

21 Tsoukalis (n 9) 59-60; Szász, *The Road* (n 2) 8-9; Chang (n 9) 22.

depreciated or appreciated, the common price system caused national prices to fluctuate.²²

But just as important were political motives. During the 1960s the economy of the Federal Republic of Germany had become increasingly powerful. This risked upsetting 'the balance of power' with France that had provided the basis for European stability and integration ever since the war had ended.²³ France feared that this stability as well as its own position on the continent would be threatened by Germany's economic strength. A monetary union could encapsulate this strength and ensure the state's continued commitment to European integration. Instead of a European economy dominated by the D-Mark, Germany would participate in a monetary union and thereby give up its strong currency in favour of a European alternative.²⁴

For Germany itself, monetary union constituted a means to achieve its new '*Ostpolitik*'.²⁵ After the Federal Republic had conducted a policy of neglect concerning its eastern counterpart – the German Democratic Republic – during the 1950s and 1960s it adopted a new approach after Willy Brandt became chancellor in 1969.²⁶ Intensifying the ties with the East was perceived as an essential step towards the eventual reunification of Germany.²⁷ In the West this policy change created fears of a return by Germany to its pre-war tendency to move back and forth between East and West, depending on what served its interests best.²⁸ For Germany, then, monetary union formed an opportunity to reassure its partners that it would not exchange reunification for a lessening of European integration; it would become so strongly embedded in the Community that giving Europe the cold shoulder would no longer be an option.²⁹

The plan announced in The Hague was prepared by a committee headed by the Prime Minister of Luxembourg, Pierre Werner.³⁰ Published in October 1970 and known as the 'Werner Report',³¹ it set out a strategy to achieve

22 Smits, *The European Central Bank* (n 4) 14. Smits mentions that next to agricultural policy, other Community measures and plans based on a common value were also negatively affected by exchange rate fluctuations. Examples he gives are capitalisation standards for public limited companies, fines and other levies of the Commission in relation to competition policy and the unit of account for the Community budget.

23 Szász, *The Road* (n 2) 20-25, 29.

24 Szász, *The Road* (n 2) 28-29; David Marsh, *The Euro: The Politics of the New Global Currency* (YUP 2009) 50-51.

25 Szász, *The Road* (n 2) 25-26.

26 Szász, *The Road* (n 2) 25-26.

27 Szász, *The Road* (n 2) 26.

28 Szász, *The Road* (n 2) 26-27; Marsh (n 24) 52.

29 Szász, *The Road* (n 2) 28-29.

30 The decision to appoint Pierre Werner as the committee's president was taken by the Council on 6 March 1970. See Council Decision 70/192/EEC of 6 March 1970 on the procedure for economic and monetary cooperation [1970] OJ L 59/44.

31 Werner Group, *Report to the Council and the Commission on the realization by stages of Economic and Monetary Union in the Community* (Luxembourg, 8 October 1970) (Werner Report).

economic and monetary union by 1980. Only a few months later, in March 1971, the Council and the representatives of the governments of the member states adopted a Resolution in which they expressed their political will to achieve this goal within a decade.³²

Both the Werner Report and the Resolution envisaged the achievement of monetary union in three stages, putting most emphasis on the first and final stages. During the first, preparatory stage, beginning on 1 January 1971 and lasting three years, the focus should be on narrowing currency fluctuation margins, streamlining economic policy through the setting of broad guidelines, coordinating fiscal policy and preparing Treaty amendments.³³ In the second stage this policy should be continued, especially by liberalising capital markets, eliminating exchange rate fluctuations and an increasingly tight coordination of economic and fiscal policies 'by ever closer regard for the common interest'.³⁴ In the final stage, for which no starting date was mentioned, currencies should be fully convertible, parity rates irrevocably fixed and national economic and fiscal policies strongly coordinated or harmonised.³⁵ Moreover, responsibility for monetary policy should be transferred to the Community, whereas in the area of economic policy a 'centre of decision' had to be established with the power to steer national fiscal policy 'to the extent necessary for the proper functioning' of the monetary union.³⁶ The Werner Report made explicit that in the final stage 'national monetary symbols' could either be maintained or exchanged in favour of a single currency. It preferred the latter, since it would underline the 'irreversibility of the venture'.³⁷

In the years that followed several initiatives were taken to further the goal of monetary union.³⁸ The most notable one related to the reduction of currency fluctuation margins.³⁹ After the United States had decided to close the gold window in August 1971, new rates for currencies in the Bretton Woods system were (temporarily) agreed on and fluctuation margins against the dollar

32 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 [1971] OJ C 28/1, para I (1971 EMU Resolution).

33 Werner Report (n 31) 15-24; 1971 EMU Resolution, para III.

34 Werner Report (n 31) 24-25, 28.

35 Werner Report (n 31) 9-13; 1971 EMU Resolution, para I.

36 Werner Report (n 31) 11-13.

37 Werner Report (n 31) 10.

38 Besides this exchange rate arrangement, several Community legislative instruments aimed at intensifying economic and monetary policy were adopted. Moreover, the European Monetary Cooperation Fund was established. For analysis see Smits, *The European Central Bank* (n 4) 16-19; Gros and Thygesen (n 2) 20-23.

39 Note that in their Resolution of March 1971 political leaders had already decided to hold exchange rate fluctuations within margins narrower than those in place for the US dollar. See 1971 EMU Resolution, para III(6). See also Werner Report (n 31) 22.

were set at 2.25% on the basis of the Smithsonian Agreement.⁴⁰ Community currencies could now fluctuate against each other within margins double the size of that vis-à-vis the dollar, a level considered too high for the common agricultural policy.⁴¹ In March 1972 the Council and the representatives of the governments of the member states therefore decided to narrow fluctuation margins between their currencies to ± 2.25 percent.⁴² Soon Denmark, the United Kingdom and Ireland (as member of the sterling bloc), which were about to accede to the Community on 1 January 1973, also entered the arrangement,⁴³ which was called the 'snake in the tunnel' as the narrow fluctuation band of participating currencies 'writhed like a like a snake through the wider band, or tunnel, against the dollar'.⁴⁴

Being part of the first 'stage' towards monetary union, the snake was only intended as a preparatory step towards the full elimination of fluctuation margins.⁴⁵ But things would not get that far. Currency realignments and states withdrawing and re-joining were the rule rather than the exception under the arrangement.⁴⁶ The first oil crisis in 1973 affected some participating states more than others and had 'asymmetric' effects on their economies.⁴⁷ Moreover, the states failed to agree on a common strategy to deal with the economic hardship.⁴⁸ Their inability to gear economic policies to one another and the tendency to focus monetary policy on domestic interests only prevented the snake from delivering monetary stability.⁴⁹

From the nine states that had initially joined the snake only five were left in it by January 1974.⁵⁰ Instead of providing monetary stability for the whole Community, the snake had developed into a 'mark zone' in which only those states able and willing to closely observe German monetary policy could

40 Tsoukalis (n 9) 117, 120; Chang (n 9) 24.

41 Tsoukalis (n 9) 120; Chang (n 9) 24.

42 Resolution of the Council and of the Representatives of the Governments of the Member States of 21 March 1972 on the application of the Resolution of 22 March 1971 on the attainment by stages of economic and monetary union in the Community [1972] OJ C 38/3, para III (1972 EMU Resolution).

43 Norway and Sweden, which were not (yet) members of the Community, would also become associated to the arrangement in May 1972 and March 1973 respectively. See also Gros and Thygesen (n 2) 16-17.

44 Szász, *The Road* (n 2) 36. After it was decided to let the dollar float on 19 March 1973 the snake was out of the 'tunnel'.

45 See also 1972 EMU Resolution, para III.

46 For an overview of withdrawals and exchange rate adjustments see Gros and Thygesen (n 2) 17.

47 Barry Eichengreen, *Globalizing Capital: A History of the International Monetary System* (Princeton University Press 1996) 157-159.

48 Eichengreen (n 47) 159.

49 Tsoukalis (n 9) 130-131; Eichengreen (n 47) 159.

50 Germany, the Netherlands, Belgium, Luxembourg and Denmark. See also Tsoukalis (n 9) 130; Gros and Thygesen (n 2) 17.

participate.⁵¹ When the Commission commissioned a group of experts headed by its former Vice-President Robert Marjolin to assess the possibility of attaining monetary union by 1980, they responded in their report:

‘Europe is no nearer to EMU than in 1969. In fact if there has been any movement it has been backward. The Europe of the Sixties represented a relatively harmonious economic and monetary entity which was undone in the course of recent years; national economic and monetary policies have never in 25 years been more discordant, more divergent, than they are today.’⁵²

With the benefit of hindsight this view seems overly pessimistic,⁵³ especially given the fact that only a few years later, in 1978, monetary integration would receive a new impetus with the establishment of the European Monetary System (EMS). But ambitions had certainly been scaled down. When it called for the establishment of this system in Bremen on 6 and 7 July 1978, the European Council no longer spoke of the ultimate objective of monetary union. Its purpose was now more modest: a ‘zone of monetary stability’.⁵⁴

Central to the Monetary System, of which the key features were laid down in a European Council Resolution adopted in Brussels on 5 December 1978,⁵⁵ was the European Exchange Rate Mechanism (ERM). This mechanism essentially formed a prolongation of the snake as states were still required to keep their currencies within fluctuation margins of 2.25%,⁵⁶ but it was attempted to inject more ‘symmetry’ in the system through some technical reforms in order to distribute adjustment efforts more evenly among states with ‘strong’ and ‘weak’ currencies.⁵⁷

Did the system succeed in creating a zone of monetary stability?⁵⁸ After a rocky start lasting until 1983, during which states were still recovering from the miserable economic conditions of the 1970s, the system entered a more tranquil period in which it helped to coordinate national monetary policies,

51 Chang (n 9) 25. See also Tsoukalis (n 9) 130.

52 Commission, *Report of the study group “Economic and Monetary Union 1980”* (8 March 1975) 1.

53 See also Gros and Thygesen (n 2) 20.

54 European Council, *Conclusions, Bremen*, 6–7 July 1978, 3.

55 Resolution of the European Council of 5 December 1978 on the establishment of the European Monetary System (EMS) and related matters, annexed to European Council Conclusions, Brussels, 5 December 1978 (1978 EMS Resolution). In addition to this Resolution, EMS arrangements were laid down in Community legislation and central bank agreements. For detailed overviews of these arrangements see Jean-Victor Louis, ‘Het Europees Monetair Stelsel’ (1979) SEW 441; René Smits, ‘Het Europees Monetair Stelsel’ (1979) 28 *Ars Aequi* 303; Jean-Jacques Rey, ‘The European Monetary System’ (1980) 17 *CML Rev* 7.

56 1978 EMS Resolution, para 3.1. Italy, whose currency floated before the introduction of the EMS, opted for margins of 6%.

57 Chang (n 9) 26–28. See also Gros and Thygesen (n 2) 44–48.

58 For an overview of the several phases in the functioning of the system see Gros and Thygesen (n 2) 65–105.

especially by keeping exchange rates in line with the D-Mark.⁵⁹ In particular from 1987 onwards the system's bands 'hardened', meaning that 'markets ... essentially treated the exchange rates as if they were fixed'.⁶⁰ But things changed over the course of 1992 when the system came to experience the most serious crisis of its existence. Ironically, this crisis in part resulted from the fact that the Community had in the meanwhile embarked on a second attempt to achieve monetary union and markets doubted whether this time it would actually be successful.

2.2 Hannover, 27-28 June 1988

Similar to the first attempt, a call at the highest political level formed the basis for the undertaking. After a series of memoranda had been circulating in 1988 between French, Italian and German (finance) ministers in which they had expressed the need to revitalise economic and monetary cooperation,⁶¹ the European Council decided at its meeting in Hannover on 27 and 28 June of that year to set up a committee that should study and propose concrete stages leading towards economic and monetary union.⁶² The committee was chaired by Commission President Jacques Delors and consisted, besides him, of national central bank governors, the Commission's vice-president and three independent experts.

The Delors Report bore great resemblance to its forerunner, the Werner Report. It too envisaged that economic and monetary union should be achieved in three stages. And it too stated that the process should culminate in the introduction of a single currency, controlled by a 'European System of Central Banks'.⁶³ The greatest difference with its predecessor was that it did not envisage the creation of a centralised institution for economic policy.⁶⁴ It put much emphasis on the principle of subsidiarity and stressed that in the area of economic policy the functions to be exercised at Community level should

59 Gros and Thygesen (n 2) 83-84; Chang (n 9) 29-30.

60 Chang (n 9) 30-31. The only realignment concerned the lira and related to its entrance to the 'normal' fluctuation bands of 2.25%. Part of the success of the system during this period can be attributed to the Basel-Nyborg agreement which reformed it in several respects. Of special interest are those reforms aimed at fencing off speculators, in particular through making better use margins of fluctuation and interest rates. See Smits, *The European Central Bank* (n 4) 26. For a detailed discussion see Gros and Thygesen (n 2) 88-93, 104-105.

61 Gros and Thygesen (n 2) 396-401; Szász, *The Road* (n 2) 101-105; Chang (n 9) 33-35.

62 European Council, Conclusions, Hannover, 27-28 June 1988, 7.

63 Committee for the study of economic and monetary union, *Report on economic and monetary union in the European Community* (17 April 1989) paras 23, 31-32 (Delors Report).

64 Delors Report (n 63) para 33. See also Gros and Thygesen (n 2) 402-403.

be 'as limited as possible'.⁶⁵ Efforts at that level should concentrate on the coordination of national policies within agreed frameworks.⁶⁶

On 26 and 27 June 1989 the European Council approved of the report at its meeting in Madrid.⁶⁷ At the same time it set the starting date for the first stage towards monetary union at 1 July 1990.⁶⁸ Then, with the dissolution of the Eastern bloc, political events unfolded at a fast pace. On 8 and 9 December 1989, in Strasbourg, the European Council decided to convene an inter-governmental conference on economic and monetary union.⁶⁹ A few months later, on 25 and 26 June 1990 in Dublin, it did the same for political union.⁷⁰ Both conferences opened in the midst of December of that year in Rome. Their results were incorporated in the Treaty on European Union that was signed in Maastricht on 7 February 1992 and entered into force on 1 November 1993.⁷¹ Two months later, with the necessary Treaty adjustments in place, the second stage of economic and monetary union was put into motion. The launch of the third stage would follow on 1 January 1999 with the introduction of the euro.⁷² Europe had achieved monetary union within less than a decade.

What explains the achievement of monetary union second time round? An increase in its economic rationale? That had certainly been an important factor. When the European Council charged Jaques Delors with the study on monetary union, European integration was experiencing a revival due to the Single European Act.⁷³ It had injected new life into the internal market by endowing its completion by the end of 1992 with constitutional status in Article 8a of the EEC Treaty.⁷⁴ At the same time it had provided the Community with its first, be it modest, monetary capacity in Article 102A.⁷⁵ It stressed that in striving for convergence of their economic and monetary policies, states had to 'take account of the experience acquired in cooperation within the framework of the European Monetary System...'. It also made clear, however, that

65 Delors Report (n 63) para 20.

66 Delors Report (n 63) paras 19-20, 33.

67 European Council, Conclusions, Madrid, 26-27 June 1989, 10.

68 European Council, Conclusions, Madrid, 26-27 June 1989, 10.

69 European Council, Conclusions, Strasbourg, 8-9 December 1989, 8.

70 European Council, Conclusions, Dublin, 25-26 June 1990, 6. Note, however, that at a special meeting on 18 April 1990 the European Council had already discussed the possibility of a conference on political union. See European Council, Conclusions, Dublin, 18 April 1990, 6.

71 Treaty on European Union, signed at Maastricht on 7 February 1992 [1992] OJ C 191/1.

72 On this date the euro was only launched as an accounting currency for cashless payments and accounting reasons. On 1 January 2001 it was also introduced in physical form (ie in the form of notes and coins).

73 Single European Act, signed at Luxembourg on 17 February 1986 and at The Hague on 28 February 1987 [1986] OJ L 169/1.

74 The definition is now laid down in Article 26(2) TFEU. The deadline of 31 December 1992 has been repealed by the Lisbon Treaty.

75 For analysis see Jean-Victor Louis, "'Monetary Capacity" in the Single European Act' (1988) 25 CML Rev 9.

any institutional changes in the economic and monetary field would require a treaty amendment.

The concurrence of these two objectives in the Single European Act – the completion of the internal market and economic and monetary cooperation – was no coincidence. The Commission, in particular its President Delors, had pushed for it in the run up to the signing of the Act, arguing that the two are inextricably linked.⁷⁶ Once the Act had entered into force, the Commission used its authority to stress their mutual dependence even more. Illustrative is its *One Market, One Money* report of 1990 in which the Commission assesses the benefits and costs of monetary union.⁷⁷ On the one hand, it argues that the benefits of the internal market can only be fully reaped if accompanied by a single currency, eliminating exchange rate uncertainty and transaction costs.⁷⁸ On the other hand, it echoes the economist Tommaso Padoa-Schioppa by pointing to the incompatibility of full capital mobility, fixed exchange rates and national monetary policy autonomy.⁷⁹ They cannot coexist and in any monetary arrangement at least one of them has to give way. Given the liberalisation of capital movements following the Act, the next logical step would be to transfer monetary policy competences to the European level.⁸⁰

That this inconsistency argument was more than simply a rhetorical tool of the Commission to further the cause of monetary union became painfully apparent during the crisis of the European Monetary System in 1992. After several years of exchange rate stability in which markets had treated exchange rates as ‘fixed’,⁸¹ seemingly anticipating a smooth transition to monetary

76 Nicolas Jabko, ‘In the name of the Market: how the European Commission paved the way for monetary union’ (1999) 6 *Journal of European Public Policy* 475, 479-481; Szász, *The Road* (n 2) 89-92.

77 Commission, *One market, one money: An evaluation of the potential benefits and costs of forming an economic and monetary union* (October 1990) (One Market, One Money Report).

78 See eg One Market, One Money Report (n 77) 20: ‘EMU will result in an amplification of the type of economic benefits that follow from the 1992 programme. Indeed only a single currency allows the full potential benefits of a single market to be achieved’.

79 One Market, One Money Report (n 77) 34-35. Note that Padoa-Schioppa himself, who would later serve on the ECB’s Executive Board, used to speak about an ‘inconsistent quartet’, adding ‘free trade’ to the analysis. See Padoa-Schioppa (n 2) 110-111, 121-124.

80 This logic also resonated among lawyers. See eg Pieter Ver Loren Van Themaat, ‘Some Preliminary Observations on the Intergovernmental Conferences: The Relations Between the Concepts of a Common Market, A Monetary Union, An Economic Union, A Political Union and Sovereignty’ (1991) 28 *CML Rev* 291, 294: ‘[T]he establishment of an internal market without internal frontiers, as required explicitly by the Single European Act (the new Article 8a of the Treaty) was already implied in the notion of the common market in Article 2 of the Treaty and it is on the other hand only one aspect of this notion ... it is submitted that the notion already implies the abolition of “monetary frontiers” To that extent a monetary union is the logical consequence of the concept of the common market in Article 2 of the Treaty’.

81 See also text to n 60 (ch 3).

union, things changed dramatically after the Danes rejected the Treaty of Maastricht in a referendum on 2 June 1992.⁸² With the fate of the Treaty hanging in the balance, markets started to reassess the exchange rate arrangement. How determined were states to defend it now that dark clouds were gathering over the prospect of monetary union? Speculators saw their chance and put increasing pressure on the British pound and the Italian lira, both of which were considered to be overvalued.⁸³

With speculation on the rise, the inconsistency between capital mobility, fixed exchange rates and national monetary policies raised its head. Participating states failed to agree on a common strategy for defending exchange rates.⁸⁴ Germany was struggling with the economic difficulties resulting from German reunification. In order to fight rocketing inflation the *Bundesbank* was raising interest rates far into the summer of 1992. Most other participants, however, found themselves in a recession and were suffering from the high interest rates needed to hold on to their exchange rates with the D-Mark.⁸⁵ Tensions reached a peak at a meeting of finance ministers and central bank governors in Bath on 4-6 September 1992.⁸⁶ Several participants, in particular the British, demanded that Germany lowered its interest rates. But German representatives refused, arguing that a 'general realignment' of exchanges rates was called for instead.⁸⁷ When the disagreement that prevailed during the meeting reached the public, markets reacted without remorse. Little more than a week later, on 16 September 1992, better known as 'Black Wednesday', the pound left the system. The Italian lira followed a day later.⁸⁸

The departure of these currencies formed the start of a period in which the European Monetary System experienced severe instability and frequent realignments which only came to an end after the ministers of finance and central bank governors decided on 2 August 1993 to broaden fluctuation margins to 15%.⁸⁹ Interestingly, although this period of instability was

82 Barry Eichengreen and Charles Wyplosz, 'The Unstable EMS' (1993) Brookings Papers on Economic Activity 51, 82ff; Chang (n 9) 50-51.

83 The British pound had only entered the ERM, with fluctuation margins of 6%, in October 1990 after not having participated in exchange rate arrangements since its departure from the snake in 1973. See also Szász, *The Road* (n 2) 176.

84 For elaborate discussions of events during the run-up to 'Black Wednesday' see Mark D Harmon and Dorothee Heisenberg, 'Explaining the European currency crisis of September 1992' (1993) 29 *German Politics and Society* 19, 24-32; Gros and Thygesen (n 2) 93-96; Szász, *The Road* (n 2) 172-180; Chang (n 9) 50-53; Marsh (n 24) 150-161.

85 Harmon and Heisenberg (n 84) 25-26; Gros and Thygesen (n 2) 93-94.

86 Harmon and Heisenberg (n 84) 28-29; Gros and Thygesen (n 2) 95; Szász, *The Road* (n 2) 177-178; Chang (n 9) 51; Marsh (n 24) 153-154.

87 Harmon and Heisenberg (n 84) 28-29.

88 Harmon and Heisenberg (n 84) 19, 31-32.

89 Szász, *The Road* (n 2) 191-192. For an overview of realignments see Gros and Thygesen (n 2) 95-101. Only for the D-Mark and the Dutch guilder were the margins of 2.25% kept in place on the basis of a bilateral agreement. See also Smits, *The European Central Bank* (n 4) 21, 125.

triggered by doubts among market participants whether monetary union would ever see the light of day, it had exactly the opposite effect. Otmar Issing, board member of the *Bundesbank* at the time, explains it very clearly:

‘The experience of this period confirms the theory of the so-called “uneasy triangle”, according to which only two of the three goals of stable exchange rates, stable prices (or monetary policy autonomy) and free movement of capital can ever be attained at the same time. Since restrictions on capital movements are incompatible with common market principles – disregarding other major objections such as the practicability of capital controls – the only choice remaining is between the other two objectives. The option of flexible exchange rates was never seriously entertained in the context of European integration ... Thus, out of the set of three objectives, it was basically “only” monetary policy that remained on the table.’⁹⁰

In other words, as there was no possibility to go back in time and undo the internal market, and given the unattractiveness of floating exchange rates, the best option was to take a great leap forward: a single currency.

But even this strengthening of its economic rationale cannot fully account for the achievement of monetary union. It cannot account for the acceleration of events towards the conclusion of the Treaty of Maastricht after the European Council had decided to move to monetary union in Madrid in June 1989, all of which took place before the exchange rate crisis of 1992. Take the Delors Report. It stresses the link between the completion of the internal market and monetary union, and even argues that in many respects the latter forms a ‘natural consequence’ of the former.⁹¹ Yet, few members of the Delors Committee had ever dreamt of the speed with which the Treaty would be concluded when they presented their report in April 1989. *Bundesbank* President Otto Pöhl recalls:

‘The Delors Report was a confused piece of work. There were some wild ideas in it. When it was formulated, I did not believe that monetary union with a European Central Bank could come about in the foreseeable future. I thought it might come in the next hundred years.’⁹²

Admittedly, Pöhl belonged to the most hawkish members of the committee. As president of the *Bundesbank* he was wary of any initiative aiming for monetary union, concerned as he was that a European single currency would not be able to deliver on price stability the same way as the D-Mark.⁹³ But this only makes the question more pressing: what can explain the rapid con-

90 Otmar Issing, *The Birth of the Euro* (CUP 2008) 7-8.

91 Delors Report (n 63) para 14.

92 Quoted in Marsh (n 24) 123.

93 Szász, *The Road* (n 2) 112-113.

clusion of the Treaty, given that Germany, from a monetary perspective, stood to lose a lot and gain little?

Answering this question requires a return to the realm of high politics. Ever since the first call for monetary union in 1969,⁹⁴ the Franco-German axis had informed European monetary cooperation, even more modest initiatives like the Monetary System.⁹⁵ Yet it gained centre stage at the end of 1989 when Europe was shaken to its foundations by the fall of the Berlin Wall and the looming prospect of German unification. All of a sudden, both France and Germany were more interested in a single currency than ever before.

To be fair, France had been pleading for a single currency long before the Wall came down on 9 November 1989, displeased as it was with the European Exchange Rate Mechanism in which it had to bear most of 'the burden of adjustment' in order to maintain stability with its German neighbour whose D-Mark operated as the 'anchor currency'.⁹⁶ Instead of having its monetary policy under the factual control of the *Bundesbank*, it preferred a currency union in which all participating states had 'a seat at the monetary table'.⁹⁷ In the words of President Mitterrand:

'Today the strongest currency in Europe is West Germany's....should we live in a mark zone where only the Germans would express themselves? I would prefer an assembly, a meeting, a permanent conference of the different authorities where France could have its say on all aspects of economic policy.'⁹⁸

But now on top of this long-cherished desire, came the urgency of 'the German question'.⁹⁹ Concerned about the position of a unified Germany at the very centre of Europe, France perceived a single currency as a means of keeping its neighbour strongly tied to Western Europe.¹⁰⁰ Or to resort once more to Mitterrand, speaking to students in Leipzig in December 1989:

94 See text to n 18 (ch 3).

95 Szász, for example, explains how the EMS originated from the joint effort of German Chancellor Helmut Schmidt and French President Giscard d'Estaing, stating: '[P]olitical considerations were the basis for the monetary initiatives in 1978, as had been the case in 1969. The reasons for establishing the European Monetary System went far beyond the merits of an exchange rate arrangement, both for Helmut Schmidt and for Valéry Giscard d'Estaing'. See Szász, *The Road* (n 2) 52.

96 Dyson and Featherstone (n 2) 25-26. See also Wayne Sandholtz, 'Choosing union: monetary politics and Maastricht' (1993) 47 *International Organization* 1, 27-29; Szász, *The Road* (n 2) 98-99.

97 Sandholtz (n 96) 29-30. See also Dyson and Featherstone (n 2) 222-223.

98 Quoted in Reuters, 27 June 1989 (as cited in Szász, *The Road* (n 2) 152).

99 Szász, *The Road* (n 2) 141.

100 Sandholtz (n 96) 32-33; Szász, *The Road* (n 2) 142-143.

'I thus assert that the reunification of Germany is also the concern of your neighbours who do not have to substitute for the German will, but who need to ensure European stability. It is almost a contradiction. Two different analytic elements, that could be thesis and antithesis, waiting for a synthesis. I think such is possible, that is to say: one has to proceed simultaneously with German and European unification.'¹⁰¹

The issue of unification had even more profound effects in Germany itself. At the meeting of the European Council in Madrid in June 1989 Chancellor Kohl approved of the Delors Report and consented to 1 July 1990 as the starting date for the first stage of monetary union, but he refrained from giving his blessing to a rapid convening of an intergovernmental conference to prepare the necessary Treaty amendments for the second and third stages.¹⁰² Personally, Kohl, and even more so his Foreign Affairs Minister Genscher, thought permissively about a single currency, as they regarded it as an indispensable key to intensifying Germany's ties with the East whilst securing political stability in Europe.¹⁰³ Yet, they were held back from acting accordingly by Germany's financial establishment, in particular the *Bundesbank* and the economics and finance ministries, which perceived monetary union to be a distant goal, only within reach after considerable convergence of the national economies had taken place.¹⁰⁴ In addition, they had to take into account German public opinion which, although positive about European integration in general, placed great pride in the D-Mark.¹⁰⁵ When asked about his readiness to set a final date for the intergovernmental conference during a bilateral with Mitterrand at the European Council meeting in Madrid, Kohl therefore allegedly told the latter: 'Abandoning the D-Mark is a great sacrifice for the Germans. Opinion is not yet ready!'¹⁰⁶

But Kohl's position changed over the second half of 1989 when German reunification loomed on the short term horizon with increasing speed. Particularly after the fall of the Wall, Kohl approached monetary union with urgency in the realisation that its geopolitical dimension was now more relevant than ever.¹⁰⁷ Keen on assuaging Mitterrand's fears about

101 François Mitterrand, *De l'Allemagne, de la France* (Editions Odile Jacob 1996) 211.

102 Szász, *The Road* (n 2) 143; Dyson and Featherstone (n 2) 312, 353-354; Marsh (n 24) 130.

103 Szász, *The Road* (n 2) 93-94, 104-106; Dyson and Featherstone (n 2) 307-313, 326-332.

104 Szász, *The Road* (n 2) 105; Dyson and Featherstone (n 2) 274-282, 284-285, 309, 311-312.

105 Szász, *The Road* (n 2) 215; Marsh (n 24) 138.

106 Quoted in Hubert Védrine, *Les mondes de François Mitterrand* (Fayard 1996) 420 (as cited in Marsh (n 24) 130).

107 Szász, *The Road* (n 2) 137ff; Dyson and Featherstone (n 2) 363-366. See also Femke van Esch, 'Why Germany Wanted EMU: The Role of Helmut Kohl's Belief System and the Fall of the Berlin Wall' (2012) 21 *German Politics* 21, 44: '[T]he 1989 revolution in Eastern Europe strengthened Kohl's pre-existing pro-European convictions, politicizing the issue of European monetary union and inciting him to act on these beliefs ... the fall of the Berlin Wall instigated a crucial shift in the German domestic balance of power by giving the chancellor

reunification, he sent him several letters in late November in which he indicated his willingness to agree on an early date for the intergovernmental conference at the upcoming December summit of the European Council in Strasbourg.¹⁰⁸ At the same time he made clear that it was of prime importance that a single currency was not pursued in isolation, but that it was accompanied by political union. And so it came to be. At its December meeting in Strasbourg, the European Council decided to hold an intergovernmental conference on economic and monetary union, starting before the end of 1990.¹⁰⁹ Several months later, in June 1990, it did the same for political union at its meeting in Dublin.¹¹⁰ Little more than a year later, on 7 February 1992, the Treaty of Maastricht was signed.

German reunification, then, turned out to significantly speed up the achievement of monetary union. This view is also taken by Michel Rocard, the French prime minister between 1988 and 1991. Looking back at the run-up to the Treaty of Maastricht, he explains:

‘There was a balance between unification of Germany and the establishment of European monetary union. Botch processes accelerated after the fall of the Berlin Wall. Kohl and Mitterrand were already engaged in both efforts. Mitterrand had to accept reunification more quickly than he thought likely, in the same way that Kohl had to accept monetary union more quickly than he had intended.’¹¹¹

Just as the move towards monetary union has both an economic and a political dimension to it, so too does its legal set-up. Creation and legal substance are even related. Let us therefore turn to this set-up and see how and where these dimensions become apparent.

3 THE STABILITY PERSPECTIVE

3.1 Explaining the original set-up

Accounts differ about which factors have inspired the move towards the single currency and how this has influenced its legal set-up. Take former Dutch Central Bank Director André Szász. He attributes much importance to the

the necessary domestic discourse and legitimacy to overrule the German financial elite on several crucial elements in the EMU negotiations’.

108 Dyson and Featherstone (n 2) 365-366. See also Szász, *The Road* (n 2) 105-106.

109 See text to n 69 (ch 3).

110 See text to n 70 (ch 3).

111 Quoted in Marsh (n 24) 137.

currency union's political dimension,¹¹² viewing its establishment and legal set-up as two sides of a compromise. The single currency itself, according to Szász, is a 'French *desire* and a German *concession*'.¹¹³ For France it formed a means to gain influence in the monetary domain, putting an end to the situation in which it had to gear its policy to a great extent to that of the *Bundesbank*. Given the single currency's geopolitical importance, Germany was prepared to go along with French desires. Yet, the reverse is true when it comes to the currency's set-up. Because of its 'deep-seated fear of inflation', Szász argues, Germany's preparedness to sacrifice its D-Mark was tied to the condition that its European replacement would be at least as strong and solid.¹¹⁴ As a result, France had to accept that the law on economic and monetary union would bear a strong 'stability' hallmark.¹¹⁵

To explain why Germany managed to exert such influence on the shape of the single currency's set-up one can point to its strong negotiating position.¹¹⁶ As the 'anchor' of the European Monetary System, Germany enjoyed most policy autonomy, allowing it to take stock of domestic demands when setting monetary policy to a greater degree than other participants.¹¹⁷ By consenting to a single currency, Germany would forego this position and have to live with a central bank gearing its policy to European-wide conditions instead.¹¹⁸ Germany also had to deal with scepticism in financial circles and among the public at large.¹¹⁹ Abandoning the D-Mark, the epitomisation of Germany's economic success following the War, in exchange for a European alternative with no inflation credentials whatsoever was a delicate issue.¹²⁰ Given these sacrifices, Germany could force its partners at the negotiating table to concede on crucial points. Andrew Moravcsik, who puts much emphasis on 'intergovernmental bargaining theory' in explaining the single currency's set-up, even goes as far as saying that 'anything less than a "German" EMU

112 See eg Szász, *The Road* (n 2) 219: 'The main motives for establishing the Economic and Monetary Union are political rather than economic'.

113 André Szász, 'Een Duits dilemma: de euro van geloofwaardigheids- naar vertrouwenscrisis' (2012) 66 *Internationale Spectator* 137, 139 (translation by the author, emphasis added). See also Szász, *The Road* (n 2) 214-215, 217-219, 222.

114 Szász, *The Road* (n 2) 215.

115 Szász, 'Een Duits dilemma' (n 113) 137.

116 See in this regard Andrew Moravcsik, *The Choice for Europe: Social Purpose and State Power From Messina to Maastricht* (Cornell University Press 1999) 440-447, 461-467.

117 Chang (n 9) 67-68.

118 See also Moravcsik (n 116) 466: 'The German government was tightly constrained, such that the asymmetrical EMS....was an acceptable alternative'.

119 Moravcsik (n 116) 394-395, 466.

120 Dyson and Featherstone (n 2) 254: '[G]erman negotiators were being asked to concede the most for EMU: the surrender of the D-Mark, the foremost symbol of Germany's postwar economic achievement...'.

would simply be vetoed at home, whereas greater compromise was possible in neighbouring countries'.¹²¹

Others attach less importance to politics and bargaining and instead stress changes in the international economy and the influence this had on the type of economic and monetary policy that states considered desirable. Illustrative is Kathleen McNamara. Central to her explanation of European monetary integration are increasing cross-border movements of capital and converging policy 'ideas' among states.¹²² The evolving structure of the global economy during the 1980s and 1990s, characterised by growing capital mobility, created an environment in which monetarist 'policy preferences' could take hold 'among European elites', even in states with the traditional habit of more expansionary policies.¹²³ This change in mind-set cleared the way for increasing monetary cooperation, eventually culminating in the Treaty of Maastricht which, according to McNamara, sets out a 'low-inflation, German-model style EMU'.¹²⁴

Accounts like those of Szász and McNamara about the creation of monetary union differ, attributing varying importance to political trade-offs, economic conditions and converging policy ideas. The truth is that neither of them can completely explain the creation of the monetary union as each of them singles out certain aspects that have been important for its establishment, but leaves out others.¹²⁵ Where they converge, however, is on the shape of its legal set-up which both regard as containing a stability-oriented policy framework. Indeed, integration theorists and political economists agree that the Union Treaties institutionalise a 'sound money' or 'stability' paradigm.¹²⁶ This paradigm attributes overriding importance to price stability as a policy goal and argues for a privileged position for the central bank to achieve it.

121 Moravcsik (n 116) 441. This does not mean, however, that Moravcsik would agree with Szász's analysis that the main motives behind the establishment of the monetary union were (geo)political. In his view German 'preference formation' in relation to monetary union was mostly grounded in economics, with geopolitical 'ideology' being of subsidiary importance. See Moravcsik (n 116) 386-389, 396-404. For a critique of this emphasis on preference formation based on 'structural economic interests' see Dyson and Featherstone (n 2) 770-774.

122 For a discussion of the argument in a nutshell see Kathleen R McNamara, *The Currency of Ideas: Monetary Politics in the European Union* (Cornell University Press 1998) 3-8.

123 McNamara, *The Currency of Ideas* (n 122) 6.

124 McNamara, *The Currency of Ideas* (n 122) 170-171.

125 Needless to say that together they cannot fully account for the monetary union's creation either.

126 See eg Martin Marcussen, 'The Dynamics of EMU Ideas' (1999) 34 *Cooperation and Conflict* 383, 402; Kenneth Dyson, *The Politics of the Euro-Zone: Stability or Breakdown?* (OUP 2000) 27; Martin Heipertz and Amy Verdun, *The Politics of the Stability and Growth Pact* (CUP 2010) 91-93. Legal academics too have recognized the influence of the stability paradigm on the legal set-up of the economic and monetary union. See most notably Matthias J Herdogen, 'Price Stability and Budgetary Restraints in the Economic and Monetary Union: The Law as Guardian of Economic Wisdom' (1998) 35 *CML Rev* 9.

The remainder of this chapter goes on to explore the substance of this stability perspective further. It claims that this perspective informs crucial elements of the single currency's original legal set-up. Without trying to account for all the reasons that have led to this particular set-up, the chapter shows that to some extent at least it is grounded in a preference for monetarism, implicitly shared by many policy makers and politicians at the time of its creation. At the same time, it certainly also reflects Germany's strong negotiating position. Where the stability perspective first of all becomes visible is at the level of goals and principles.

3.2 Price stability as the overriding aim

A convergence in economic policy beliefs is key to an understanding of the economic and monetary union's primary aim: price stability. This convergence means a shift away from the policy paradigm of 'Keynesianism' towards that of 'monetarism'. Each employs a very different conception of the economy and the extent to which it can be steered by the government.

During the first decades following the Second World War, Keynesianism dominated much of macro-economic policy-making in Europe.¹²⁷ 'Keynesians', Peter Hall explains, 'regard the private economy as unstable and in need of government intervention'.¹²⁸ The government has to actively pursue economic growth and combat unemployment, in particular by stimulating demand through 'expansionary' use of monetary and fiscal tools.¹²⁹ After the oil crisis in 1973, however, Keynesianism lost much of its appeal when it became clear that states had failed to reach their employment and growth targets.¹³⁰ On the contrary: many of them were facing 'stagflation', meaning that they were struggling with a recession and inflation at the same time.¹³¹

The failure of Keynesian responses to the economic problems of the 1970s made policy makers receptive to a different school of thought: monetarism.¹³² Contrary to Keynesians, Hall makes clear, monetarists regard 'the private economy as basically stable and government intervention as likely to do more harm than good'.¹³³ Expansionary monetary policies are unsuited for com-

127 McNamara, *The Currency of Ideas* (n 122) 84-87.

128 Peter A Hall, 'From Keynesianism to monetarism: Institutional analysis and the British economic policy in the 1970s' in Sven Steinmo, Kathleen Thelen and Frank Longstreth (eds), *Structuring Politics: Historical Institutionalism in Comparative Analysis* (CUP 1992) 92.

129 Paul De Grauwe, *Economics of Monetary Union* (10th edn, OUP 2014) 150. See also Hall (n 128) 92.

130 McNamara, *The Currency of Ideas* (n 122) 65, 146.

131 McNamara, *The Currency of Ideas* (n 122) 65, 146.

132 This view can ultimately be traced back to the ideas of Milton Friedman. See eg Milton Friedman, 'The Role of Monetary Policy' (1968) 58 *The American Economic Review* 1.

133 Hall (n 128) 92. See also McNamara, *The Currency of Ideas* (n 122) 144-146.

bating unemployment as there is no 'permanent trade-off' with inflation.¹³⁴ They may affect unemployment in the short-run, but they cannot structurally push it beneath its 'natural rate'.¹³⁵ One of the main reasons for this inability to improve employment in the long-run lies in the problem of 'time-inconsistency'.¹³⁶ Assuming that the public is 'rational', it will anticipate the government's tendency to create 'surprise inflation' when they have to determine prices or negotiate salaries.¹³⁷ This interaction between the government and the public, both acting on their rational expectations, creates an 'inflationary bias' in which monetary policy leads to higher inflation but without the desired effect on employment.¹³⁸

What monetary policy should aim for instead, and above anything else, is price stability. Keeping prices stable offers the best prospects of preventing inflation and creating the requisite conditions for sustainable economic growth.¹³⁹ To the extent that the government does want to do something about unemployment, it should concentrate efforts on 'structural policies', for example reforms of the labour laws or tax system.¹⁴⁰

During the 1980s and 1990s the monetarist view gained in popularity, even in states with a traditional habit of expansionary policies. The European Monetary System was instrumental to this change. By 'tying their hands' to Germany – that is: by closely following the policy of the *Bundesbank* – central banks of participating states were able to strengthen their credibility and bring inflation down to acceptable levels.¹⁴¹ A good example of the disciplining effect of the system is the policy 'U-turn' of France at the beginning of the 1980s.¹⁴² As the first socialist president of France in more than two decades, and with the Communists participating in his government, Mitterrand tried to steer the French economy by applying the Keynesian medicine when he

134 McNamara, *The Currency of Ideas* (n 122) 146.

135 McNamara, *The Currency of Ideas* (n 122) 67, 146. See also De Grauwe (n 129) 150.

136 De Grauwe (n 129) 40-45, 150. For a classic analysis of the policy problem of 'time-inconsistency' see Finn E Kydland and Edward C Prescott, 'Rules Rather Than Discretion: The Inconsistency of Optimal Plans' (1977) 85 *Journal of Political Economy* 473; Robert J Barro and David B Gordon, 'A Positive Theory of Monetary Policy in a Natural Rate Model' (1983) 91 *Journal of Political Economy* 589.

137 William Bernhard, J Lawrence Broz and William R Clark, 'The Political Economy of Monetary Institutions' (2002) 56 *International Organization* 693, 705. See also McNamara, *The Currency of Ideas* (n 122) 146-147.

138 Bernhard, Broz and Clark (n 137) 705. See also De Grauwe (n 129) 150.

139 McNamara, *The Currency of Ideas* (n 122) 67, 145; De Grauwe (n 129) 150.

140 De Grauwe (n 129) 150. See also McNamara, *The Currency of Ideas* (n 122) 147.

141 Chang (n 9) 29-30, 42. For an extensive analysis of the disciplining effect of the EMS on central bank credibility see Francesco Giavazzi and Marco Pagano, 'The Advantage of Tying One's Hands: EMS Discipline and Central Bank Credibility' (1988) 32 *European Economic Review* 1055.

142 Chang (n 9) 28. See also McNamara, *The Currency of Ideas* (n 122) 135-139.

came to office in 1981.¹⁴³ The attempt was short-lived as it did not improve the economy, but triggered severe exchange rate problems and high inflation. Only two years later, in 1983, the French government therefore changed course and started to implement a '*franc fort* policy' by trying to align its monetary policy to that of Germany.¹⁴⁴

Besides its disciplining effect, the European Monetary System also more generally served as a platform for the spread of monetarist views, in particular through the example set by Germany in conducting a monetary policy of restraint. 'When most of Europe was struggling with stagflation after the first oil crisis', McNamara argues, 'West Germany stood out as successful in managing its economy, particularly in terms of inflation and employment'.¹⁴⁵ 'German officials were not hesitant to make known their views on the importance of price stability', she continues, 'proselytizing the merits of restrictive monetary policy to their neighbours'.¹⁴⁶

It would be wrong, however, to think that all members of the Community equally favoured price stability and that in making it the currency union's overriding rationale Germany's function was confined to that of a role model preaching the monetary gospel. Together with other stability-minded states like The Netherlands, it simply also negotiated hard to achieve this goal. As the state where the stability culture was most strongly entrenched, making sure that the future currency union would be oriented towards price stability was of great importance to Germany. This was particularly true for its financial elites, represented most forcefully by the *Bundesbank*, whose thinking was significantly influenced by 'ordoliberalism'.¹⁴⁷

Developed as an alternative to the defects of the Weimar Republic, in particular the severe economic and political instability caused by hyperinflation, ordoliberalism sought to create an economic system that would guard society against both '*laissez-faire* liberalism' and 'collectivist' rule.¹⁴⁸ To this end, it advocated a powerful state capable of securing and regulating a healthy market economy.¹⁴⁹ One of its key responsibilities was to put in place a policy

143 Chang (n 9) 28; McNamara, *The Currency of Ideas* (n 122) 135-139.

144 Chang (n 9) 28. See also McNamara, *The Currency of Ideas* (n 122) 137-139.

145 McNamara, *The Currency of Ideas* (n 122) 69.

146 McNamara, *The Currency of Ideas* (n 122) 69 (as well as 152-158). Dyson and Featherstone (n 2) 752 equally argue that due to Germany's economic success 'What followed in the EMU negotiations was imitation of the EC economy judged to have been most successful in managing monetary policy – Germany'.

147 Dyson and Featherstone (n 2) 278-279.

148 Werner Bonefeld, 'Freedom and the Strong State: On German Ordoliberalism' (2012) 17 *New Political Economy* 633, 634-635, 639. See also Dyson and Featherstone (n 2) 276-277.

149 Bonefeld (n 148) 641: "[O]rdoliberalism" asserts the authority of the state as the political master of the free economy. Freedom is freedom within the framework of order, and order is a matter of political authority. Only on the basis of order can freedom flourish and can a free people be trusted to adjust to the price mechanism willingly and self-responsibly'.

set-up to achieve such an economy, in particular by having a well-functioning 'price mechanism'.¹⁵⁰ Ensuring monetary stability was therefore one of ordoliberalism's central preoccupations.¹⁵¹

Negotiations over the set-up of the currency union not only took place during the intergovernmental conference on economic and monetary union – much of it happened earlier, and indirectly, in the Delors Committee.¹⁵² Admittedly, central bankers belonged to the circle of officials and experts where the influence of monetarist ideas was particularly strong.¹⁵³ But their report was not only a result of stability-mindedness. Within the committee a very different dynamic was at work as well. Its president, Jacques Delors, knew that any report the committee was going to produce would be most influential if it had the unanimous approval of its members.¹⁵⁴ And in order to obtain unanimity he had to persuade the central bank president of the most critical state, Otto Pöhl, to consent.¹⁵⁵ Soon he realised that this would only be possible if the report stressed the importance of price stability. Kenneth Dyson and Kevin Featherstone put it as follows:

[T]he Delors Committee was a rapid learning experience about what was politically realistic as the basis for unanimity ... he [Delors, ed] was quick to learn that an independent ECB pledged to price stability was a price to be paid for agreement on EMU to anchor the most important principle for the Germans – that the single currency must be "at least as stable as the D-Mark".¹⁵⁶

The Delors Report indeed pays great tribute to price stability, even to such an extent that after its publication several members of the committee stated in the press that it contained 'a lot of German thinking' and that Governor Pöhl 'had good reason to look happy'.¹⁵⁷ This inclination to price stability first of all shows up at the level of objectives and principles. The report mentions price stability as one of the guiding principles of economic and monetary policy and as the primary objective of monetary policy.¹⁵⁸

150 Bonefeld (n 148) 638: 'The free market allows social cooperation between autonomous individuals by means of a "signalling system", the price mechanism. It thus requires monetary stability as a "calculating machine"....that informs consumers and producers of the degree of scarcity in the whole economy'.

151 Dyson and Featherstone (n 2) 276; Bonefeld (n 148) 638.

152 See Moravcsik (n 116) 435-446, 464-466.

153 Amy Verdun, 'The role of the Delors Committee in the creation of EMU: an epistemic community?' (1999) 6 *Journal of European Public Policy* 308, 321.

154 Jabko (n 76) 481; Szász, *The Road* (n 2) 112-113, 118.

155 Charles Grant, *Delors: Inside the House that Jacques Built* (Nicholas Brealey Publishing 1994) 122-123; Jabko (n 76) 482; Moravcsik (n 116) 435; Szász, *The Road* (n 2) 114.

156 Dyson and Featherstone (n 2) 718.

157 Quoted in 'Bankers agree on EC route to unity', *Financial Times*, 13 April 1989 (as cited in Jabko (n 76) fn 28).

158 Delors Report (n 63) paras 16, 32.

Due to the fact that the Delors Report carried the unanimous approval of all committee members it greatly influenced the treaty negotiations that followed. Many even say it formed a ‘blueprint’ for the treaty provisions on economic and monetary policy.¹⁵⁹ And indeed, as far as goals and principles are concerned, these provisions are similarly driven by a concern for price stability. Besides the fact that price stability serves as a general aim of the Union,¹⁶⁰ Article 119(3) TFEU mentions it as the first guiding principle of economic and monetary policy. The other principles – sound public finances and monetary conditions and a sustainable balance of payments – fit the monetarist school of thought with its aversion to fiscal laxity.¹⁶¹ More important even is that Article 119(2) TFEU declares price stability to be the primary objective of monetary policy. Support of general economic policies through monetary means is of secondary importance, possible only in as far as it does not conflict with price stability.

However, the importance of the stability paradigm reaches far beyond the realm of objectives and principles. It also exerts a profound influence on the Union’s monetary policy set-up, in particular on the constitutional position of the European Central Bank.

4 THE CONSTITUTIONAL POSITION OF THE EUROPEAN CENTRAL BANK

4.1 The stability argument for independence

Given the overriding aim of price stability, it is hardly surprising how Article 127 TFEU shapes the mandate of the European Central Bank. As an almost natural extension of Article 119(2) TFEU, its first paragraph determines that the primary objective of the European System of Central Banks – consisting of the European Central Bank and the national central banks –¹⁶² is to maintain price stability. Only without prejudice to this goal can the system support the general economic policies in the Union in order to achieve the latter’s objectives set out in Article 3 TEU.¹⁶³ More interesting than the system’s mandate, is the capacity in which it pursues price stability. This capacity is one of great independence. Again, the influence of monetarism and German demands have been key in bringing it about.¹⁶⁴

159 Jabko (n 76) 482; Verdun (n 153) 309.

160 See Art 3(3) TEU.

161 Dyson (n 126) 29-30.

162 Arts 282(1) TFEU and 1 of the Statute on the ESCB and ECB laid down in Protocol No 4 annexed to the Union Treaties (Central Bank Statute).

163 See also Art 282(2) TFEU and Art 2 Central Bank Statute.

164 See also Smits, *The European Central Bank* (n 4) 159.

The negative experience with high inflation during the 1970s not only contributed to the importance of price stability as a monetary policy goal. It also created momentum for central bank independence. In fact, the two are strongly linked, the idea being that price stability benefits from central bank independence. The argument supporting this idea is, in principle, quite straightforward and focuses on the possible risks of having democratically elected governments in control of monetary policy. Two such risks deserve to be mentioned specifically, each of them focusing on the negative inflationary effects of using monetary policy to push unemployment below its natural rate.

The first has to do with monetary policy being determined by 'office-motivated' governments.¹⁶⁵ Eager to cling on to their position, elected politicians are predominantly motivated to bring home the next election.¹⁶⁶ They are therefore inclined to boost the economy in the run-up to the election in order to achieve growth and reduce unemployment, for example through excessively low interest rates.¹⁶⁷ The second risk concerns 'partisan' politicians.¹⁶⁸ Unlike office-motivated politicians, partisan ones will not necessarily stick to a monetary policy that offers them the best prospects of winning elections. What they aim for instead, is a policy that is most in line with their political beliefs.¹⁶⁹ As a result, socialist or left-wing politicians will be inclined to pursue a more expansionist monetary agenda that is beneficial for growth and employment for a little while but also carries greater inflationary risk.¹⁷⁰ In combination with the time-inconsistency argument discussed above,¹⁷¹ both risks may materialise and lead to an inflation bias with higher inflation but no long-term effects on employment.¹⁷²

A possible solution to these democratic pitfalls lies in the transfer of monetary policy competences out of the hands of elected politicians into those of 'technocratic' central bankers who can 'commit credibly' to modest inflation targets.¹⁷³ During the 1980s and early 1990s this strategy was supported by a considerable amount of empirical studies arguing that the greater a central bank's independence, the lower the rate of inflation.¹⁷⁴ Whether and to what

165 Alberto Alesina, 'Macroeconomics and Politics' (1988) 3 *NBER Macroeconomics Annual* 13, 14. See also Kathleen R McNamara, 'Rational Fictions: Central Bank Independence and the Social Logic of Delegation' (2002) 25 *West European Politics* 47, 51.

166 Alesina (n 165) 14; McNamara, 'Rational Fictions' (n 165) 51.

167 Alesina (n 165) 15; McNamara, 'Rational Fictions' (n 165) 51.

168 Alesina (n 165) 15. See also McNamara, 'Rational Fictions' (n 165) 51-52.

169 Alesina (n 165) 15; McNamara, 'Rational Fictions' (n 165) 51-52.

170 Alesina (n 165) 15-16; McNamara, 'Rational Fictions' (n 165) 51-52.

171 See text to n 136 (ch 3).

172 McNamara, 'Rational Fictions' (n 165) 52.

173 McNamara, 'Rational Fictions' (n 165) 52.

174 See eg Vittorio Grilli, Donato Masciandaro and Guido Tabellini, 'Political and Monetary Institutions and Public Financial Policies in the Industrial Countries' (1991) 13 *Economic Policy* 341; Alberto Alesina and Lawrence H Summers, 'Central Bank Independence and Macroeconomic Performance: Some Comparative Evidence' (1993) 25 *Journal of Money,*

extent such studies indeed prove that central bank independence leads to better inflation results is open to debate.¹⁷⁵ Critics question the causal connection between the two, in particular by pointing out that such studies fail to take into account the stance of society at large concerning inflation.¹⁷⁶ What matters, however, is that from the 1980s onwards independence was widely *perceived* as necessary for price stability and that this has influenced the constitutional position of the European Central Bank.¹⁷⁷ A great deal of this influence was exercised by the most arduous advocates of independence: central bankers themselves. Not only did they sit on the Delors Committee, which argued strongly in favour of independence,¹⁷⁸ they also made themselves heard via the Committee of Central Bank Governors which was in charge of preparing the Bank's Statute.¹⁷⁹

Besides the shift from Keynesianism to monetarism, German negotiating demands have been vital in shaping the Bank's independent position.¹⁸⁰ Given its essential concern to make sure that the future single currency would have a stability record that would be at least as solid as that of its D-Mark,¹⁸¹ Germany tried to 'model' the European Central Bank after the independent *Bundesbank*.¹⁸² Its financial elites attached even more importance to central

Credit and Banking 151; Thomas Havrilesky and James Granato, 'Determinants of inflationary performance: Corporatist structures vs. central bank autonomy' (1993) 76 *Public Choice* 249. For a discussion see also Sylvester CW Eijffinger and Jacob de Haan, 'The Political Economy of Central Bank Independence' (Special Papers in International Economics, Princeton University 1996) 7-12.

175 McNamara, 'Rational Fictions' (n 165) 58-59.

176 See Bernd Hayo, 'Inflation culture, central bank independence and price stability' (1998) 14 *European Journal of Political Economy* 241. See also Peter A Hall and Robert J Franzese, Jr, 'Mixed Signals: Central Bank Independence, Coordinated Wage Bargaining, and European Monetary Union' (1998) 52 *International Organization* 505 (arguing that the proposition that central bank independence leads to low inflation only holds in states with coordinated wage-bargaining systems); McNamara, 'Rational Fictions' (n 165) 58-59.

177 For an analysis of the popularity and acceptance of central bank independence see McNamara, 'Rational Fictions' (n 165) 59-66; James Forder, 'Why is Central Bank Independence So Widely Approved?' (2005) 39 *Journal of Economic Issues* 843.

178 Delors Report (n 63) para 32.

179 See also Matthias Kaelberer, *Money and Power in Europe: The Political Economy of European Monetary Cooperation* (State University of New York Press 2001) 184.

180 Moravcsik (n 116) 441-442, 444-445.

181 See text to n 114, 156 (ch 3).

182 Jakob de Haan and Laurence Gormley state in this regard that 'the Statutes of the ECB are largely modelled after the law governing the Bundesbank'. See Jakob de Haan and Laurence W Gormley, 'The Democratic Deficit of the European Central Bank' (1996) 21 *EL Rev* 95, 95. For the argument that the institutional position of the ECB is actually very different from that of the *Bundesbank* due to the legal character of the provisions governing its independence see Marijn van der Sluis, 'Maastricht Revisited: Economic Constitutionalism, the ECB and the Bundesbank' in Maurice Adams, Federico Fabbrini and Pierre Larouche (eds), *The Constitutionalization of European Budgetary Constraints* (Hart Publishing 2014) 105.

bank independence in a monetary union than in a purely national context. Speaking shortly before the start of the intergovernmental conference on monetary union, *Bundesbank* President Pöhl explained why:

‘Historical experience shows that monetary stability can best be expected of a system which is independent of political interference. This applies to the EC to an even greater extent than to nation-states because in a confederation such as the EC there is always a tendency to orientate oneself towards averages and compromises, but that is the worst possible compass for monetary policy. Only an independent institution is in a position to resist the recurring wishes of politicians to prescribe monetary policy targets which are often inconsistent with the objective of stability.’¹⁸³

In other words, the *Bundesbank* estimated the risks associated with having politicians in control of monetary policy to be greater in the case of a shared currency, making the need for an independent central bank even more pressing.

4.2 Legal safeguards for independence

Article 282(3) TFEU is the first provision to answer the desire for central bank independence. It determines that the European Central Bank ‘shall be independent in the exercise of its powers and in the management of its finances’.¹⁸⁴ But legal safeguards for independence are more plentiful and specific than this general clause. Scattered around in the TFEU and the Statute of the Bank (hereafter ‘Statute’), they aim to protect independence in several ways: ‘institutionally’, ‘organizationally’, ‘functionally’ and ‘financially’.¹⁸⁵

Institutional independence aims to shield a central bank from, generally speaking, the government’s executive and legislative branches.¹⁸⁶ Several

183 Karl Otto Pöhl, ‘Towards Monetary Union in Europe’ (Speech at the General Meeting of the Mont Pelerin Society, 3 September 1990) in James M Buchanan, *Europe’s Constitutional Future* (Institute of Economic Affairs 1990) 38 (as cited in Rosa M Lastra, ‘The Independence of the European System of Central Banks’ (1992) 33 *Harvard Int’l LJ* 475 (fn 9)).

184 Prior to the entry into force of the Lisbon Treaty, the EC Treaty did not employ the notion ‘independence’ in relation to the ECB. It did so only in relation to national central banks in Article 116(5) EC. See also Fabian Amtenbrink, Leendert A Geelhoed and Suzanne Kingston, ‘Economic, Monetary and Social Policy’ in PJG Kapteyn and others (eds), *The Law of the European Union and the European Communities* (Kluwer Law International 2008) 951-952.

185 A similar subdivision, be it sometimes differently worded, is used by many legal academics. See eg Smits, *The European Central Bank* (n 4) 155-157; Amtenbrink, Geelhoed and Kingston (n 184) 953. It is also used by the ECB in its convergence reports which are further discussed below (see text to n 438 (ch3)).

186 Smits, *The European Central Bank* (n 4) 155; Amtenbrink, Geelhoed and Kingston (n 184) 953.

treaty provisions aim to protect this facet of the Bank's independence, both in law and in fact. Legally, its separation from other branches of government finds its expression in Articles 282(3) TFEU and Article 9.1 of the Statute. Together, these provisions ensure that the Bank has separate legal personality and enjoys in each member state 'the most extensive legal capacity accorded ... under its national law'. But the Bank's institutional independence extends beyond its legal status as Articles 130 TFEU and 7 of the Statute stipulate that it 'shall not seek or take instructions' from Union institutions and bodies or national governments.¹⁸⁷ The same also applies the other way around since these entities must not seek to influence members of the Bank. The aim of this prohibition is very clear and was aptly put by the Court in the *OLAF* case as seeking 'to shield the ECB from all political pressure in order to enable it effectively to pursue the objectives attributed to its tasks'.¹⁸⁸ Protecting the Bank against such pressure is also one of the primary aims of the prohibition on monetary financing in Article 123 TFEU, which will be further discussed below in relation to fiscal policy.¹⁸⁹

Personal independence concerns the composition of the Bank's decision-making bodies and the conditions governing the employment of their members.¹⁹⁰ Concerning appointment, Articles 283(2) TFEU and 11.2 of the Statute determine that members of the Executive Board, which is in charge of implementing the monetary policy decided on by the Governing Council,¹⁹¹ must be appointed by the European Council from among 'persons of recognized

187 Both provisions also apply to national central banks.

188 Case C-11/00 *Commission v ECB* [2003] EU:C:2003:395, para 134 (*OLAF*). The fact that the ECB enjoys great independence does not mean, however, that it is completely separated from the Union or exempted from each and every rule of (secondary) Union law. In *OLAF* the Court has made clear that provided, first, that the Union has a competence to legislate and, second, that such legislation does not affect the ECB's independence, the latter cannot escape its application (para 135ff). It has thereby also brought some clarification to the debate on the consequences of the ECB's independence for its legal position in the (then) Community legal order. Some, notably Chiara Zilioli and Martin Selmayr, had argued that due to its independence and separate legal personality the ECB formed a 'Community within the Community', an 'independent specialized organization of Community law'. Others disagreed with this view, arguing that despite its far-reaching independence the ECB is the central bank of the (now) Union. In its judgment, the Court leans towards the latter view. For an overview of the debate see Zilioli and Selmayr, 'The External Relations of the Euro Area' (n 4) 282-286; Chiara Zilioli and Martin Selmayr, 'The European Central Bank: An Independent Specialized Organization of Community Law' (2000) 37 CML Rev 591; Ramon Torrent, 'Whom is the ECB the Central Bank of?: Reaction to Zilioli and Selmayr' (1999) 36 CML Rev 1229; Fabian Amtenbrink and Jakob de Haan, 'The European Central Bank: An Independent Specialized Organization of Community Law: A Comment' (2002) 39 CML Rev 65.

189 See text to n 274 (ch 3).

190 Amtenbrink, Geelhoed and Kingston (n 184) 954. For an extensive overview of the different dimensions of personal, or organisational, independence see Lastra (n 183) 482-488.

191 Art 12.1 Central Bank Statute. To the extent possible, the ECB must have recourse to the national central banks for the implementation of its policies.

standing and professional experience in monetary or banking matters'. The provision aims to prevent appointments made purely for political reasons.¹⁹² The term of office of Executive Board members is set at the relatively long period of 8 years.¹⁹³ Appointment is non-renewable so as to make sure that members do not set monetary policy with the possibility of reappointment playing in the back of their minds.¹⁹⁴ The situation is somewhat different for national central bank governors who, together with the Executive Board members, sit on the Bank's Governing Council which has to formulate monetary policy.¹⁹⁵ Their term of office cannot be shorter than five years and is renewable.¹⁹⁶

The possibility to dismiss members of the Executive Board is limited. Only if a member no longer meets the requirements for the duties accompanying his position, or has engaged in serious misconduct, is compulsory retirement possible. A decision to this end must be taken by the Court on application by the Governing Council or the Executive Board.¹⁹⁷ Whilst being in office, members of the Executive Board are not allowed to engage in any other occupation, paid or not, except for those instances in which prior approval has been given by the Governing Council.¹⁹⁸

192 Smits, *The European Central Bank* (n 4) 162.

193 Arts 282(3) TFEU and 11.2 Central Bank Statute.

194 Lastra (n 183) 484-486; Amtenbrink, Geelhoed and Kingston (n 184) 955.

195 Art 12.1 Central Bank Statute. It should be noted that the Statute does not say anything about the independence of members of the governing bodies of national central banks other than governors. This is somewhat strange as decisions may have to be taken by national central bank boards as 'a collegiate body'. See Smits, *The European Central Bank* (n 4) 166.

196 Art 14.2 Central Statute. Given that the Statute is silent about reappointment, it follows that reappointment of central bank governors is possible. See also Smits, *The European Central Bank* (n 4) 165.

197 Art 11.4 Central Bank Statute. Similar grounds of dismissal apply to national central bank governors. Their dismissal, which is a national measure, can be appealed by the governor in question or the Governing Council before the Court on grounds of infringement of the Union Treaties or any rule of law relating to their application. See Art. 14.2 Central Bank Statute.

198 Art 11.1 Central Bank Statute. A similar rule for national central bank governors is lacking. Moreover, Union law is silent about the possibility for both Executive Board members and national governors to take up employment once their appointment has expired. Art 37.1 Central Bank Statute only requires board members of the ECB and national central banks 'not to disclose information of the kind covered by the obligation of professional secrecy'. See also Smits, *The European Central Bank* (n 4) 164, 166; Amtenbrink, Geelhoed and Kingston (n 184) 955-956. The Governing Council's Code of Conduct does determine that during the first year after their term of office has ended, its members should 'avoid any conflict of interests that could arise from any new private or professional activities'. See European Central Bank, Code of Conduct for the Members of the Governing Council [2002] OJ C 123/9, point 6. See also Amtenbrink, Geelhoed and Kingston (n 184) 956.

Independence also shows up in the implementation of the tasks entrusted to the System of Central Banks.¹⁹⁹ The most important task concerns the formulation and implementation of monetary policy, which is in the hands of the Eurosystem – consisting of the European Central Bank and the national central banks in the currency union – as long as not all states have adopted the single currency.²⁰⁰ In carrying out this task the Bank enjoys a substantial degree of ‘functional’ independence, allowing it to decide on its own how to discharge its monetary responsibilities.²⁰¹ This functional independence can be further subdivided into two more specific kinds: ‘goal’ independence and ‘instrumental’ independence.²⁰² The first relates to the aims pursued, the second concerns the means employed to attain these aims.

Goal independence resides in the fact that nowhere do the Treaties or the Statute define price stability. Articles 127(1) and 282(2) TFEU, as well as Article 2 of the Statute, turn it into the primary aim of monetary policy,²⁰³ yet they fail to define the notion. It is therefore up to the Bank to put flesh on it.²⁰⁴ At the start of the currency union it defined 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.²⁰⁵ In response to fears that this could lead to a deflationary strategy, it subsequently redefined its target as a year-on-year increase in the index ‘below, but close to, 2%’.²⁰⁶

When it comes to independence in the use of monetary policy instruments, laid down in Articles 17 to 21 of the Statute, a distinction should be made between ‘direct’ and ‘indirect’ instruments.²⁰⁷ Direct instruments are those that impose obligations on a central bank’s counterparts in order to influence

199 The European System of Central Banks has to carry out several tasks which can be subdivided into ‘basic’ and ‘non-basic’. The basic tasks are laid down in Arts 127(2) TFEU and 3.1 Central Bank Statute and concern monetary policy, foreign exchange policy, the management of official foreign reserves and the promotion of a smooth payment system. The non-basic tasks are spread over the TFEU and the Statute. See also Lastra and Louis (n 9) 134. An especially interesting non-basic task concerns prudential supervision and the stability of the financial system, which is regulated in Arts 127(5)–(6) TFEU and 3.3 and 25 Central Bank Statute. On this task see text to n 289 (ch 4).

200 Arts 282(1) TFEU and 1 Central Bank Statute.

201 Amtenbrink, Geelhoed and Kingston (n 184) 954.

202 Lastra (n 183) 491.

203 Strictly speaking, these provisions make clear that price stability is not just the primary aim of monetary policy but of all tasks entrusted to the European System of Central Banks.

204 In contrast to eg the Reserve Bank of New Zealand. This central bank also has as its primary aim to pursue price stability, but it has to agree with the government on a goal for inflation. In the UK too quantification of price stability is left to the government. See Fabian Amtenbrink, ‘On the Legitimacy and Democratic Accountability of the European Central Bank: Legal Arrangements and Practical Experiences’ in Anthony Arnall and Daniel Wincott (eds), *Accountability and Legitimacy in the European Union* (OUP 2002) 148–149.

205 See eg European Central Bank, ‘Monthly Bulletin’ (ECB January 1999) 46.

206 European Central Bank, ‘The Monetary Policy of the ECB’ (ECB 2004) 50–51. See also Amtenbrink, Geelhoed and Kingston (n 184) 965.

207 Amtenbrink, Geelhoed and Kingston (n 184) 965.

market circumstances.²⁰⁸ Indirect instruments also have this aim, but they do not pursue it through the imposition of obligations. Instead, such instruments are based on the voluntary participation of counterparts.²⁰⁹ An example of a direct instrument can be found in Article 19 of the Statute and relates to minimum reserves. Generally speaking, such reserves aim to control 'monetary expansion' by requiring credit institutions to hold in reserve with the central bank certain amounts of money proportionate to the deposits they manage.²¹⁰ Open market operations, principally governed by Article 18 of the Statute, are examples of indirect instruments. They serve to 'steer' interest rates and control liquidity conditions and take place most often on the basis of 'repurchase agreements' or 'collateralized loans'.²¹¹

The European Central Bank enjoys most independence in the use of indirect instruments. Article 18.2 of the Statute allows it to determine on its own the 'general principles for open market and credit operations carried out by itself or the national central banks...'.²¹² Its independence is more limited in relation to the direct instrument of minimum reserves. In line with the obligatory nature of this instrument, certain decisions over its use are left to the Council. Article 19.2 of the Statute determines that this institution has to 'define the basis for minimum reserves and the maximum permissible ratios between those reserves and their basis, as well as the appropriate sanctions in cases of non-compliance'.²¹³ Within these limits, the Bank's Governing Council can adopt regulations concerning the calculation and determination of reserves.²¹⁴

A final way in which the independence of the Bank shows up concerns its finances. Here, too, external influence is limited. The Bank's budget is kept apart from that of the Union and it finances its activities through several

208 Smits, *The European Central Bank* (n 4) 226.

209 Smits, *The European Central Bank* (n 4) 226.

210 Smits, *The European Central Bank* (n 4) 224, 277ff. For a discussion of the ECB's use of minimum reserve requirements see European Central Bank, 'The implementation of monetary policy in the euro area' (ECB 2011) 11-12, 82-89.

211 European Central Bank, 'The implementation of monetary policy in the euro area' (n 210) 10-11, 19-26.

212 See in this regard Guideline (EU) 2015/510 of the European Central Bank of 19 December 2014 on the implementation of the Eurosystem monetary policy framework (ECB/2014/60) [2015] OJ L 91/3, as last amended by Guideline (EU) 2016/2298 of the European Central Bank of 2 November 2016 [2016] OJ L 344/102.

213 The Council has to take these decisions in accordance with the procedure set out in Arts 129(4) TFEU and 41 Central Bank Statute. It has used its competence in Art 19.1 Central Bank Statute to adopt Council Regulation 2531/98 of 23 November 1998 concerning the application of minimum reserves by the European Central Bank [1998] OJ L 318/1, as last amended by Council Regulation 134/2002 of 22 January 2002 [2002] OJ L 24/1.

214 Art 19.1 Central Bank Statute. The Governing Council has made use of this power by adopting Regulation 1745/2003 of 12 September 2003 on the application of minimum reserves (ECB/2003/9) [2003] OJ L 250/10, as last amended by Regulation 1358/2011 of 14 December 2011 (ECB/2011/26) [2011] OJ L 338/51.

specific funding channels.²¹⁵ It has its own capital, provided by the national central banks which are its sole shareholders,²¹⁶ may acquire income from the management of foreign reserves and can receive 'seigniorage' (proceeds from the creation of money).²¹⁷ The need to ensure financial independence also forms the reason for the European Court of Auditors' limited possibilities to examine the accounts of the European Central Bank. It can assess the 'operational efficiency' of the Bank's management, yet is excluded from pronouncing on its monetary strategy.²¹⁸

The independence enjoyed by the European Central Bank – institutionally, personally, functionally and financially – is further reinforced by the fact that its safeguards are all laid down in the TFEU and the Statute and can therefore only be changed through treaty amendment.²¹⁹ Surprisingly, however, its independence was not strongly contested in the treaty negotiations on economic and monetary union. Ever since the publication of the Delors Report price stability, and with it central bank independence, were seen as important foundations for the future currency union. Even France, whose central bank had traditionally been under government control,²²⁰ did not seriously question the need for independence as it realised that the chance of having a single currency would be close to zero if it did not cede ground on this point. What it aimed for instead was curbing the power of the future bank through political safeguards in the area of economic policy.²²¹

Telling for this change in negotiating strategy are the recollections of former *Banque de France* Governor Jacques de Larosière concerning a discussion he had on the Delors Report with Pierre Bérégovoy, French finance minister at the time. De Larosière tells how he had been summoned by the minister to justify the far-reaching independence envisaged for the future central bank,

215 See also Smits, *The European Central Bank* (n 4) 167-168; Amtenbrink, Geelhoed and Kingston (n 184) 956.

216 Arts 28 and 29 Central Bank Statute. Art 47 Central Bank Statute determines that national central banks of states which do not (yet) belong to the currency union do not have to pay up their subscribed capital unless the General Council decides that 'a minimal percentage has to be paid up in order to cover the operational costs of the ECB'. These national central banks therefore do not share in the ECB's net profits or in the monetary income of the System of Central Banks. See Arts 32.5 and 33.1 Central Bank Statute.

217 Amtenbrink, Geelhoed and Kingston (n 184) 956. See also Smits, *The European Central Bank* (n 4) 167.

218 Art 27.2 Central Bank Statute. See also Amtenbrink, Geelhoed and Kingston (n 184) 956.

219 See also Smits, *The European Central Bank* (n 4) 168-169.

220 As Fabian Amtenbrink puts it: 'France also embodies a tradition of government-guided monetary policy with the Banque de France representing something similar to an administrative arm of the executive'. See Fabian Amtenbrink, 'The Democratic Accountability of Central Banks: The European Central Bank in the Light of its Peers' (DPhil thesis, University of Groningen 1998) 69.

221 Dyson and Featherstone (n 2) 181-182, 193-194, 211, 222-223.

and that he explained to him that this was actually not such a bad idea.²²² He then describes how the minister responded:

'M. Bérégovoy turned to his advisers and said, "The Governor is right." He stressed that, instead of criticizing the Delors Report, the Trésor should be working to put together a political counterweight to the European central bank. He said, "There's going to be a super-monetary power. We need a *gouvernement économique* [economic government] to balance that." I said to Bérégovoy, "What you have just said is wisdom itself"'.²²³

Let us see whether and to what extent Union law provides for such an economic government.

5 ECONOMIC POLICY: FISCAL PRUDENCE AS A SAFEGUARD FOR STABILITY

5.1 Hopes and fears for a *gouvernement économique*

Those discussing the single currency's economic foundation, lawyers and economists alike, often do so by contrasting it to its monetary foundation. And for good reason as the difference between the two is striking. Whereas the Union has been granted the exclusive competence over monetary policy in the euro area,²²⁴ no such transfer has taken place in the economic realm. Article 5(1) TFEU merely determines that the member states 'shall coordinate their economic policies within the Union'. Article 119(1) TFEU further specifies that the activities of the Union and the states shall comprise the adoption of an economic policy that is based on 'the close coordination' of national economic policies. What explains this 'asymmetry' between the Union's economic and monetary competences?²²⁵ And how does Union law give shape to the coordination of economic policy? Again, the answer lies to a considerable extent in the desire to safeguard price stability.

As with much of the single currency's legal framework, the contours of the economic policy arrangements were already laid down in the Delors Report. Contrary to its predecessor, the Werner Report, it envisaged far less centralisation of competences in this field.²²⁶ This was in part due to the fact that the report already anticipated that states were unwilling to cede much of their

222 Marsh (n 24) 127-128.

223 Quoted in Marsh (n 24) 128.

224 Art 3(1)(c) TFEU.

225 On this asymmetry see eg Alicia Hinarejos, *The Euro Area Crisis in Constitutional Perspective* (OUP 2015) 3ff.

226 See also text to n 63 (ch 3).

competence in this sensitive field.²²⁷ Yet, it was also in line with the departure from Keynesian thinking that had occurred in the intervening period and the accompanying decline in popularity of viewing the government, as Daniel Gros and Niels Thygesen say, 'as a sort of "benevolent" social planner who would ensure that demand was always at the right level'.²²⁸ At the same time, and in contrast to its recommendations for monetary policy, the report did not set out a detailed view of what this less centralised economic policy framework should look like. It confined itself to stating that:

'In the economic field a wide range of decisions would remain the preserve of national and regional authorities. However, given their potential impact on the overall domestic and external economic situation of the Community and their implications for the conduct of a common monetary policy, such decisions would have to be placed within an agreed macroeconomic framework and be subject to binding rules and procedures.'²²⁹

This formulation left so much undecided that states could still take up very different positions during the treaty negotiations.

France saw the recommendation as a confirmation of its desired *gouvernement économique*, a term used to indicate the necessity of a 'counterweight',²³⁰ or '*contre pouvoir*',²³¹ to an independent central bank. As France realised at an early stage in the negotiations that such an independent central bank was the price to pay if it wanted to have a single currency, it shifted attention to the establishment of a 'political pole', an economic government, capable of balancing the 'monetary pole'.²³² In a statement issued in December 1990 at the start of the intergovernmental conference, Finance Minister Bérégovoy described the French position as follows:

'It is also necessary to ensure that, in the Economic and Monetary Union, the "monetary pole" advances in parallel with the "economic pole"; the independence of the monetary institution can only be conceived within the interdependence with a strong "Economic Government". This Economic Government must be fully demo-

227 Fabian Amtenbrink and Jakob de Haan, 'Economic Governance in the European Union: Fiscal Policy Discipline versus Flexibility' (2003) 40 CML Rev 1075, 1078; Lastra and Louis (n 9) 61.

228 Gros and Thygesen (n 2) 324. See also Szász, *The Road* (n 2) 158-159; Dyson (n 126) 32.

229 Delors Report (n 63) para 19.

230 David J Howarth, 'Making and breaking the rules: French policy on EU "gouvernement économique"' (2007) 14 Journal of European Public Policy 1061, 1075.

231 Dyson and Featherstone (n 2) 182, 229-230.

232 Dyson and Featherstone (n 2) 181-182.

cratic and its decisions must be directly binding on the member states, who will continue to execute the main elements of economic policy.²³³

In a draft treaty that it presented shortly thereafter, in January 1991, the French government further defined its vision of *gouvernement économique*.²³⁴ It attributed central importance to the European Council, which should ensure an adequate 'policy mix' between monetary, fiscal and other macro-economic policies by setting broad policy guidelines.²³⁵ Within these guidelines the Council would be in charge of coordinating national economic policies, whilst the central bank would determine the appropriate monetary policy stance.²³⁶

Germany was adamantly against incorporating anything like a *gouvernement économique* into the Treaty. It regarded the prior, *ex-ante* coordination of economic and monetary policy under the guise of ensuring an appropriate policy mix as a threat to central bank independence.²³⁷ Moreover, it sought to limit the involvement of the European Council, which it regarded as 'too political' in nature and prone to give in to short-term economic demands.²³⁸ Instead, it favoured the Council of Ministers in its ECOFIN composition.²³⁹

The treaty provisions governing the coordination of national economic policies – Articles 120 and 121 TFEU – to a considerable extent favour the German view.²⁴⁰ They are placed in the economic policy chapter, as a result of which they do not extend to monetary policy which is regulated in a separate chapter.²⁴¹ Moreover, the arrangements fall short of a real economic government. Article 121(1) TFEU merely determines that the member states 'shall regard

233 Communication publiée à l'issue du Conseil des Ministres du 5 décembre 1990, 'Les progrès vers L'Union Économique et Monétaire' (as cited in Szász, *The Road* (n 2) 157).

234 French Government, *Draft Treaty on economic and monetary union* (Agence Europe No 1686, 31 January 1991) (French EMU-Draft Treaty). See also Dyson and Featherstone (n 2) 229-230; Howarth (n 230) 1066-1067.

235 Art 4-1(1) French EMU-Draft Treaty stated: 'On the basis of a report by the Council, the Commission and the ESCB, the European Council shall determine the broad guidelines for Economic and Monetary Union. It shall guarantee its satisfactory operation'. On the notion of 'policy mix' see Dyson and Featherstone (n 2) 181, 229-230; Dyson (n 126) 13; Howarth (n 230) 1066-1070.

236 Arts 1-1, 1-2, 1-3 and chapter 2 French EMU-Draft Treaty. See also Howarth (n 230) 1067. Note, moreover, that Arts 1-2 and 1-3 made clear that the coordination of economic policies by the Council had to be based on additional, superior economic guidelines set by the European Council. See in this regard n 243 (ch 3).

237 Szász, *The Road* (n 2) 158; Dyson (n 126) 13, 36.

238 Dyson and Featherstone (n 2) 411.

239 Arts 102A and 105 German government, *Overall proposal by the Federal Republic of Germany for the intergovernmental conference* (Agence Europe No 1700, 20 March 1991) (German EMU-Draft Treaty). It should be noted that, whereas the draft was only published by Agence Europe in March 1991, it had already been presented to the intergovernmental conference late February. See Dyson and Featherstone (n 2) 412.

240 Dyson (n 126) 36; Dyson and Featherstone (n 2) 788.

241 See Arts 127-133 TFEU (Ch 2).

their economic policies as a matter of common concern and shall coordinate them within the Council...’.

Articles 120 and 121(2) TFEU make clear that broad policy guidelines serve as anchor points for this coordination. The European Council is involved in the formulation of these guidelines, which cover the economic situation of the Union as a whole as well as that of specific member states,²⁴² but less prominently than the French had hoped for.²⁴³ The Council, acting on the basis of a proposal by the Commission, formulates a draft for these broad guidelines and reports its finding to the European Council. The latter subsequently discusses a conclusion on the guidelines on the basis of the Council’s report. Yet it is the Council, acting on the basis of this conclusion, which formally adopts recommendations setting out the guidelines.

These recommendations in turn play a prominent role in the multilateral surveillance procedure that is regulated in Articles 121(3)-(5) TFEU. The Council monitors, on the basis of Commission reports, economic developments in the Union and the member states, and examines the consistency of their policies with the broad policy guidelines. When it appears that a state’s policies are not in line with these guidelines, or risk upsetting the functioning of the economic and monetary union in another way, the Commission may address a warning to the state concerned.²⁴⁴ Moreover, in such a situation the Council, on a recommendation of the Commission, may address recommendations to the state. It can also, on the basis of a Commission proposal, decide to make these recommendations public.²⁴⁵

It is thus no exaggeration to say that the primacy of price stability not only shines through in the goals and principles of the currency union and its monetary set-up, but that it has also greatly influenced its economic foundation. A shift away from Keynesian to monetarist thinking, as well as a fear among stability-minded states for political threats to central bank independence, have been key in attributing the Union with only little capacity to actively shape economic policy. But this is not the only way in which stability concerns have influenced the single currency’s economic base. They also provide the rationale behind the strife of Union law to bring about fiscal prudence through the imposition of discipline.

242 Amtenbrink, Geelhoed and Kingston (n 184) 915-916.

243 See Art 1-2 French EMU-Draft Treaty: ‘The European Council shall, on the basis of a report by the Council, define the broad guidelines of Community economic policy’.

244 The possibility for the Commission to issue warnings only features in Art 121(4) TFEU (ex Art 103(4) EC) since the entry into force of the Lisbon Treaty.

245 Art 121(4) TFEU determines that actions of the Council on the basis of this provision are taken by qualified majority vote, without however taking into account the vote of the member state concerned. Prior to the entry into force of the Lisbon Treaty, the former Art 103(4) EC did not provide for this exclusion.

5.2 Primary law and the logic of discipline

5.2.1 *The logic of discipline*

The decision to grant the Union only modest economic policy competences and the pursuit of fiscal prudence are not only driven by the same need to safeguard price stability. They are also interrelated. Due to the fact that the member states remain the most important players in the realm of economic policy, ways need to be sought to prevent, and deal with, any negative consequences that may result from their fiscal imprudence. This had already been realised by the drafters of the Delors Report, who formulated their concern as follows:

‘However, an economic and monetary union could only operate on the basis of mutually consistent and sound behaviour by governments and other economic agents in all member countries. In particular, uncoordinated and divergent national budgetary policies would undermine monetary stability and generate imbalances in the real and financial sectors of the Community.’²⁴⁶

Several negative consequences that may flow from fiscal negligence can be identified.²⁴⁷ The first deals with the threat of rising interest rates.²⁴⁸ Sizeable deficits can affect the ‘overall savings-investment balance’, which in turn may push up interest rates in the currency union.²⁴⁹ These higher interest rates may have the effect of ‘crowding out’ other debtors, public and private, as it becomes more expensive for them to obtain financing.²⁵⁰ Nevertheless, crowding out effects do not provide the strongest justification for putting limits on national budgets since they operate through the market. As Gros and Thygesen explain: ‘There is no reason on economic efficiency grounds to impose ceilings on deficits just because other market participants dislike increases in the market price for savings’.²⁵¹

Things are different for costs of fiscal laxity that are not confined to the market mechanism and therefore constitute truly ‘negative externalities’.²⁵² One such externality occurs when a rise in public expenditure financed by market borrowings leads to an increase in the money supply.²⁵³ As a result

246 Delors Report (n 63) para 30.

247 Whether and to what extent the risk that national governments display fiscal imprudence in a monetary union is greater than in national monetary regimes is open to debate. See De Grauwe (n 129) 218-222.

248 Gros and Thygesen (n 2) 326-327.

249 Gros and Thygesen (n 2) 326. See also De Grauwe (n 129) 215-216.

250 Smits, *The European Central Bank* (n 4) 74.

251 Gros and Thygesen (n 2) 326.

252 Heipertz and Verdun (n 126) 71-74.

253 Heipertz and Verdun (n 126) 72.

of this increase, and in order to counter any inflation risk, the Bank may consider it necessary to raise interest rates, which in turn may constrain economic activity.²⁵⁴ Moreover, the rise in interest rates could drive up the euro relative to other currencies and negatively affect the trade balance.²⁵⁵

A third, and the most worrisome negative consequence, concerns the European Central Bank itself and in particular its ability to independently discharge its mandate to achieve price stability. It thereby touches upon the most important feature of the stability paradigm.²⁵⁶ States that pursue expansionary fiscal policies and increasingly turn to the capital markets to finance them, could pressure the Bank to ease its interest rates in order to facilitate market access.²⁵⁷ They could even induce it to 'finance' their debts by granting credit facilities or buying up their bonds.²⁵⁸ A critic may argue that such pressurising is impossible given that, as shown above, Union law contains safeguards for the Bank's independence.²⁵⁹ However, the truth is that such legal safeguards do not provide the final word if push comes to shove. If a state's deficit or debt becomes so large that it gets into a funding crisis, with possible spill-over effects to the banking sector, the Bank may have no other option but to intervene.²⁶⁰ In fact, as chapter 6 will show, during the crisis it was precisely this dilemma that the Bank faced.²⁶¹

The last negative consequence, that of risks for central bank independence and price stability, also shows that the struggle for fiscal prudence should not only be framed in negative terms. In other words, it is not only because of the Union's limited competences in the economic realm that Union law promotes sound fiscal policies. The monetarist school of thought with its preference for price stability gained in popularity in many parts of the world during the 1980s and 1990s and formed part of a broader neo-liberal swing towards 'financial orthodoxy'.²⁶² The pursuit of fiscal prudence formed a key feature of this development and was not limited to Europe.²⁶³ On the contrary, states like Canada, the United States and New Zealand also implemented reforms granting (*de facto*) greater powers to their treasuries or finance ministries, or

254 Heipertz and Verdun (n 126) 72.

255 Heipertz and Verdun (n 126) 72.

256 Heipertz and Verdun (n 126) 74-75.

257 Heipertz and Verdun (n 126) 74; Gros and Thygesen (n 2) 327; De Grauwe (n 129) 216.

258 Heipertz and Verdun (n 126) 74-75.

259 See text to n 184 (ch 3).

260 Gros and Thygesen (n 2) 327.

261 See generally ch 6.

262 Philip G Cerny, *Rethinking World Politics: A Theory of Transnational Neopluralism* (OUP 2010) 142-144.

263 Cerny (n 262) 143-144.

putting in place fiscal rules limiting the government's budgetary room for manoeuvre.²⁶⁴

According to Alasdair Roberts, the desire for fiscal prudence was part of a broader search for a mode of government suited to the age of globalisation.²⁶⁵ The answer was found in a 'design philosophy' he terms the 'logic of discipline'.²⁶⁶ This logic, according to Roberts, consists of two elements. The first stresses the necessity of reform in areas that are key to financial markets.²⁶⁷ Faced with the negative consequences of 'conventional methods of democratic governance' that lead to 'short-sighted' and 'unstable' policies, it makes 'a call for reforms that will promote policies that are farsighted, consistent over time, and crafted to serve the general interest'.²⁶⁸ The second component concerns the shape that the reform should take.²⁶⁹ In general terms, the reform should lead to a 'depoliticisation' of the area of governance concerned, the idea being that the shift away from 'everyday politics' makes it easier to implement policies that support the long-term general interest.²⁷⁰ In the case of fiscal prudence, Roberts argues, the necessity of reform resulted from the high inflation and unemployment rates that many western states were facing throughout the 1970s.²⁷¹ The shape of change presented itself in reforms that sought to curb the 'fiscal drift' of governments by curtailing their discretion in financial housekeeping.²⁷²

This logic of discipline may be criticised for depicting the turn to fiscal prudence too negatively, or for being too general in nature to thoroughly compare and examine the ways in which different states have sought to control their budgets during the last decades. Nonetheless, it provides a valuable tool for understanding the instruments that Union law uses to keep national fiscal policies in check. Indeed, the logic of discipline is visible in two instruments. One makes use of what could be called *market discipline*, the other resorts to *public discipline*.²⁷³

264 See in this regard Alasdair Roberts, *The Logic of Discipline: Global Capitalism and the Architecture of Government* (OUP 2010) 47-64.

265 Roberts (n 264) 4.

266 Roberts (n 264) 4.

267 Roberts (n 264) 4-5, 11-12.

268 Roberts (n 264) 4-5.

269 Roberts (n 264) 5.

270 Roberts (n 264) 5.

271 Roberts (n 264) 26-28, 47-48.

272 Roberts (n 264) 48, 57ff.

273 See also Stefaan Van den Bogaert and Vestert Borger, 'Twenty Years After Maastricht: The Coming of Age of the EMU?' in Maartje de Visser and Anne Pieter van der Mei (eds), *The Treaty on European Union 1993-2013: Reflections from Maastricht* (Intersentia 2013) 454.

5.2.2 *Market discipline*

The instrument of market discipline is embodied in three prohibitions laid down in Articles 123-125 TFEU. Together these three prohibitions try to ensure that member states are, as René Smits calls it, subject 'to the full rigour of the market'.²⁷⁴ Each of them cuts off certain financing mechanisms and thereby aims to ensure that states are solely responsible for their fiscal behaviour and cannot rely on the financial help of third parties. This should lead markets to judge the capacity of states to honour their financial commitments on similar terms as they would apply to other borrowers and charge higher risk premiums if they have doubts about it, causing interest rates to rise.²⁷⁵ This, in turn, should induce a state to adjust its policies, putting it back on the track of fiscal prudence.

The first prohibition, the one in Article 123(1) TFEU, contains a ban on monetary financing. It is repeated in Article 21(1) of the Statute and cuts off two financing mechanisms. First of all, it prohibits the granting of credit facilities by the European Central Bank and national central banks to a state's central government, other authorities and public bodies or public undertakings. Second, it rules out that the European Central Bank and national central banks buy up their debt instruments directly. Similar prohibitions apply in relation to Union institutions, bodies, offices or agencies. Together these two prohibitions not only aim to ensure that states have to obtain financing on the markets under normal conditions, but also to avoid situations in which the Bank's independence as well as its main responsibility – the achievement of price stability – is put under pressure due to the financing of government budgets (or those of other public entities covered by them).²⁷⁶ Article 123(2) TFEU, again repeated in Article 21(3) of the Statute, makes clear that the prohibitions do not apply to publicly-owned credit institutions, thereby ensuring that they are not treated disadvantageously by the Bank compared to their private counterparts.²⁷⁷

Article 125(2) TFEU allows for the specification of definitions of the prohibition on monetary financing by the Council. The latter has made use of this possibility by adopting Regulation 3603/93.²⁷⁸ It provides definitions of terms such as 'overdraft facilities', 'other type of credit facilities', 'debt

²⁷⁴ Smits, *The European Central Bank* (n 4) 75.

²⁷⁵ Smits, *The European Central Bank* (n 4) 75-77; Amtenbrink, Geelhoed and Kingston (n 184) 907-908, 910-911.

²⁷⁶ Smits, *The European Central Bank* (n 4) 74, 290-291.

²⁷⁷ Smits, *The European Central Bank* (n 4) 75.

²⁷⁸ Council Regulation (EC) 3603/93 of 13 December 1993 specifying definitions for the application of the prohibitions referred to in Articles 104 and 104b(1) of the Treaty [1993] OJ L 332/1 (Reg 3603/93). At the time of its adoption the relevant legal basis for this regulation was Art 104 EC Treaty.

instruments' and 'public sector'.²⁷⁹ At the same time it makes clear that certain activities do not fall under the scope of the prohibition, given that they are not regarded as conflicting with its purpose.²⁸⁰ Several of these exempted activities, like the granting of intra-day credits to the public sector, the collection of cheques for this sector and involvement in the issue of coins,²⁸¹ can be seen as specific elaborations of Article 21(2) of the Statute which permits the European Central Bank and national central banks to act as 'fiscal agents' for the public entities covered by the ban.²⁸²

What is most interesting about Regulation 3603/93, however, cannot be found in its operative part, but in its preamble. Contrary to direct purchases of public debt instruments on the primary market, purchases on the secondary market, where debt instruments are traded after they have initially been issued by the state on the primary one, are not mentioned in Article 123(1) TFEU. This makes sense as they can be an effective monetary policy tool.²⁸³ Nonetheless, the 7th recital of the preamble makes clear that secondary market purchases 'must not be used to circumvent the objective of that Article'. As will become clear in subsequent chapters, the question of whether certain actions taken by the Bank on the secondary market in defence of the single currency could be seen as circumventions of the ban on monetary financing would take centre stage during the crisis.²⁸⁴

Article 124 TFEU contains the second prohibition related to market discipline. It provides that 'any measure, not based on prudential considerations, establishing privileged access' by central governments and public bodies to financial institutions shall be prohibited. The same goes for privileged access by Union institutions and entities. The rationale behind the ban is clear: the state (or any other public entity covered by the ban) should not be able to obtain financing through 'forced savings' imposed on financial institutions.²⁸⁵ A classic example constitutes an obligation for a bank to invest some of its capital in government debt instruments.²⁸⁶ Such a measure puts the state in a beneficial position compared to private actors who are unable to resort to such coercive means.

As with the prohibition on monetary financing, the specifics concerning the ban on privileged access are laid down in secondary law based on Article

279 See Arts 1(1), 1(2) and 3 Reg 3603/93.

280 Smits, *The European Central Bank* (n 4) 293.

281 See Arts 4, 5 and 6 Reg 3603/93.

282 See also Recital 11 Reg 3603/93; Smits, *The European Central Bank* (n 4) 295-296.

283 Smits, *The European Central Bank* (n 4) 289-290.

284 See especially text to n 333 (ch 4) and chs 6-7.

285 Smits, *The European Central Bank* (n 4) 75.

286 Smits, *The European Central Bank* (n 4) 75.

125(2) TFEU.²⁸⁷ Regulation 3604/93 defines a measure establishing privileged access as being any measure that either ‘obliges financial institutions to acquire or hold liabilities’ of public sector entities, or confers on them specific ‘tax advantages’ or other advantages that ‘do not comply with the principles of a market economy’ in order to encourage them to acquire or hold such liabilities.²⁸⁸ The Regulation also gives definitions of ‘prudential considerations’, ‘public undertaking’ and ‘financial institutions’.²⁸⁹

The centrepiece of the instrument of market discipline is the ‘no-bailout’ clause in Article 125(1) TFEU. It aims to ensure that the disciplining effect of the bans on monetary financing and privileged access are not counteracted by financing by the Union or other member states.²⁹⁰ To this end it determines that neither the Union nor a member state shall be ‘liable for’ or ‘assume’ the commitments of another member state. An exception is made for ‘mutual financial guarantees for the joint execution of a specific project’.

Unlike the prohibitions on monetary financing and privileged access, the ban on bail-out lacks detailed specifications in secondary law. Although Regulation 3603/93 also applies to Article 125(1) TFEU, its relevance for this provision is limited as it only specifies the notions of ‘public sector’ and ‘public undertaking’.²⁹¹ This does not mean that Union law does not provide any clarifications concerning the ban. It certainly does, but not in secondary law. One has to turn to primary law instead to find information about scope and meaning of the ban, in particular Article 122(2) TFEU. This provision, included at the insistence of the Commission as well as several states which feared a ruthless application of the no-bailout clause,²⁹² allows the Union to grant financial assistance to a member state in case the latter is ‘in difficulties or is seriously threatened with severe difficulties caused by natural disasters or

287 Council Regulation (EC) 3604/93 of 13 December 1993 specifying definitions for the application of the prohibition of privileged access referred to in Article 104a of the Treaty [1993] OJ L 332/4 (Reg 3604/93). At the time of its adoption the legal basis for this Reg was Art 104a EC Treaty.

288 Art 1(1) Reg 3604/93.

289 Arts 2-4 Reg 3604/93.

290 Amtenbrink, Geelhoed and Kingston (n 184) 908-909.

291 See Arts 3 and 8 Reg 3603/93.

292 See also Jörn Pipkorn, ‘Legal Arrangements in the Treaty of Maastricht for the Effectiveness of the Economic and Monetary Union’ (1994) 31 CML Rev 263, 273-274; Ulrich Häde, ‘Haushaltsdisziplin und Solidarität im Zeichen der Finanzkrise’ (2009) 20 EuZW 399, 402-403; Jean-Victor Louis, ‘Guest Editorial: The No-Bailout Clause and Rescue Packages’ (2010) 47 CML Rev 971, 982. The assistance clause is, however, worded more cautiously than the Commission had initially envisaged in its draft treaty of December 1990, especially by requiring that assistance can only be granted in case of difficulties caused by ‘exceptional occurrences beyond its control’. See also Dyson and Featherstone (n 2) 732 and text to n 143 (ch 7). Note, moreover, that assistance in case of difficulties caused by ‘exceptional occurrences’ could at first only be granted on the basis of unanimity in the Council. Since the entry into force of the Treaty of Nice only a qualified majority is required.

exceptional occurrences beyond its control'. As chapters 5 and 7 will show, the question of how to read the relationship between the ban on bail-out and this assistance clause, and what this says about any limits applying to the ban and the instrument of market discipline became the subject of intense debate during the crisis.²⁹³

5.2.3 *Public discipline*

This short discussion of Articles 122(2) and 125(1) TFEU already shows that the issue of fiscal prudence was also the subject of debate between stability-minded states and those preferring a more lenient approach during the negotiations on the Treaty of Maastricht. Yet, this debate was much more fierce and visible as far as the instrument of public discipline was concerned. The Delors Committee had already argued in its report that it was unwise to put all trust in the disciplining force of the markets.²⁹⁴ It advised that in addition there should be an element of public discipline in the form of 'upper limits on budget deficits of individual member countries'.²⁹⁵ It refrained, however, from giving more detailed guidance on the nature and substance of these limits, or on the desirability of sanctioning states that violate them. As a result, the issue of public discipline, in particular that of quantitative limits and sanctions, received considerable attention during the treaty negotiations.

How different the views on these issues were among the participants to the intergovernmental conference becomes clearly apparent from several draft treaties that circulated shortly before or during the conference. The Commission's draft, published on 10 December 1990,²⁹⁶ did not (yet) mention quantitative upper limits on deficits,²⁹⁷ let alone any sanctions for violating

293 See especially text to n 147 (ch 5) and text to n 141 (ch 7).

294 For a more elaborate discussion of the committee's view in this regard see text to n 26 (ch 4).

295 Delors Report (n 63) para 33.

296 See Commission, *Draft Treaty amending the Treaty establishing the European Economic Community with a view to achieving economic and monetary union* (Bulletin of the European Communities, supplement 2/91) (Commission EMU-Draft Treaty). It should be noted that at an earlier stage the Commission had already issued a communication on economic and monetary union. See Commission, 'Communication of 21 August 1990 on economic and monetary union' SEC (90)1659 final (Bulletin of the European Communities 1991, supplement 2/91). The decision to table a real draft proposal was only made shortly before the opening of the conference. See Dyson and Featherstone (n 2) 725-727.

297 In its commentary on the separate provisions of the draft, the Commission did recognise that it would be 'necessary to have one or more benchmarks' for establishing the excessiveness of a deficit, and that it would come up with proposals in this regard. See Commission, *Commentary to the Draft Treaty on Economic and Monetary Union* (Bulletin of the European Communities, supplement 2/91) 54. The reference values were eventually devised by the Monetary Committee. See n 309 (ch 3).

them.²⁹⁸ It confined itself to stating that 'excessive budget deficits shall be avoided' and that the Council could adopt 'appropriate measures' to that end.²⁹⁹ The French draft of January 1991 paid more attention to public discipline. Not only did it state that excessive deficits had to be avoided,³⁰⁰ it also provided for the possibility of sanctions in case Council recommendations on the reduction of excessive deficits were not implemented.³⁰¹ Yet, the envisaged sanctions were different to those that would eventually end up in the Treaty,³⁰² focusing on reducing financial benefits paid out of the Community budget for the state concerned, restricting or suspending transactions in its public debt instruments by the Bank and instructing the national supervisory authorities to take all necessary steps to safeguard the stability of the financial system. Moreover, it did not mention quantitative limits to budget deficits.³⁰³

The German draft, published late February 1991, spoke out most clearly in favour of public discipline. It required states to 'carry out a budgetary policy that helps to guarantee price stability as a result of exercising strict discipline with regard to spending and limiting the deficit'.³⁰⁴ Moreover, it stressed the necessity of having quantitative limits on deficits in place – although not yet mentioning any specific numbers – the violation of which would give rise to the presumption of an excessive deficit.³⁰⁵ If deficits were indeed found excessive, the Council had to 'set a mandatory ceiling for the deficit' of the state concerned and recommend measures to comply with it.³⁰⁶ The envisaged sanctions for states failing to respect their ceiling were severe, ranging from the suspension of aid paid out of Community funds to 'other appropriate' sanctions.³⁰⁷ These other appropriate sanctions, as became clear during the

298 In the explanatory memorandum to the draft, the Commission recognised that there was not yet agreement on the bindingness of the principle to avoid excessive deficits. It stated that 'sanctions might be envisaged', but made clear that it 'would prefer a system of incentives' in the context of the multilateral surveillance procedure. See Commission, *Commentary to the EMU-Draft Treaty* (n 297) 36.

299 Art 104a(2) Commission EMU-Draft Treaty.

300 Art 1-4(2) French EMU-Draft Treaty.

301 Arts 1-3(3) and 1-4(3) French EMU-Draft Treaty.

302 Dyson and Featherstone (n 2) 240 state, however, that France was strongly in favour of fines in the case of excessive deficits. According to Andrew Moravcsik (n 116) 445, on the contrary, France was not that convinced of the necessity of fines, yet did not 'overtly oppose' them.

303 According to Kenneth Dyson and Kevin Featherstone (n 2) 240, the absence of quantitative limits in the French draft treaty did not reflect opposition to such limits, but had to do with the fact that France was awaiting work in the Monetary Committee on this issue. For the committee's work see n 309 (ch 3).

304 Art 105B(1) German EMU-Draft Treaty.

305 Arts 105B(1)-(2) German EMU-Draft Treaty.

306 Art 105B(2) German EMU-Draft Treaty.

307 Art 105B(3) German EMU-Draft Treaty.

treaty negotiations, could be as far-reaching as expulsion out of the currency union.³⁰⁸

The instrument of public discipline that was eventually incorporated in Article 126 TFEU inevitably forms a compromise between these views. Nonetheless, the final result to a considerable extent leans towards that of Germany. The first paragraph of Article 126(1) TFEU stipulates that the member states 'shall avoid excessive government deficits'. Article 126(2) TFEU, in line with the German view, then links this obligation to specific, quantitative limits by stating that both a government's deficit and debt are examined in relation to certain reference values set out in Protocol No 12 annexed to the Union Treaties. Article 1 of this Protocol sets the reference value for the deficit at 3% of GDP and that for debt at 60% of GDP.³⁰⁹

This is not to say, however, that the German view on quantitative limits had managed to become incorporated in the Treaty totally unscathed. The reference values are not absolute as Article 126(2) TFEU provides that in certain situations an excess over (one of) the reference values is permissible. A deficit exceeding the ratio of 3% to GDP will not be regarded as excessive if it 'has declined substantially and continuously and reached a level that comes close to the reference value', or if 'the excess is only exceptional and temporary and the ratio remains close to the reference value'. Similarly, a debt exceeding the reference value of 60% of GDP will not be seen as excessive if the ratio 'is sufficiently diminishing and approaching the reference value at a satisfactory pace'.

Compliance with these budgetary criteria takes place on the basis of the so-called 'excessive deficit procedure'. It starts with the Commission monitoring budgetary developments in the member states in light of the reference values. Article 126(3) TFEU states that the Commission shall prepare a report if it finds that a state does not comply with these values, thereby taking into account whether its deficit exceeds investment expenditure as well as other factors, in particular its medium-term economic and budgetary position. The Commission can also prepare this report if a state does comply with the budgetary criteria, but it nonetheless considers that there is a risk of an excessive deficit.

Article 126(5) TFEU subsequently makes clear that if the Commission takes the view that an excessive deficit exists or may occur, and after having

308 Moravcsik (n 116) 445-446.

309 These numbers were proposed by the Monetary Committee (the precursor of the current Economic and Financial Committee) that had to devise the budgetary dimension to the Treaty provisions on economic and monetary union. See Monetary Committee of the European Communities, *Report by the Alternates on the Excessive Deficit Procedure* (Brussels 12 April 1991) para 4. See also Mathieu Segers and Femke van Esch, 'Behind the Veil of Budgetary Discipline: The Political Logic of the Budgetary Rules in the EMU and the SGP' (2007) 45 JCMS 1089, 1100. On the consistency between the reference values of 3% and 60% see Gros and Thygesen (n 2) 339-340.

obtained the opinion of the Economic and Financial Committee,³¹⁰ it shall address an opinion to the relevant state and inform the Council. The latter then has to decide in line with Article 126(6) TFEU, and on a proposal from the Commission, whether an excessive deficit actually exists. If the Council considers this to be the case, Article 126(7) TFEU obliges it to adopt, without undue delay and on a recommendation of the Commission, recommendations on how to bring the excessive deficit to an end. In case the state concerned has taken no effective action within the period set by the Council in its recommendation, Article 126(8) TFEU provides that the latter may decide to make its recommendations public.

If a state persists in refusing to act upon the Council's recommendations, Article 126(9) TFEU stipulates that the latter may decide to give notice to the state to take, within a specified period, measures to remedy the situation. As long as the state fails to take these measures the Council may decide to apply sanctions on the basis of Article 126(11) TFEU. Although not as severe as Germany had hoped for, they can be tough. Whereas one may question the severity of publishing additional information before issuing bonds or inviting the European Investment Bank to reconsider its lending policy, such doubts disappear when the sanctions concern non-interest bearing deposits or even outright fines. To the extent that excessive deficits have, in the view of the Council, been corrected, Article 126(12) TFEU obliges the latter to abrogate some or all of its recommendations and sanctions taken over the course of the procedure.³¹¹

Even though to a considerable extent Germany managed to mould the instrument of public discipline in line with its own views, it was not satisfied with the final result. Especially within financial circles there was concern that Article 126 TFEU did not provide enough safeguards for fiscal discipline once the single currency was introduced.³¹² One could see how the prospect of membership of the currency union could induce states to fiscal prudence prior to entry. Yet, the exceptions to the quantitative limits and the degree of discretion attributed to the Council in deciding whether or not to impose sanctions raised doubts about the ability of Union law to bring about such prudence once states would have managed to get 'in'.³¹³ Only a few years after the conclusion

310 See Art 126(4) TFEU. The Economic and Financial Committee replaced the Monetary Committee with the start of the third stage of the economic and monetary union on 1 January 1999. Art 134 TFEU regulates its position and functioning.

311 Art 126(13) TFEU makes clear that the Council takes decisions on the basis of Arts 126(6)-(9) and 126(11) TFEU by qualified majority vote and without taking into account the vote of the member state concerned. Prior to the entry into force of the Lisbon Treaty the exclusion of the member state concerned was not provided for decisions taken on the basis of Art 126(6) TFEU (ex Art 104(6) EC).

312 Segers and Van Esch (n 309) 1101; Heipertz and Verdun (n 126) 45.

313 Heipertz and Verdun (n 126) 45-46. See also Seegers and Van Esch (n 309) 1100-1101.

of the Treaty of Maastricht, and still before the launch of the single currency, the German government therefore argued again, and more loudly, for public discipline.

5.3 Secondary law and the logic of discipline

5.3.1 *Waigel's proposal for a Stability Pact*

For the *Bundesbank*, the fiscal arrangements in the Treaty of Maastricht were no more than an intermediary result, at best.³¹⁴ Telling is the following statement by the bank in its monthly report of February 1992 in which it comments on the result achieved by Europe's political leaders at Maastricht:

'As part of its advisory function, the Bundesbank pointed out at an early stage that the implications of monetary policy pursued in a monetary union at Community level – in particular the implications for the value of money – will be crucially influenced by the economic and fiscal policies of ... the participating countries ... The Maastricht decisions do not yet reveal an agreement on the future structure of the envisaged political union and on the required parallelism with monetary union.'³¹⁵

The *Bundesbank's* concern that the treaty arrangements on political and economic, in particular fiscal, integration were lagging behind those for monetary policy fuelled public scepticism over the future single currency. Especially over the course of 1995, when the initial boost caused by reunification was over and Germany's economy and fiscal position had weakened, public opinion about monetary union turned increasingly negative.³¹⁶ The opposition in the *Bundestag* soon tried to cash in on the situation by presenting themselves as 'stability-hardliners', criticising the Kohl-government for the weak fiscal arrangements arrived at in Maastricht.³¹⁷ Illustrative are the remarks of SPD leader Scharping which he made during the debate on the 1996 budget:

'Maastricht, of which one could say it is the important breakthrough in direction towards a common economic and monetary union, requires strengthening. It requires strengthening in the form of a better coordination of budgetary and fiscal policy, it needs a better, more lasting assurance of the stability criteria compared

314 See also Dyson and Featherstone (n 2) 450–451; Seegers and Van Esch (n 309) 1101; Heipertz and Verdun (n 126) 45–46.

315 Deutsche Bundesbank, 'Monthly Report' (Bundesbank February 1992) 51. See also Dyson and Featherstone (n 2) 450; Seegers and Van Esch (n 309) 1101.

316 Heipertz and Verdun (n 126) 50.

317 Heipertz and Verdun (n 126) 50.

to what is currently foreseen by the Treaty. This is also required as not to overburden the European Central Bank.³¹⁸

With criticism on the rise and the launch of the single currency approaching, the Kohl government had to regain the initiative on monetary union. It tried to do so through its Finance Minister Theo Waigel, who presented a proposal for a *Stabilitätspakt für Europa* (Stability Pact for Europe) on 10 November 1995.³¹⁹

Aiming at the reinforcement of the fiscal commitments of member states participating in the currency union, the proposal's most important suggestions for improving public discipline were the following.³²⁰ First of all, it argued that the deficit limit of 3% of GDP should be respected even if the economy were to take a turn for the worse. States should therefore aim for a deficit of 1% of GDP over the medium term under 'normal economic conditions', making it possible to respect the upper limit of 3% if the economic environment deteriorated. Exceeding this ultimate limit would only be possible 'in extremely exceptional cases', and only with the consent of at least a qualified majority of the participating states.³²¹ Second, the proposal envisaged that sanctions would be automatically imposed upon transgression of the 3% limit, without any intervention of the Council being required.³²² These sanctions would have to take the form of 'stability deposits' amounting to 0.25% of GDP 'for each full or partial percentage point' crossing the limit.³²³ If the limit was still transgressed after two years, the deposit would become a fine.³²⁴ Third, the supervision and coordination of the pact's 'binding commitments' should be placed in the hands of a '*Stabilitätsrat*' (Stability Council).³²⁵

From the start it was clear that Germany's proposal for a stability pact, or at least elements of it, could not be implemented without amending the Treaties. In particular the automatic imposition of sanctions was problematic, given that Article 126(11) TFEU specifically envisages that the Council takes a decision to this end.³²⁶ Although its proposal did not specifically say so, it was therefore understood that Germany was aiming for a separate international treaty

318 Deutscher Bundestag, 13. Wahlperiode, 67. Sitzung, Bonn, 8 November 1995, 5775 (translation, with some modifications, resembles the one of Heipertz and Verdun (n 126) 50-51).

319 Waigel (n 1).

320 See also Hugo J Hahn, 'The Stability Pact for European Monetary Union: Compliance With Deficit Limit as a Constant Legal Duty' (1998) 35 CML Rev 77, 80; Seegers and Van Esch (n 309) 1101-1102.

321 Waigel (n 1) 3.

322 Hahn (n 320) 80-81; Seegers and Van Esch (n 309) 1101-1102.

323 Waigel (n 1) 3.

324 Waigel (n 1) 3.

325 Waigel (n 1) 3.

326 Hahn (n 320) 81-83.

implementing the pact.³²⁷ However, most other member states were against a new, separate international treaty, instead favouring the tightening of fiscal commitments on the basis of the current Treaties.³²⁸ They were supported by the Commission in this regard, which feared that the creation of a stability council on the basis of a separate treaty would undermine its own position and prerogatives in the field of fiscal policy.³²⁹

Quite soon, therefore, the German government realised that it had to let go of its insistence on a separate treaty if it wanted to achieve any tightening of fiscal policy.³³⁰ It consequently had to accept giving up the idea of automatic sanctions.³³¹ In return, however, it obtained the green light from other states to mould the second-best option, that of secondary law, in the spirit of its stability pact.³³² And indeed the final result, approved by the European Council at its summit in Amsterdam on 16-17 June 1997 and cosmetically termed the 'Stability and Growth Pact' in order to allow the French government to show at home that it had not given in to fiscal discipline at the cost of growth,³³³ pays tribute to the German proposal in several respects.

5.3.2 *The Stability and Growth Pact*

The Stability and Growth Pact (hereafter 'Pact'), in its pre-crisis form,³³⁴ consisted of two Council Regulations, a European Council Resolution, as well as a report of the (ECOFIN) Council.³³⁵ The latter did not form part of the Pact

327 Hahn (n 320) 81; Seegers and Van Esch (n 309) 1102.

328 Heipertz and Verdun (n 126) 32.

329 Seegers and Van Esch (n 309) 1102.

330 Heipertz and Verdun (n 126) 32.

331 Seegers and Van Esch (n 309) 1102.

332 Heipertz and Verdun (n 126) 32.

333 European Council, Conclusions, Amsterdam, 16-17 June 1997. See also Hahn (n 320) 87; Heipertz and Verdun (n 126) 31, 34, 36, 56-60. As Heipertz and Verdun explain, at the instigation of the French, and in an attempt to further balance the picture, the European Council also adopted a Resolution on Growth and Employment. Moreover, France obtained the final consent of Chancellor Kohl to include a Title on Employment in the Treaty of Amsterdam, the final draft of which was approved by the heads of state at that summit as well.

334 For a discussion of the amendments of the Pact as a result of the crisis see text to n 167 (ch 4).

335 Council Regulation (EC) 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies [1997] OJ L 209/1, as amended by Council Regulation (EC) 1055/2005 of 27 June 2005 [2005] OJ L 174/1 (Reg 1466/97, as amended by Reg 1055/2005); Council Regulation (EC) 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure [1997] OJ L 209/6, as amended by Council Regulation (EC) 1056/2005 of 27 June 2005 [2005] OJ L 174/5 (Reg 1467/97, as amended by Reg 1056/2005); Resolution of the European Council on the Stability and Growth Pact, Amsterdam, 17 June 1997 [1997] OJ C 236/1 (European Council Resolution on the Stability and Growth Pact); Council Report

from the start,³³⁶ but was added to it when it was amended in 2005.³³⁷ In the next chapter the reasons for this amendment will be discussed. For now, it suffices to examine the most important features of the Pact as it stood after its amendment in 2005.

Of the four documents making up the Pact, the two Council Regulations are by far the most important. The first Regulation, numbered 1466/97, is based on Article 121(6) TFEU (ex Art 99(5) EC) which allows Parliament and Council to adopt detailed rules for the multilateral surveillance procedure in Articles 121(3) and (4) TFEU. As explained above,³³⁸ this procedure serves as a general coordination mechanism for the economic policies of the member states. Indeed, as Fabian Amtenbrink explains, 'the concept of economic policy must...be more widely interpreted' than as mere fiscal policy, as 'the "quality" and the competitive strength of the national economic policies and of the Community economy as a whole is only partly determined by the budgetary and monetary conditions...'.³³⁹ However, and in line with the initial German proposal for a stability pact, the Regulation was heavily geared towards fiscal policy, attributing only secondary importance to other economic issues.

This focus on fiscal policy already became apparent from the Regulation's title which first mentions the 'strengthening of budgetary positions' and only thereafter talks about 'the surveillance and coordination of economic policies'. The primacy of fiscal policy was similarly discernible in Article 1 which set out the purpose of the Regulation. By defining and detailing the multilateral surveillance procedure, the Regulation aimed to 'prevent, at an early stage, the occurrence of excessive general government deficits', only thereafter stating that it also more generally aimed 'to promote the surveillance and coordination of economic policies'. No wonder, therefore, that the Regulation was, and still is, usually referred to as the 'preventive arm' of the Pact.³⁴⁰

to the European Council, *Improving the implementation of the Stability and Growth Pact*, Brussels, 21 March 2005, 7423/05.

336 For an extensive analysis of the Pact in its original form see Fabian Amtenbrink, Jakob de Haan and Olaf CHM Sleijpen, 'The Stability and Growth Pact: Placebo or Panacea (I) (1997) 9 EBLR 202; Fabian Amtenbrink, Jakob de Haan and Olaf CHM Sleijpen, 'The Stability and Growth Pact: Placebo or Panacea (II) (1997) 10 EBLR 233.

337 See Recital 2 Council Regulation (EC) 1055/2005 of 27 June 2005 amending Regulation (EC) 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies [2005] OJ L 174/1. See also Jean-Victor Louis, 'The Review of the Stability and Growth Pact' (2006) 43 CML Rev 85, 90.

338 See text to n 240 (ch 3).

339 Amtenbrink, Geelhoed and Kingston (n 184) 914.

340 See eg Louis, 'The Review of the Stability and Growth Pact' (n 337) 92; Chang (n 9) 124.

At the basis of the Regulation's efforts to prevent excessive deficits were 'stability programmes' which each member state had to submit annually.³⁴¹ Central to these programmes, which according to the Regulation provided 'an essential basis for price stability and for sustainable growth conducive to employment creation',³⁴² were 'medium-term budgetary objectives'. Each state had such an objective for its budgetary stance, which could 'diverge from the requirement of a close to balance or in surplus position'.³⁴³ For states participating in the currency union or in the second Exchange Rate Mechanism (ERM2)³⁴⁴ the objective had to range 'between -1% of GDP and balance or surplus, in cyclically adjusted terms, net of one-off and temporary measures'.³⁴⁵ By requiring states to pursue medium-term objectives, the Regulation answered Germany's demand for having in place a 'safety margin' as regards the deficit limit of 3% of GDP, whilst allowing states to face cyclical developments.³⁴⁶

The stability programme had to provide information about the medium-term budgetary objective and the 'adjustment path' the state intended to pursue towards this objective.³⁴⁷ In addition, it had to set out 'the main assumptions about expected economic developments' and provide detailed assessments of the measures taken to achieve the objective.³⁴⁸ Moreover, the programme had to contain 'an analysis of how changes in the main economic assumptions' would impact the state's fiscal position,³⁴⁹ and provide the reasons for any deviations from the adjustment path towards the medium-term objective.³⁵⁰

The Council, based on assessments of the Commission and the Economic and Financial Committee, had to examine the plans presented by the member states in their programmes.³⁵¹ Of particular importance was the fact that it had to verify whether states pursued an 'annual improvement' towards their medium-term objective of at least 0.5% of GDP, thereby taking into account

341 Arts 3(1) and 4(1) Reg 1466/97, as amended by Reg 1055/2005. Member states outside the currency union do not have to submit 'stability', but 'convergence' programmes. See text to n 462 (ch 3).

342 Art 3(1) Reg 1466/97, as amended by Reg 1055/2005. See also Recitals 1 and 8.

343 Art 2a Reg 1466/97, as amended by Reg 1055/2005.

344 For information about ERM II see text to n 428 (ch 3).

345 Art 2a Reg 1466/97, as amended by Reg 1055/2005. Prior to its amendment in 2005, Reg 1466/97 did not provide for differentiated medium term objectives for each specific state, instead containing a single objective for all states of close to balance or surplus. See in this regard Fabian Amtenbrink and Jakob de Haan, 'Reforming the Stability and Growth Pact' (2006) 31 EL Rev 402, 408; Louis, 'The Review of the Stability and Growth Pact' (n 337) 92-93.

346 See Recital 4 and Art 2a Reg 1466/97, as amended by Reg 1055/2005, which specifically use the term 'safety margin'.

347 Art 3(2)(a) Reg 1466/97, as amended by Reg 1055/2005.

348 Arts 3(2)(b)-(c) Reg 1466/97, as amended by Reg 1055/2005.

349 Art 3(2)(d) Reg 1466/97, as amended by Reg 1055/2005.

350 Art 3(2)(e) Reg 1466/97, as amended by Reg 1055/2005.

351 Art 5(1) Reg 1466/97, as amended by Reg 1055/2005.

that adjustment efforts could be more ambitious in ‘good times’ and less in the event of an economic downturn.³⁵² Illustrative of the Regulation’s predominant focus on fiscal policy and discipline is that only after having set out these fiscal parameters, it stated that the Council should also verify whether the stability programmes facilitated the coordination of economic policies, and whether these policies were consistent with the broad guidelines adopted on the basis of Article 121(2) TFEU.³⁵³

Within three months after submission of the programme the Council, on the recommendation of the Commission, had to issue an opinion on it and, if necessary, invite the state concerned to make adjustments.³⁵⁴ The Council would subsequently monitor the implementation of the programme.³⁵⁵ In the case of any divergences, it had to issue, in line with Article 121(4) TFEU, a recommendation to the state ‘with a view to giving early warning’ of a possible excessive deficit.³⁵⁶ If the divergences subsequently persisted the Council, again in line with Article 121(4) TFEU, had to make a recommendation to the state ‘to take prompt corrective measures’.³⁵⁷

The second Regulation, numbered 1467/97 and commonly referred to as the ‘corrective’ or ‘punitive’ arm of the Pact,³⁵⁸ is based on Article 126(14) TFEU (ex Art 104 EC) and aims to speed up and clarify the implementation of the excessive deficit procedure. In its pre-crisis form, it did so in three ways essentially.

The first was by clarifying the notions ‘exceptional’ and ‘temporary’ in Article 126(2)(a) TFEU, allowing member states to get off the hook if they had deficits exceeding the limit of 3% of GDP.³⁵⁹ Prior to the Pact’s amendment in 2005 the notion ‘exceptional’ was defined more strictly, and therefore more in line with Germany’s proposal for a stability pact which had argued that exceeding the 3% limit should only be possible in ‘extremely exceptional’ situations. In its original, unamended form, Regulation 1467/97 provided that such an exceptional situation was present in the event of a ‘severe economic downturn’, which it subsequently defined as ‘an annual fall of real GDP of at

352 Prior to its amendment in 2005, Reg 1466/97 did not contain this adjustment benchmark of 0.5% of GDP. See also Amtenbrink and De Haan, ‘Reforming the Stability and Growth Pact’ (n 345) 408.

353 Art 5(1) Reg 1466/97, as amended by Reg 1055/2005.

354 Art 5(2) Reg 1466/97, as amended by Reg 1055/2005.

355 Art 6(1) Reg 1466/97, as amended by Reg 1055/2005.

356 Art 6(2) Reg 1466/97, as amended by Reg 1055/2005.

357 Art 6(3) Reg 1466/97, as amended by Reg 1055/2005.

358 See eg Chang (n 9) 124.

359 The other exception mentioned by Art 126(2)(a) TFEU, which allows a state to run a deficit exceeding the 3% limit if the deficit ‘has declined substantially and continuously and reached a level that comes close to the reference value’, received less attention in Reg 1467/97, as amended by Reg 1056/2005. The formula featured in Art 2(7) in relation to excessive deficits reflecting the implementation of pension reforms.

least 2%'.³⁶⁰ However, when taking a decision under Article 126(6) TFEU on the existence of an excessive deficit the Council could take into account observations of a state showing that its downturn was exceptional even though the fall was less than 2%.³⁶¹ In a Resolution adopted by the European Council in Amsterdam on 17 June 1997, the states nonetheless committed themselves to not make use of this possibility if the fall was less than 0.75% of GDP.³⁶²

Since its amendment in 2005, Regulation 1467/97 defined the notion of 'exceptional' more leniently as being present if the excess over the 3% limit resulted from 'a negative annual GDP volume growth rate or from an accumulated loss of output during a protracted period of very low annual GDP volume growth relative to its potential'.³⁶³ Moreover, both the Commission when drawing up its report on the basis of Article 126(3) TFEU as well as the Council when taking a decision on the existence of an excessive deficit under Article 126(6) TFEU, had to take into account a host of considerations that could be relevant for assessing the nature and quality of the excess over the 3% limit, such as 'contributions fostering international solidarity', expenses related to 'the unification of Europe', policies stimulating research and development, and the implementation of pension reforms.³⁶⁴

The second way in which Regulation 1467/97 clarified the excessive deficit procedure was by attaching specific time limits to each of the steps the Commission and Council could or must take under Article 126 TFEU.³⁶⁵ Of particular interest was the maximum period that could transpire between the Council taking a decision on the existence of an excessive deficit on the basis of Article 126(6) TFEU and the actual imposition of sanctions by this institution on the basis of Article 126(11) TFEU. After the amendment of 2005, this period stood at 16 months.³⁶⁶ Obviously, when a state was acting upon Council recommendations or notices given on the basis of Articles 126(7) or (9) TFEU, the excessive deficit procedure was held in abeyance.³⁶⁷ Yet, the Commission and Council would carefully monitor whether a state was actually implement-

360 Arts 2(1) and 2(2) Reg 1466/97 (unamended).

361 Art 2(3) Reg 1467/97 (unamended).

362 European Council Resolution on the Stability and Growth Pact, point 7 of the part addressed to the member states. The number 0.75% formed a compromise between Germany (arguing for 1%) and France (arguing for 0.5%), arrived at during the European Council summit in Dublin on 13-14 December 1996. See Heipertz and Verdun (n 126) 31, 35.

363 Art 2(2) Reg 1467/97, as amended by Reg 1056/2005. See also Amtenbrink and de Haan, 'Reforming the Stability and Growth Pact' (n 345) 408-409; Louis, 'The Review of the Stability and Growth Pact' (n 337) 95-98.

364 See Arts 2(3)-2(5) Reg 1467/97, as amended by Reg 1056/2005.

365 See Arts 3-8 Reg 1467/97, as amended by Reg 1056/2005.

366 Art 7 Reg 1467/97, as amended by Reg 1056/2005. Prior to its amendment of 2005, the Reg set this period at 10 months. See also Louis, 'The Review of the Stability and Growth Pact' (n 337) 99.

367 Arts 9(1)-(2) Reg 1467/97, as amended by Reg 1056/2005.

ing a Council recommendation or notice and whether the actions taken by it were adequate to ensure correction of the excessive deficit within the set time limits.³⁶⁸ If, after having given notice to take measures for correcting the deficit on the basis of Article 126(9) TFEU, the Council considered that the state in question was not implementing the measures, or only inadequately, it had to impose sanctions on the basis of Article 126(11) TFEU.³⁶⁹ The same course of action had to be taken in case the deficit had not been corrected within the deadline set by the Council in its notice.³⁷⁰

The issue of sanctions also leads to the third way in which Regulation 1467/97 clarified the excessive deficit procedure. It limited the Council's discretion in choosing between the possible sanctions listed in Article 126(11) TFEU by requiring it, 'as a rule', to resort to non-interest bearing deposits.³⁷¹ If the deposit was imposed for an excess over the government *deficit* reference value, it needed to comprise a 'fixed component' of 0.2% of GDP and a 'variable component' equalling one tenth of the difference between the deficit in the preceding year and the 3% limit.³⁷² The total amount of a single deposit could not, however, exceed 0.5% of GDP.³⁷³ It had to be converted into a fine if after two years the excessive deficit, according to the Council, had not been corrected.³⁷⁴ The Regulation here clearly echoed Germany's proposal for a stability pact with its preference for 'stability deposits' that should be turned into a fine after two years.

Although even the sanction mechanism therefore paid tribute to German wishes, it did not fulfil the desire for automatic sanctions. Given the unwillingness of other states to conclude a separate treaty and, more importantly, the impossibility to establish automaticity on the basis of the current Treaties, Germany had to concede this point. But this did not prevent it from trying to create as much automaticity as possible through the back door, in the European Council Resolution adopted in Amsterdam in June 1997. One of its most essential features is the commitment of the Council '*always to impose sanctions*' if a state would not take the action necessary to end an excessive deficit in line with its recommendations.³⁷⁵ As the next chapter will show,³⁷⁶ however, this 'quasi-automaticity' in the sanctioning mechanism has proved

368 Arts 9(3) and 10(1)-(2) Reg 1467/97, as amended by Reg 1056/2005.

369 Art 10(2) Reg 1467/97, as amended by Reg 1056/2005.

370 Art 10(3) Reg 1467/97, as amended by Reg 1056/2005.

371 Art 11 Reg 1467/97, as amended by Reg 1056/2005.

372 Art 12(1) Reg 1467/97, as amended by Reg 1056/2005.

373 Art 12(3) Reg 1467/97, as amended by Reg 1056/2005.

374 Art 13 Reg 1467/97, as amended by Reg 1056/2005.

375 European Council Resolution on the Stability and Growth Pact, point 3 of the part addressed to the Council (emphasis added).

376 See text to n 76ff (ch 4).

to be one of the Pact's major weaknesses.³⁷⁷ In fact, the Council has never had to face the dilemma of living up to its political commitment in the Resolution as it already proved unable to enforce public discipline at earlier stages of the excessive deficit procedure.

6 ACCESSION TO THE CURRENCY UNION

6.1 Negotiating accession: stability versus inclusiveness

A member state cannot decide on its own when to join the currency union. Union law subjects accession to conditions, the fulfilment of which is dependent on the judgment of Union institutions. Putting limits on entry can make sense from an economic point of view. Not every area is optimal for a single currency. A currency union composed of greatly diverging economies can make it very hard, if not impossible, for a central bank to implement a single monetary policy. One would therefore expect the conditions that Union law attaches to entry to focus on issues that feature prominently in the theory of 'optimum currency areas', which aims to ascertain under what conditions it is favourable to share a currency,³⁷⁸ for example labour mobility.³⁷⁹ The reality is, however, that the accession arrangements are not primarily concerned with such issues. What they are concerned with first and foremost is safeguarding price stability.³⁸⁰ But not without limits, however, as even the desire for price stability needs to compete with that for inclusiveness. Indeed, accession is the issue on which Germany had to compromise most during the treaty negotiations.

Accession was the issue least dealt with by the Delors Report. It argued extensively that the achievement of monetary union should happen in three stages, but it refrained from setting out clearly when the transition to the final stage should take place and who would be able to join. Delors realised that accession was a contentious topic and that having the report unanimously approved would be very difficult if it discussed the issue in great detail.³⁸¹

³⁷⁷ On Germany's consent to 'quasi-automaticity' see Heipertz and Verdun (n 126) 34.

³⁷⁸ The theory was introduced by Robert Mundell in the 1960s and has subsequently been elaborated on by other economists, notably Ronald McKinnon and Peter Kenen. See Robert A Mundell, 'A Theory of Optimum Currency Areas' (1961) 51 *The American Economic Review* 657; Ronald I McKinnon, 'Optimum Currency Areas' (1963) 53 *The American Economic Review* 717; Peter Kenen, 'The Theory of Optimum Currency Areas: An Eclectic View', in Robert A Mundell and Alexander K Swoboda (eds), *Monetary Problems in the International Economy* (University of Chicago Press 1969) 41.

³⁷⁹ De Grauwe (n 129) 136.

³⁸⁰ De Grauwe (n 129) 136.

³⁸¹ Moravcsik (n 116) 436; Dyson and Featherstone (n 2) 718.

He therefore tried to keep the committee away from the subject,³⁸² which is clearly visible when reading the report. It recognises the fact that a monetary union is hardly sustainable if it is not accompanied by 'a sufficient degree of convergence of economic policies' and therefore stresses the importance of 'parallelism': the 'parallel advancement in economic and monetary integration'.³⁸³ Yet, when it discusses the conditions that should be attached to the transition from one stage to another, in particular the final stage, or when this should take place, it is extremely ambiguous, limiting itself to stating that:

'The conditions for moving from stage to stage cannot be defined precisely in advance; nor is it possible to foresee today when these conditions will be realized. The setting of explicit deadlines is therefore not advisable. This observation applies to the passage from stage one to stage two and, most importantly, to the move to irrevocably fixed exchange rates.'³⁸⁴

The report subsequently argues that although there should be 'consensus on the final objectives', the legal provisions on economic and monetary union should allow for 'a degree of flexibility concerning the date and conditions on which some member countries would join certain arrangements'.³⁸⁵ The issue of accession left so undefined, it became the most contentious topic during the treaty negotiations.

Negotiations over accession essentially took place between two groups of states, 'economists' and 'monetarists', each having different ideas about the sequence in which economic and monetary integration should proceed.³⁸⁶ As with much of the negotiations, Germany and France were the prime exponents of these groups. According to economist states, led by Germany, economic integration should precede closer cooperation in the monetary realm. Monetarists, guided by France, took the opposite stance, arguing that precedence should be attributed to monetary integration which would subsequently 'spill over' to other areas.³⁸⁷

Understanding why Germany insisted on having economic integration prior to movement on the monetary front requires a return to ordoliberal thinking. One of its essential features, Dyson and Featherstone explain, is that it 'offered a traditionally German historicist account of how economies functioned'.³⁸⁸

382 Dyson and Featherstone (n 2) 718-720.

383 Delors Report (n 63) para 42.

384 Delors Report (n 63) para 43.

385 Delors Report (n 63) para 44.

386 Tsoukalis (n 9) 90-93; Szász, *The Road* (n 2) 9-10; Chang (n 9) 23.

387 Szász, *The Road* (n 2) 9. As Szász correctly points out, one should not confuse such monetarists with 'monetarism' as an economic school of thought, which is discussed above (see text to n 132 (ch 3)).

388 Dyson and Featherstone (n 2) 277.

Ordoliberals regarded economic preferences and views as products of history, thereby stressing the importance but at the same time also the complexity of economic convergence for monetary union.³⁸⁹ Not having gone through times of hyperinflation to the same extent as Germany, other states could hardly be expected to be similarly convinced of the value of price stability and the policy prescriptions that go with it.³⁹⁰ One could require them by law to act in line with certain economic priorities, but such a 'top-down' approach offered no guarantees that they would actually display the desired behaviour.³⁹¹ Having durable monetary integration implied that each state should first be intrinsically devoted to stability.³⁹² Ideally, economic integration should in turn be preceded by political integration in order to make the enterprise truly sustainable.³⁹³ In short, ordoliberals perceived monetary union to be the 'coronation' of a lengthy process of prior political and economic integration.³⁹⁴

The strongest proponent of this coronation theory was the *Bundesbank*. In its view, the recommendations of the Delors Report on *parallelism* represented, at best, the lower bound of what it conceived possible in terms of integration,³⁹⁵ and it was concerned that the intergovernmental conference would lead to a further weakening of accession arrangements. In an attempt to influence the negotiations, it issued a declaration in which it set out its vision on monetary union shortly before the start of the conference.³⁹⁶ After stating that it considered it necessary to 'point out which conditions must be met if monetary stability is to be assured in future, too',³⁹⁷ it stressed the importance of having political and economic integration in tandem with steps towards monetary union.

Although it failed to give clear guidance on political union, the *Bundesbank* was rather precise about economic convergence. Meeting the economic requirements for the start of the final stage was only possible 'in the course of a lengthy *transitional process*'.³⁹⁸ At the end of this period, a range of 'pre-requisites' should be met, of which the 'convergence of anti-inflation policy' received most attention. Inflation should be 'very largely eliminated in all the

389 Dyson and Featherstone (n 2) 277.

390 Dyson and Featherstone (n 2) 277.

391 Dyson and Featherstone (n 2) 275, 277.

392 Dyson and Featherstone (n 2) 275, 277.

393 Dyson and Featherstone (n 2) 277, 291.

394 Dyson and Featherstone (n 2) 291. See also Szász, *The Road* (n 2) 9 (describing it as the 'crowning theory').

395 Dyson and Featherstone (n 2) 291, 390-392.

396 Deutsche Bundesbank, 'Statement on creating Economic and Monetary Union in Europe' (Bundesbank, 19 September 1990) in Richard Corbett, *The Treaty of Maastricht – From Conception to Ratification: A Comprehensive Reference Guide* (Longman 1993) 244-247. See also Dyson and Featherstone (n 2) 391-393.

397 Deutsche Bundesbank, 'Statement on creating Economic and Monetary Union' (n 396) 244.

398 Deutsche Bundesbank, 'Statement on creating Economic and Monetary Union' (n 396) 246.

countries' and price differences 'virtually stamped out'.³⁹⁹ Moreover, fiscal deficits should have been reduced 'to a level which is tolerable over the longer term and unproblematic in terms of anti-inflation policy'.⁴⁰⁰ The sustainability of the convergence in anti-inflation policy should also be 'reflected in the markets' verdict', meaning that there should be a 'virtual harmonization of capital market rates'.⁴⁰¹

The *Bundesbank* concluded its declaration with a statement on the issue of deadlines, the most sensitive topic. It argued:

'A particularly important point in the Bundesbank's eyes is that the transition to another stage (no matter whether this is a transitional stage or the final stage) should be made solely dependent of the fulfilment of previously defined economic and economic policy conditions, rather than on specific timetables. Hence the transition to another stage must not be linked to deadlines fixed in advance.'⁴⁰²

The *Bundesbank* subsequently made clear that the points it had discussed were 'indispensable, and not optional, requirements'. It therefore urged the German delegation to stand firm during the negotiations and to 'advocate these points vigorously'.⁴⁰³ And this the German government did. In its draft treaty it argued that 'the passage to the final stage of economic and monetary union' had to be dependent on states having achieved price stability 'to a large extent', budgetary deficits having been 'brought down to a level....compatible with stability', and 'a clear approximation between the interest rates' on financial markets.⁴⁰⁴ Concerning the issue of deadlines, the draft did not speak of final dates. It only provided that no later than three years after the start of the second stage, the European Council should examine whether at least a majority of states fulfilled the requirements.⁴⁰⁵ If it decided, unanimously, that this was indeed the case, it had to 'set the date for passage to the final stage' for these states.⁴⁰⁶ Otherwise, launching the final stage would have to wait.

Representing the monetarist camp, the French argued differently. Taking the view that economic convergence would actually be stimulated by monetary union, they did not attach so much value to convergence as the Germans. But there was another reason why France thought more permissively about accession. It was afraid that very rigid criteria would lead to a situation in which too many states would not be able to join, at least not at first, and that the

399 Deutsche Bundesbank, 'Statement on creating Economic and Monetary Union' (n 396) 246.

400 Deutsche Bundesbank, 'Statement on creating Economic and Monetary Union' (n 396) 246.

401 Deutsche Bundesbank, 'Statement on creating Economic and Monetary Union' (n 396) 246.

402 Deutsche Bundesbank, 'Statement on creating Economic and Monetary Union' (n 396) 247.

403 Deutsche Bundesbank, 'Statement on creating Economic and Monetary Union' (n 396) 247.

404 Art 8F(2) German EMU-Draft Treaty.

405 Art 8F(1) German EMU-Draft Treaty.

406 Arts 8F(1) and (3) German EMU-Draft Treaty.

currency union would then mainly consist of members reasoning along German lines.⁴⁰⁷ Being less strict on convergence would ensure a greater degree of inclusiveness in participation and a more balanced policy approach.

The French draft treaty, as well as the one from the Commission which was almost identical in this respect,⁴⁰⁸ clearly reflected this more lenient view on entry. Eager to demonstrate to Germany that it also cared about the durability of monetary union,⁴⁰⁹ the government had incorporated a provision on convergence.⁴¹⁰ Yet, it lacked detailed criteria like those in the German draft as it simply stated that the European Council had to verify 'on the basis of an assessment of...the convergence of economic and monetary developments in the Member States ...' whether the requirements for moving to the final stage had been met.⁴¹¹ And whereas it envisaged the possibility that not all states would participate in the final stage from the start, it also required the Council to specify in advance 'the duration' of their absence.⁴¹²

Concerning the issue of dates, the French draft required the European Council to conduct the verification of convergence within three years of the commencement of the second stage, which was to begin on 1 January 1994.⁴¹³ If it judged positively on convergence, it had to set the period within which the decision to introduce a single currency was to be taken.⁴¹⁴ While the French draft was therefore more specific on dates and deadlines for the final stage compared to the German one, it was still rather indeterminate. But over the course of the negotiations, the French position on deadlines changed. The Treaty would have to mention a final date for the start of monetary union, to be set no later than 1 January 1999, no matter how many states could participate.⁴¹⁵

6.2 The balance between stability and inclusiveness

Article 140 TFEU shows how this battle for stability and inclusiveness was decided. Its first paragraph sets out several convergence criteria – legal and

407 Chang (n 9) 49-50. Chang also refers to Willem Buiter who argues that indeed '[A] key albeit unstated objective of the (mainly Dutch and German) drafters of the original fiscal-financial Maastricht criteria was to keep Italy (and perhaps also the two other Iberian nations) out of the EMU'. See Willem H Buiter, 'The 'Sense and Nonsense of Maastricht' Revisited: What Have We Learned About Stabilization in EMU?' (2006) 44 *JCMS* 687, 692 (fn 7).

408 Of particular interest in this regard are Arts 109f and 109g Commission EMU-Draft Treaty.

409 Dyson and Featherstone (n 2) 230.

410 Art 5-9 French EMU-Draft Treaty.

411 Art 5-9 French EMU-Draft Treaty.

412 Art 5-10 French EMU-Draft Treaty.

413 Art 5-9 French EMU-Draft Treaty.

414 Arts 5-1 and 5-9 French EMU-Draft Treaty.

415 Dyson and Featherstone (n 2) 247-252.

economic – that member states need to fulfil in order to join the currency union. The economic criteria, which are further defined in Protocol No 13 on the convergence criteria, aim to ensure that a state has achieved a high degree of ‘sustainable convergence’. In doing so, they clearly reflect Germany’s desire to prevent the currency union from having ‘an inflationary bias’.⁴¹⁶ What is more, they bear great similarity to the anti-inflation indicators mentioned by the *Bundesbank* in its statement on monetary union.⁴¹⁷ That safeguarding price stability is their first and foremost concern, is also confirmed by the European Central Bank. In its convergence report of 2016, for example, it states:

[T]he 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 having economic conditions that are conducive to the maintenance of price stability and the coherence of the euro area can participate in it.⁴¹⁸

The concern with inflation is most obvious with the first criterion as it requires a state to have achieved a high degree of price stability, meaning that it should have ‘a rate of inflation which is close to that of, at most, the three best performing states in terms of price stability’.⁴¹⁹ Article 1 of the Protocol on the convergence criteria further defines the notion of ‘being close’ by stating that the excess over the inflation rate of the best performing states may not be more than 1.5%. Satisfying the price stability condition is not, however, simply a numbers game. Given that convergence needs to be sustainable, the Commission and the European Central Bank pay attention in their reports to issues like expected price developments and the existence of an economic and institutional environment supportive of price stability.⁴²⁰

The second criterion focuses on deficits and debts by requiring a government’s fiscal position to be sustainable. Article 140(1) TFEU states, rather vaguely, that this sustainability is measured by examining whether or not a member state has ‘a budgetary position without a deficit that is excessive as determined in accordance with Article 126(6) TFEU’. This raises the question whether the criterion is substantive or formal. If the criterion has to be read substantively, there should be no deficit or debt in excess of the limits of 3% and 60%, subject

416 De Grauwe (n 129) 136.

417 See text to n 396 (ch 3).

418 European Central Bank, ‘Convergence Report June 2016’ (ECB June 2016) 5 (ECB Convergence Report 2016).

419 Art 140(1) TFEU. The three best performing member states do not necessarily have to form part of the euro area, something which is criticised by economists. See on this point Amtenbrink, Geelhoed and Kingston (n 184) 933-934; Lastra and Louis (n 9) 78.

420 See eg ECB Convergence Report 2016 (n 418) 7-8. See also Lastra and Louis (n 9) 78-79.

to the exceptions in Article 126(2) TFEU and their clarifications in the Pact.⁴²¹ Yet, if it must be interpreted formally, the decisive factor is the presence or absence of a Council decision establishing the existence of an excessive deficit on the basis of Article 126(6) TFEU. Article 2 of the Protocol on the convergence criteria puts beyond doubt that the latter is the case.⁴²²

This criterion, too, is strongly inspired by the need to maintain price stability. States with a high debt burden may consider it beneficial to create 'surprise inflation'.⁴²³ Some of their bonds have a long maturity and the interest rates for such bonds have been determined in accordance with inflation estimates at the time of their issuance.⁴²⁴ By pushing up inflation beyond such expectations the 'real value' of the bonds diminishes, making it easier for a state to honour its financial commitments.⁴²⁵ In addition, as explained above,⁴²⁶ states with troubling fiscal records may 'pressure' other states or the Bank to bail them out in order to deal with any default risk, which may have equally negative consequences for price stability and central bank independence.⁴²⁷ Both risks, surprise inflation and default, form reasons to require states to straighten up their fiscal positions before joining the currency union.

The third requirement relates to exchange rate stability. Article 140(1) TFEU prescribes that a member state should have observed 'the normal fluctuation margins of the Exchange Rate Mechanism of the European Monetary System for at least two years, without devaluing against the euro'. Since the start of the monetary union on 1 January 1999, the provision should be read as referring to the second Exchange Rate Mechanism (ERM II),⁴²⁸ which has

421 See text to n 309 (ch 3).

422 Nonetheless, in its convergence reports the ECB does go beyond what is required by 'black-letter' law as it also pays attention to factors like the sustainability of a state's fiscal position by examining its expected future development. See eg ECB Convergence Report 2016 (n 418) 10-11.

423 De Grauwe (n 129) 139. On 'surprise inflation' see also text to n 137 (ch 3).

424 De Grauwe (n 129) 139.

425 De Grauwe (n 129) 139.

426 See text to n 256 (ch 3).

427 De Grauwe (n 129) 139-140.

428 The requirement that a member state should have observed the 'normal' fluctuations margins formed a problem for the states that were to join the currency union first on 1 January 1999. In the run up to the launch of the currency union the first exchange rate mechanism (ERM I) was still in force. However, the exchange rate crisis of 1992-1993 had led to a 'temporary' widening of the fluctuation bands for most currencies from +/- 2.25 % to +/- 15%. As a result, the question arose which margins, the old or new ones, should be taken into account. In order to avoid many states failing to satisfy the exchange rate criterion, it was decided to adopt a flexible approach, putting emphasis on the objective of the criterion to prevent exchange rate fluctuations from unstable monetary policies. See René Smits, 'Het begin van de muntunie: besluitvorming en regelgeving' (1999) 47 SEW 2, 3-5; John Usher, 'Legal Background of the Euro' in Paul Beaumont and Neil Walker (eds), *Legal Framework of the Single European Currency* (Hart Publishing 1999) 14-15; Amtenbrink, Geelhoed and Kingston (n 184) 935-936.

replaced the first mechanism and now regulates the exchange rates between the single currency and those of states that have not (yet) joined.⁴²⁹ This second mechanism functions on the basis of central rates of the currencies of participating states against the euro. Formalizing the practice that had been adopted under the first mechanism in response to the 1992-93 exchange rate crisis,⁴³⁰ it requires states to keep their currencies within standard fluctuation margins of $\pm 15\%$.⁴³¹

Article 3 of the Protocol on the convergence criteria further specifies the exchange rate requirement by stating that a state should have 'respected the normal fluctuation margins' of the mechanism 'without severe tensions for at least the last two years before the examination'. In particular, it may not have 'devalued its currency's bilateral central rate against the euro on its own initiative'. The rationale behind this prohibition on devaluation is clear: a state should not be allowed to 'fix' its exchange rate with a view to joining the currency union at a more advantageous rate that would boost its competitiveness.⁴³²

The fourth and last requirement focuses on the 'durability' of convergence and stipulates that a member state's convergence and participation in the Exchange Rate Mechanism should be 'reflected in the long-term interest rate levels'.⁴³³ Article 4 of the Protocol on the convergence criteria further defines that over a period of one year prior to the assessment, a state must have had an average nominal long-term interest rate not exceeding by more than 2% that of the states with the best price stability records.⁴³⁴ Being similar to the convergence requirement on price stability, the condition is based on the idea

429 ERM II is essentially based on two documents. The first is a European Council Resolution setting out the main features of the mechanism. See Resolution of the European Council on the establishment of an exchange rate mechanism in the third stage of economic and monetary union, Amsterdam, 16 June 1997 [1997] OJ C 236/5 (ERM II Resolution). The second document is an agreement between the ECB and the national central banks outside the euro area which contains the mechanism's operating procedures. See Agreement of 16 March 2006 between the European Central Bank and the national central banks of the Member States outside the euro area laying down the operating procedures for an exchange rate mechanism in stage three of Economic and Monetary Union [2006] OJ C 73/21, as last amended by the Agreement of 6 December 2013 [2013] OJ C 17/1.

430 See text to n 81 (ch 3).

431 Point 2.1 ERM II Resolution. Point 2.4, however, makes clear that 'on a case-by-case basis' fluctuation bands narrower than the standards ones may be used. Such narrower bands apply to the Danish krone, which can fluctuate within margins of $\pm 2.25\%$.

432 De Grauwe (n 129) 141.

433 Art 140(1) TFEU.

434 In line with the criterion on price stability, the best performing member states in terms of price stability do not necessarily have to belong to the currency union. See Lastra and Louis (n 9) 82.

that the convergence of interest rates shows the 'trust' of markets in the coming together of inflation levels and fiscal positions.⁴³⁵

These four convergence criteria, in particular those on inflation, fiscal positions and interest rates, are strongly focused on price stability. Is there any room for other economic considerations relevant for the currency union's viability? Yes there is. Article 140(1) TFEU concludes by stating that when assessing convergence the Commission and the Bank should also take into consideration issues like market integration, the balance of payments situation and labour cost developments. Both institutions indeed pay attention to such other factors in their convergence reports since they can provide valuable insights about a state's ability to join the currency union without severe problems.⁴³⁶ However, this does not take away the fact that the law's emphasis is not on these additional criteria, but on the individual ones mentioned above.⁴³⁷

The legal criteria, less eye-catching than the economic ones but certainly important, focus on two provisions: Articles 130 and 131 TFEU. Both provisions apply to member states even before they join the currency union, yet conformity with them is specifically assessed at the time of accession.⁴³⁸ Article 130 TFEU, already discussed above,⁴³⁹ lays down independence requirements concerning both the European Central Bank and the national central banks. Article 131 TFEU sets out a duty for member states to ensure that their national legislation, including the regulatory regime for their central banks, is compatible with the Treaties and the Statute.⁴⁴⁰ Together, they aim to secure that national central banks can carry out their monetary policy tasks effectively and free from improper influence upon accession.⁴⁴¹

435 Amtenbrink, Geelhoed and Kingston (n 184) 936-937. See also Lastra and Louis (n 9) 81-82.

436 The Commission examines the additional criteria for each state under a separate heading in its convergence reports. The ECB conducts their assessment under the headings of the 'normal' convergence criteria. See eg Commission, 'Convergence Report 2016' (European Economy Institutional Paper 026, 2016) (Commission Convergence Report 2016); ECB Convergence Report 2016 (n 418).

437 Rosa Maria Lastra and Jean-Victor Louis express the view that the additional criteria could become more important as a consequence of the economic governance reforms that have been introduced in response to the debt crisis. See Lastra and Louis (n 9) 82-83.

438 Note that under the former EC Treaty Art 131 TFEU (ex Art 109 EC) did not apply fully to states outside the currency union. Art 116(5) EC (now Art 139 TFEU) stated that in the second stage of economic and monetary union each state had 'to start the process leading to the independence of its central bank, in accordance with Article 109'.

439 See text to n 187 (ch 3).

440 The fact that Art 131 TFEU only speaks about compatibility with the Treaties and the Statute does not mean that states do not have to ensure compatibility with EU secondary legislation. Indeed, the need to ensure compatibility with Union law results from the principle of primacy, not solely from Art 131 TFEU. See also ECB Convergence Report 2016 (n 418) 18-19.

441 See also Smits, *The European Central Bank* (n 4) 121-123; Lastra and Louis (n 9) 74-75.

A broad range of topics falls under the requirement of legal convergence, ranging from independence and confidentiality, monetary financing and privileged access, to legal integration of national central banks into the Euro-system.⁴⁴² Nonetheless, and in line with the single currency's stability focus, the issue of independence stands out, both in law and in fact. Its legal importance is evident in the fact that Article 140(1) TFEU specifically mentions the independence provision of Article 130 TFEU, whereas a reference to Article 131 TFEU would have sufficed. After all, the duty to ensure compatibility of national legislation with the Treaties and the Statute covers the independence requirements contained therein. Its practical relevance appears from the fact that independence receives much attention in convergence assessments.⁴⁴³ Or to put it in the words of the Bank:

'When assessing legal convergence....The ECB is particularly concerned about any signs of pressure being put on the decision making bodies of any Member State's NCB which would be inconsistent with the spirit of the Treaty as regards central bank independence'.⁴⁴⁴

What about dates and deadlines? Here, Germany had to compromise more, possibly even most out of all issues related to monetary union. This was clearly visible in the former EC Treaty, in particular Article 121. Its third paragraph stipulated that the Council, in its composition of heads of state or government,⁴⁴⁵ had to decide by qualified majority and no later than 31 December 1996 whether a majority of states fulfilled the convergence criteria and whether it was appropriate to launch the third stage. If it ruled positively on both issues, it had to set a date for the final stage.⁴⁴⁶ Article 121(4) EC subsequently determined that if no such date had been set by the end of 1997, the third stage would commence on 1 January 1999.⁴⁴⁷

442 See ECB Convergence Report 2016 (n 418) 16-41; Commission Convergence Report 2016 (n 436) 26-27.

443 In their reports the Commission and the ECB use a broad interpretation of Art 130 TFEU in order to examine independence in all its facets (institutionally, organisationally, functionally and financially).

444 ECB Convergence Report 2016 (n 418) 16.

445 Since the entry into force of the Lisbon Treaty, the European Council has the status of a Union institution. As a result, the present treaty provisions governing the accession procedure no longer refer to the 'the Council, meeting in the composition of heads of state or government'.

446 The Council decided at the time that there was no majority of states fulfilling the convergence criteria. See Council Decision 96/737/EC of 13 December 1996 in accordance with Article 109j(3) of the Treaty establishing the European Community, on entry into the third stage of economic and monetary union [1996] OJ L 335/48.

447 In Protocol No 24 on the transition to the third stage of economic and monetary union, annexed to the EC Treaty, member states declared the 'irreversible character' of the transition to the third stage of monetary union and stated that none of them would prevent this transition. The Protocol has been deleted with the entry into force of the Lisbon Treaty.

The insertion of a final date into the EC Treaty was a clear victory for the monetarist camp.⁴⁴⁸ Of course, the economist view prevailed in as far as only states fulfilling the convergence criteria would be able to join. However, the decision on fulfilment was a political one, to be taken by the Council in its composition of heads of state and government and acting by qualified majority. Germany's financial establishment feared that the presence of a final date would set in motion a decision-making dynamic in which the issue of stability would be subordinate to that of participation and inclusiveness.⁴⁴⁹ And as the next chapter will show, this fear was not without grounds.⁴⁵⁰ Leaving states with a special status aside,⁴⁵¹ except for Greece all members of the Community were found to comply with the convergence criteria and consequently joined the currency union on 1 January 1999, even though the fiscal record of some was shaky to say the least.⁴⁵² And contrary to the monetarist idea that convergence would benefit from sharing a currency, after the start of monetary union considerable economic imbalances persisted, and in some respects even worsened.

6.3 The stability focus of the 'outs'

Since the entry into force of the Lisbon Treaty much of this compromise on dates and deadlines can no longer be found in primary law.⁴⁵³ The launch of monetary union being a matter of the past, Articles 140(1)-(3) TFEU merely govern the accession of new member states. Until they accede, they are considered 'states with a derogation' and are subject to a special legal regime laid down in Chapter 5 of Title VIII of the TFEU and Chapter 9 of the Statute. As a result, they are exempted from the focus on stability in several ways.⁴⁵⁴

448 Dyson and Featherstone (n 2) 251-252, 255, 448, 451.

449 Dyson and Featherstone (n 2) 448.

450 See text to n 6 and n 221 (ch 4).

451 See text to n 453 (ch 3).

452 See Council Decision 98/317/EC of 3 May 1998 in accordance with Article 109j(4) of the Treaty [1998] L 139/30.

453 Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community, signed at Lisbon, 13 December 2007 [2007] OJ C 306/01.

454 For more elaborate and general analyses of (legal) 'differentiation' in the economic and monetary union following the crisis see Stefaan Van den Bogaert and Vestert Borger, 'Differentiated integration in EMU' in Bruno De Witte, Andrea Ott and Ellen Vos (eds), *Between Flexibility and Disintegration: The Trajectory of Differentiation in EU Law* (Edward Elgar 2017) 209; Christoph Herrmann, 'Differentiated integration in the field of economic and monetary policy and the use of "(semi-)extra" Union legal instruments: the case for "inter se Treaty amendments"' in Bruno De Witte, Andrea Ott and Ellen Vos (eds), *Between Flexibility and Disintegration: The Trajectory of Differentiation in EU Law* (Edward Elgar 2017) 237.

The most important exemption in the area of monetary policy concerns the tasks and objectives of the System of Central Banks. Central banks outside the currency union are not required to make price stability their primary aim.⁴⁵⁵ Nonetheless, price stability certainly has legal relevance for states with a derogation, and not only because they will have to deliver on it in order to qualify for euro area membership.⁴⁵⁶ Its legal relevance also results from Article 119(3) TFEU, which requires all states, within or outside the currency union, to gear their economic and monetary policies to the principles set out therein, including price stability. Moreover, states with a derogation are subject to the independence requirements in Article 130 TFEU, which is intrinsically linked to price stability.⁴⁵⁷

As regards economic policy, the most notable deviations from the stability focus concern fiscal prudence.⁴⁵⁸ States with a derogation are covered in full by the prohibitions relating to market discipline in Articles 123-125 TFEU, yet they benefit from greater assistance possibilities. Whereas members of the currency union can only receive Union assistance on the basis of Article 122(2) TFEU, states with a derogation can also find relief in Article 143 TFEU. Its first and second paragraphs allow the Council to grant assistance to them in case they are 'in difficulties or are seriously threatened with difficulties' concerning their balance of payments and where such difficulties risk 'jeopardising' the internal market or the common commercial policy. The granting of balance of payments aid is further specified in Regulation 332/2002 which establishes a medium-term assistance facility to this end.⁴⁵⁹

Concerning public discipline, states with a derogation are subject to the obligation in Article 126(1) TFEU to avoid excessive deficits just like states in the currency union. However, they cannot be coerced into remedying such

455 Art 139(2)(c) TFEU. More generally speaking, member states with a derogation are also not subject to the acts of the ECB. See Art 139(2)(e) TFEU.

456 See text to n 419 (ch 3).

457 Given that on the basis of Art 139(2)(c) TFEU member states with a derogation are not subject to the tasks and objectives of the System of Central Banks, one may have the impression that Art 130 TFEU has only relevance for central banks belonging to the Euro-system. This, however, is not the case. Arts 282(1) TFEU and 1 Central Bank Statute put beyond doubt that their central banks form part of the European System of Central Banks and consequently fall under the scope of Art 130 TFEU.

458 Deviations are, however, not confined to fiscal discipline. Art 139(2)(a) TFEU, for example, makes clear that states with a derogation are not subject to the parts of the broad economic policy guidelines, adopted on the basis of Art 121(2) TFEU, that relate to the euro area generally.

459 Council Regulation 332/2002 of 18 February 2002 establishing a facility providing medium-term financial assistance for Member States' balance of payments [2002] OJ L 53/1, as last amended by Council Regulation 431/2009 of 18 May 2009 [2009] OJ L 128/1 (Reg 332/2002). Given that Art 143(2) TFEU (ex Art 119(2) EC) was considered not to provide a legal basis for a Reg that facilitates the granting of Union assistance financed exclusively through the capital markets and not by other member states, Art 352 TFEU (ex Art 308 EC) was used as a legal basis. See also Recital 14 Reg 332/2002.

deficits.⁴⁶⁰ This means that the Council cannot give notice to them on the basis of Article 126(9) TFEU to take the measures it deems necessary for the reduction of the deficit, nor can it adopt sanctions on the basis of Article 126(11) TFEU. Logically, the provisions of the Pact's 'corrective arm', in its pre-crisis form, that related to these coercive measures, did not apply to them either.⁴⁶¹

Differences were also visible in the Pact's preventive arm. States with a derogation also had to reach medium-term budgetary objectives. If they participated in the second Exchange Rate Mechanism, the target for these objectives was even the same as those for members of the currency union, ranging between -1% of GDP and balance or surplus.⁴⁶² However, they did not pursue these objectives in the context of 'stability programmes', as states in the currency union do, but on the basis of 'convergence programmes'. The content of both programmes being very similar, the greatest difference lay in the fact that convergence programmes also served to promote exchange rate stability between the euro and the currencies of state's outside the currency union.⁴⁶³ In addition to a state's budgetary objective, they therefore had to set out its 'medium-term *monetary* policy objectives' and explain how both objectives related to exchange rate stability.⁴⁶⁴

Two member states benefit from a special status governed by separate Protocols: Denmark and the United Kingdom.⁴⁶⁵ Denmark is in a similar position to states with a derogation, the only difference being that it is not under an obligation to work towards adoption of the euro.⁴⁶⁶ Matters are more complicated for the United Kingdom. In line with its traditional reluctance concern-

460 See Art 139(2)(b) TFEU. They are therefore also refrained from imposing discipline on their fellow states in the currency union. Since the entry into force of the Lisbon Treaty, Art 139(4) TFEU determines that the voting rights of states with a derogation are also suspended for recommendations made on the basis of Art 121(4) TFEU to states in the currency union in the framework of multilateral surveillance. It similarly excludes them from voting on excessive deficit measures for these states taken by the Council on the basis of Arts 126(6)-(8), (12) and (13) TFEU. More generally speaking, Art 139(4) TFEU prevents states with a derogation from voting on the measures listed in Art 139(2) TFEU.

461 See also Recital 9 Reg 1467/97, as amended by Reg 1056/2005.

462 Art 2a Reg 1466/97, as amended by Reg 1055/2005.

463 Recital 10 Reg 1466/97, as amended by Reg 1055/2005. See also Jean-Victor Louis, 'Differentiation and the EMU' in Bruno De Witte, Dominik Hanf and Ellen Vos (eds), *The Many Faces of Differentiation in EU Law* (Intersentia 2001) 53.

464 Art 7(2)(a) Reg 1466/97, as amended by Reg 1055/2005.

465 Sweden has a *de facto* special status. It did not negotiate an opt-out, but in a consultative referendum in September 2003 its population rejected adoption of the single currency. It is therefore unlikely that it will participate in the near future, especially given the fact that it has not brought its legislation on central bank independence in line with Union law and refrains from participating in ERM II. See ECB Convergence Report 2016 (n 418) 63-64, 138-139, 193-198.

466 See Protocol No 16 on certain provisions relating to Denmark.

ing European integration, it was sceptical about plans for monetary union when these appeared on the political agenda at the end of the 1980s. Prime Minister Margaret Thatcher consented to the establishment of the Delors Committee because she thought that *Bundesbank* President Pöhl as well as his British counterpart Leigh-Pemberton 'would manage to put a spoke in the wheel of this particular vehicle of European integration'.⁴⁶⁷ But she miscalculated Pöhl's position. He was very critical of plans for monetary union, but not out of political-ideological conviction.⁴⁶⁸ Once he felt that the committee's report would represent his views to a considerable extent, he could put his signature under it.⁴⁶⁹ Out of fear of making a fool of himself by being the only one to turn down the report, Leigh Pemberton did the same.⁴⁷⁰ The final result produced by the Delors Committee therefore turned out to be very different to what Thatcher had hoped for. Reflecting on her years in Downing Street, she says:

'When the Delors Report finally appeared in April 1989 it confirmed our worst fears. From the beginning there had been discussion of a "three-stage" approach, which might at least have allowed us to slow the pace and refuse to "advance" further than the first or second stage. But the report now insisted that by embarking on the first stage the Community committed itself irrevocably to the eventual achievement of full economic and monetary union. There was a requirement for a new treaty and for work on it to start immediately ... None of these was acceptable to me.'⁴⁷¹

The British aversion to a single currency was eventually settled through an 'opt-out'.⁴⁷² The United Kingdom is under no obligation to adopt the single

467 Margaret Thatcher, *The Downing Street Years* (Harper Collins Publishers 1993) 741.

468 Szász, *The Road* (n 2) 113; Dyson and Featherstone (n 2) 347-348.

469 Szász, *The Road* (n 2) 113. According to Dyson and Featherstone (n 2) 347-348: 'This development in Pöhl's position reflected the fact that....it was clear that the basic requirements of the Bundesbank had been accepted ... In this respect Pöhl's signature posed no real problem.'

470 According to Leigh-Pemberton himself, quoted in Marsh (n 24) 124: 'My brief from Mrs Thatcher was to follow Pöhl. I wrote a letter to Mrs Thatcher saying that, once Karl Otto Pöhl had signed, I saw no reason why I should not do the same. I would look ridiculous if I was the only governor who did not sign. I would look like Mrs Thatcher's poodle'.

471 Thatcher (n 467) 708.

472 Protocol No 15 on certain provisions relating to the United Kingdom of Great Britain and Northern Ireland. For a discussion about 'the general spread of opt-outs' following the Treaty of Maastricht see Bruno De Witte, 'Variable geometry and differentiation as structural features of the EU legal order' in Bruno De Witte, Andrea Ott and Ellen Vos (eds), *Between Flexibility and Disintegration: The Trajectory of Differentiation in EU Law Today* (Edward Elgar 2017) 11-15.

currency, unless it notifies the Council of its intention to do so.⁴⁷³ Until that time, which will most likely never arrive now that the British people have voted in a referendum to leave the Union, the Protocol meticulously determines which treaty provisions on economic and monetary policy apply to the state. As a result, it is exempted from the focus on stability in ways that 'normal' states with a derogation are not. Three such ways deserve to be mentioned specifically. The first concerns central bank independence. Paragraph 4 of the Protocol determines that the independence requirements in Article 130 TFEU do not apply to the United Kingdom and its central bank, the Bank of England.⁴⁷⁴ The other two exemptions concern the area of fiscal prudence. The instrument of market discipline, in particular the prohibition on monetary financing, is curtailed by the fact that the British government 'may maintain its "ways and means" facility with the Bank of England'.⁴⁷⁵ Public discipline is restrained too as the United Kingdom is not subject to the obligation in Article 126(1) TFEU to avoid excessive deficits;⁴⁷⁶ it is only supposed to 'endeavour to avoid' them.⁴⁷⁷

Its special status notwithstanding, during the crisis the United Kingdom would not shy away from interfering in the politics of the currency union. In fact, as chapters 5 and 6 will show,⁴⁷⁸ at critical points in time it hampered efforts to save the euro. To a great extent these efforts would be devised in the European Council and fora that are reserved for members of the currency union, such as the Euro Summit and the Eurogroup.⁴⁷⁹ The European Council and the Euro Summit in particular would come to take up a leading role and thereby show the *existence* and *importance* of a government for the Union and the euro, despite Germany's attempts to ban it from its legal set-up.

473 Para 1 of Protocol No 15 on certain provisions relating to the United Kingdom of Great Britain and Northern Ireland. As point 9(a) of the Protocol makes clear, the United Kingdom shall have the right to adopt the euro only if it satisfies the convergence criteria laid down in Art 140(1) TFEU.

474 Nonetheless, the United Kingdom has granted the Bank of England considerable independence with the Bank of England Act 1998. See also Amtenbrink, 'The Democratic Accountability of Central Banks' (n 220) 65.

475 Para 10 of Protocol No 15. See also Recital 5 Reg 3603/93.

476 Para 4 of Protocol No 15.

477 Para 5 of Protocol No 15. The United Kingdom can, however, become the subject of an excessive deficit procedure. Yet, and similar to all states with a derogation, it cannot be coerced into remedying excessive deficits. Para 4 of the Protocol makes clear that Arts 126(9) and (11) TFEU do not apply to the United Kingdom.

478 See text to n 149 and 310 (ch 5) and n 88 (ch 6).

479 See especially chs 5 and 6.

7 CONCLUSION

When the member states signed and ratified the Treaty of Maastricht in 1992-93, they jointly committed themselves to a currency union focused on price stability. The solidarity they were required to display was therefore largely negative in kind as the actions they had to perform mainly focused on their own condition, especially in the area of fiscal policy. Economic and political considerations were at the basis of this decision to create a monetary union geared towards price stability. Increasing capital mobility made it difficult to reconcile the system of fixed, but adjustable exchange rates under the European Monetary System with national monetary autonomy. A currency union would put an end to the problems posed by this inconsistent trinity as it entails the transfer of monetary policy competences to Union level. The move towards a single currency also had a strong geopolitical dimension. The fall of the Wall in November 1989 significantly speeded up plans for monetary union that had already been set in motion by the European Council at its Hannover summit in 1988 when it charged Jacques Delors with the task of proposing a plan to achieve monetary union in stages.

Understanding the motives behind, as well as the timing of the currency union's creation also helps to read its legal set-up. This was devised at a time when states experienced a convergence of economic policy preferences, characterised by a shift away from Keynesianism and towards monetarism. This convergence was promoted by the European Monetary System, which allowed states to 'import' price stability by adjusting their policies to that of the *Bundesbank*. Germany's anchor position in the system also equipped the state with a strong bargaining position on monetary union, enabling it to force through its concern for price stability at crucial points during the treaty negotiations. As a result, the single currency's legal set-up came to institutionalise a 'stability paradigm' which attributes overriding importance to price stability and seeks to position the central bank in such a way that it is able to pursue this goal.

The influence of this paradigm becomes most readily apparent at the level of goals and principles, where price stability features prominently, and in the constitutional position of the European Central Bank, which is characterised by great independence. Yet, it also determines the Union's system of economic policy, in two ways in particular. First, the Union has been endowed with few competences in this area. Out of concern for central bank independence, the Union has not been given the competence to ensure an adequate 'policy mix' between economic and monetary policy through prior coordination by the European Council. Second, Union law contains two specific instruments to induce member states to apply fiscal prudence and avoid hampering the Bank's ability to pursue price stability. One of these is the instrument of market discipline. It operates through the prohibitions on monetary financing, privi-

leged access and bail-out and aims to ensure that states have to finance themselves on the markets and under market conditions by cutting off other financing mechanisms.

The other instrument relates to public discipline. Central to this instrument is the obligation to avoid excessive deficits and debts, which Union law defines, albeit it with exceptions, as a deficit exceeding 3% of GDP and a debt above 60% of GDP. The Stability and Growth Pact, created at the initiative of Germany, seeks to put flesh on this obligation. Its preventive part, in its pre-crisis form, obliged states to pursue medium-term budgetary objectives ranging between -1% and balance or surplus so as to prevent excessive deficits. The Pact's corrective arm specified the excessive deficit procedure in Article 126 TFEU by clarifying when states were allowed deficits exceeding the 3% limit, attaching time limits to the specific procedural steps and specifying the sanctioning mechanism that applies in the event a state fails to act on Council recommendations.

Finally, the stability paradigm is evident in the conditions on accession to the currency union. These conditions, legal and economic, focus to a great extent on the need to prevent the currency from developing an inflation bias. Accession is the issue on which Germany and other stability minded states had to compromise most, in particular by consenting to a final date for the launch of the single currency and by leaving the decision on entry in the hands of the heads of state acting by qualified majority. Concerns for stability here clearly had to give in to the desire for inclusiveness.

Legally entrenching economic wisdom to extreme degrees may have seemed the safest route to stability when the member states devised the currency union at the beginning of the 1990s. Yet, as the next chapter will demonstrate, when the debt crisis hit Europe in late 2009, it painfully laid bare the problematic nature of this approach.

