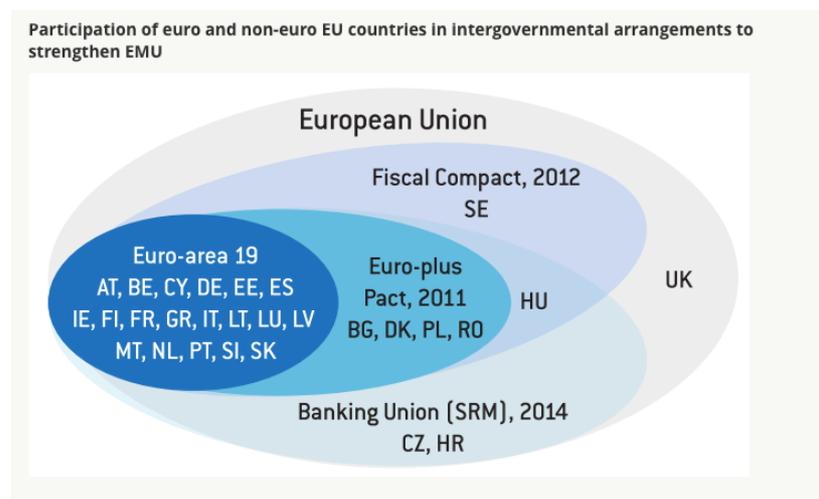


"Economic and Legal Assessment of existing mechanisms and procedures"¹

A main challenge of the current EU and EMU framework is, precisely, to complete and stabilize the framework. First, there is a need to further clarify the distinct socio-economic, legal, political and institutional characteristics of the *European Union* (EU) and the *Economic and Monetary Union* (EMU). Second, since the latter represents the highest level of interdependence within the EU it needs to have a coherent, stable and efficient structure. The Five Presidents' Report (2015) outlines four pillars for a complete architecture of EMU -- *i*) Economic Union, *ii*) Fiscal Union, *iii*) Financial Union, and *iv*) Political Union. While progress has been made in (i) – (iii) since the start of the start of the euro crisis (2010)², the framework is far from being complete and, in particular, the EMU lacks basic legal-institutional structure (e.g. together with the ECB, the Eurocouncil and the Eurogroup have been the most active organisms through the euro crisis, nevertheless they are 'informal bodies' within the EU-EMU framework). Nevertheless, clarifying the differences between EU and EMU does not mean that there will be an absolute dividing line between the two since, as the graph (from Bruegel) indicates, EU member states may opt to participate in different institutions, or policies, which define EMU. The ADEMU project focuses in (*i*) and (*ii*), but necessarily refers to (*iii*) and (*iv*), since the four pillars are interrelated.



Most of the ADEMU research analyses the economic dimension of EMU, however it is not possible to successfully develop a EMU framework without accounting for its legal dimension. This is the focus of the ADEMU Law team and of this Milestone (and it is a part of Work Package 4). The ADEMU Law team, building in their transnational study on the ["Constitutional Change through Euro Crisis Law"](#),

¹ ADEMU Milestone (MS8)

² In particular: (i) the *Macroeconomic Imbalance Procedure* (2014); (ii) the *European Stability Mechanism* (2012) and the *Fiscal Compact* (into 'force' from January 1, 2013), and (iii) Banking Union: *Single Supervisor Mechanism* (2013) and *Single Resolution Mechanism* (2014).

organized a ADEMU workshop to set up the agenda on the [*“Legal and Institutional Dimensions of EMU”*](#) (October, 2015), where they identified four research themes regarding the legal and constitutional constraints and challenges posed at both European and national level by the institutional innovations in (i) – (iv):

- 1) *Constitutional conditions posed to legal change of EMU at both EU and national level,*
- 2) *Legal aspects of the overall new EMU/economic governance package,*
- 3) *Legal aspects of risk-sharing mechanisms,*
- 4) *Legal aspects of banking union.*

A summary of the corresponding research carried out in the first year of the ADEMU project follows. We also punctually refer to the ADEMU economic research, which has proceeded in parallel. While this is a ‘assessment on existing mechanisms’, the final report will be a ‘assessment of the proposed mechanisms’; therefore, the interrelation between the legal and economic research is crucial and, fortunately, it has already been the practice within the ADEMU Working Groups, Workshops and Conferences in this first year.

With regard to research theme 1) *Constitutional conditions posed to legal change of EMU at both EU and national level*, Beukers and Fasone (2016) argue that significant long-term developments in EMU are conditioned not only by the current EU legal framework but also by national constitutions. Taking Germany, Portugal and the United Kingdom as examples, they argue that any sustainable settlement for EMU will have to address national competence concerns, take European and national fundamental rights seriously, and find a durable settlement between euro ins and outs.

With regard to research theme 2) *Legal aspects of the overall new EMU/economic governance package*, Kilpatrick (2016) identifies three central legal challenges with the current economic governance regime, namely (a) limits to the competence of the EU to strengthen economic governance, (b) the issue of compatibility with fundamental rights and legitimacy, and the importance of protecting and enhancing social rights and economic security for individuals, and (c) the sheer complexity of economic governance. Kilpatrick proposes three possible interpretations of the effectiveness of the Economic regime of EMU: from the ‘benevolent interpretation,’ according to which it is a question of time and experience to develop shared principles and practices of healthy public finances and closer coordination, to the ‘skeptical view’, based on the inconsistent experience of violating accepted rules through political bargaining and adaptation, she emphasizes the ‘pragmatic intelligence view,’ which recognizes the effect of transparency, monitoring and peer-pressure in shaping national fiscal policies towards the agreed EMU objectives of monetary, financial and fiscal stability. Which view will eventually be right will depend on how well the *Macroeconomic Imbalance Procedure* works and, more importantly, on how large and persistent the macroeconomic imbalances in the Euro Area remain, which is also a research

theme of ADEMU³.

With regard to research theme 3) *Legal aspects of risk-sharing mechanisms*, Martinelli (2016) identifies various legal challenges to recent developments in the area of debt restructuring (Greek debt swap operation and ESM obligations), and argues that serious considerations should be given to the development of a more robust regime for sovereign debt workout in the euro area. He identifies the need to refine the Euro Collective Actions Clause (CAC) in the short term, and to develop a statutory framework for sovereign insolvency in the medium term or long term. Challenges include the question of what to do with debt instruments held by the Eurosystem, and of how to eliminate altogether the risk of holdout behaviour. The problem of the ‘debt overhang’ is a recurrent theme in the economic research agenda of ADEMU (Work Package 1)⁴.

Focusing on core legal and institutional considerations relating to recent developments and future plans for further risk-sharing among Member States (European Stability Mechanism, prospects for euro-bonds, variations of fiscal stabilisation mechanisms), Leino-Sandberg (2016) argues that a more stable EMU needs to be broadly experienced as legitimate and fair. So far in the context of EMU developments and plans, including those concerning risk-sharing, considerations of legitimacy, accountability and “fairness” have been approached as separate or additional to substantive considerations of stability and sustainability.

Leino-Sandberg and Saarenheimo (2016) argue that the option of moving to greater risk-sharing among the Member States, building on strengthened EU level steering, is simply not realistic within the envisaged time frame. While many economic arguments can be found in favour of a rule-based equalising mechanism, they question the effectiveness of requirements of compliance with new binding convergence criteria as a precondition for participation in risk-sharing mechanisms. They also question the possibility to prevent one-way income transfers by rules and institutions, when they should be enforced on sovereign States. These are concerns, already present in the Five Presidents’ Report (2015), which the ADEMU research team is taking on board and where intensively discussed in the Workshop on [“Risk-Sharing Mechanisms for the EU”](#) (EUI, 20-21 May 2016) and specifically addressed in the ongoing ADEMU work of Árpád Ábrahám, Ramon Marimon and co-authors.

With regard to research theme 4) *Legal aspects of banking union*, Petit and Monti (2016) identify the main challenges and risks of banking union, with a focus on current Single Supervisory Mechanism (SSM). These include the lack of a suitable provision within the Treaties to create the elements of Banking Union, concerns of democratic legitimacy related to the limited involvement of the

³ In particular, the CERGE team has assembled a new data set on Macroeconomic Imbalances, which was presented in the ADEMU workshop on [“Macroeconomic and Financial Imbalances and Spillovers”](#) (Prague, April 29-30, 2016).

⁴ It will be one of the topics of the ADEMU Conference on *“Debt Sustainability, Default and Lending Institutions”* (Cambridge, September 2-4, 2016).

European Parliament, and the complexity to the legal background of the banking union aggravated by the use of intergovernmental agreements. Limits posed to the delegation of powers to independent agencies posed by the so-called *Meroni* doctrine create the risk of suboptimal decisions by the political European Commission as opposed to an independent regulator. The effectiveness of the current supervisory scheme is moreover jeopardized by different horizontal and vertical divergence risks. The institutional analysis of the SSM exposes a *de facto* division between euro and non-euro Member States, Petit and Monti identify risks of marginalisation, misrepresentation and disintegration.

Yiatrou (2016) argues that the credibility of the current banking resolution regime is limited, especially with regard to larger banks, and identifies important economic implications. Her study of the technicalities and target-levels of the envisaged funds to finance the resolution of banks in trouble reveals that they will not be enough without imposing on the public's purse, and that the new banking resolution regime therefore has limited credibility in achieving orderly resolutions. This means the objective of severing the bank-sovereign bond and putting an end to bail-outs is not fully met. The regime fails to influence the credit risk valuation by the bank's creditors in a way that disciplines the bank's perverse risk-taking incentives. On the other hand, the regime is probably as good as it gets absent the ECB's capacity to serve as a lender of last resort.⁵

⁵ The Political Economy aspects of the European Banking Union are also part of the ADEMU research agenda (Work Package 4); in particular, David Levine and Andrea Mattozzi study the problem of the 'regulatory capture' of banking regulatory institutions by private banking collusive groups.