Sustainable Economic and Monetary Union in Europe in turbulent times

> *We cannot solve our problems with the same thinking we used when we created them.*
> **Albert Einstein** (1879-1955)
>
> *Including something in the universe of possible options is quite a powerful thing, even if you still don't like it, think it's unlikely, or difficult. At least, starting to think of an option as possible makes a difference to your thinking.*
> **Martin Sandbu**, interviewed by Nicholas Barrett, journalist, European University Institute (2016).

1. *Introductory words*

Grateful I am for the invitation to come to the European University Institute and speak in Fiesole to give my views on a dynamic Economic and Monetary Union (EMU) in Europe. It is an honour to share my perspectives with other scholars in the ADEMU project that I am happy to be affiliated with in an advisory capacity. I am a member of the ADEMU Advisory Committee, which is to provide "an external monitoring role and periodic advice to the ADEMU Consortium".

Speaking of capacities, I am here in my personal capacity, or that of a fellow researcher at the University of Amsterdam, where I am a part-time law professor; my chair concerns EMU law. Most of my time, I am a consultant on EMU law and banking regulation and supervision (at RS Law & Society Consulting B.V.), an alternate member of the ECB's Administrative Board of Review (ABoR) and an assessor at the Belgian Competition Authority (BCA). What I will say, or omit to say, may not be attributed to any of these authorities, where I contribute subject to professional secrecy.

Speaking of scholarly activities, mine have concentrated this past year on democracy in EMU, with a paper[1] presented at the Conference on *The Democratic Principle and the Economic and Monetary Union*[2], held in Rome on 22 January 2016, with a chapter

[1] *From subordinated to prominent: the role of the European Commission in EMU - Reflections on Euro Area democracy*.
[2] Organised by Professor Luigi Daniele, EU Law Chair, *Università di Roma Tor Vergata*. See: http://diritto.typepad.com/files/brochure-22-january-2016.pdf.

on the legality of the ECB's non-standard monetary policy measures[3] in a forthcoming *Research Handbook on Central Banking*[4], and with a forthcoming academic contribution on bank holding regulation from an African comparative law perspective[5]. This latter contribution is written together with John Taylor, of London Queen Mary's Centre for Commercial Law Studies, to which I am affiliated as a Visiting Professorial Fellow. These publications come on top of presentations on EMU law and BHC regulation[6] given in Lisbon and Johannesburg and Pretoria[7].

Today's presentation concentrates on legal and institutional issues of EMU. Furthermore, I will endeavour to place these issues in a wider, societal context. Sustainability is key: both in the sense of a project that lasts, as it is conceived to be irreversible, and in the sense that its policies and effects are sustainable from economic and ecological points of view. 'Economic' in the same sense as we speak of sustainable banking nowadays, implying practices that serve the client and lead to long-term viability, not just short-term profitability. And 'ecological', implying respect for man and nature, acknowledging effects on both of policies entertained and choices made.

After sketching my analysis of the current crisis, or malaise, I intend to focus on economic governance, monetary union and banking union, in each case proffering specific suggestions for the way ahead, in terms of policies and research. Doing so, I will also devote attention to general issues of European politics and society, to embed the EMU focus in a wider perspective on the world around us and to look beyond our

[3] *A central bank in times of crisis: the ECB's developing role in the EU's currency union*.
[4] Rosa Maria Lastra and Peter Conti-Brown (eds.), *Research Handbook on Central Banking* (forthcoming).
[5] *Bank Holding Supervision: A Comparative Inventory and A Call for Pan-African Regulation.*
[6] The lectures on BHC regulation at MOCOMILA, the Committee on International Monetary Law of the International Law Association (ILA), and the South African Reserve Bank (SARB) were joint presentations with John Taylor.
[7] At the CIRSF (Research Center on Regulation and Supervision of the Financial Sector) Annual International Conference 2016 in Lisbon on 23 June, at the 77th Biennial Conference of the ILA in Johannesburg on 4 August and at a seminar at the SARB in Pretoria on 5 August 2016. See: http://renesmits.eu/index.php/calendar/past-events/.

area of specialist expertise. Here, I will show my colours as a sociologist which I am, as well, by training, if not by profession since, after law school, I pursued a career as in-house counsel at the central bank and, then, at the competition authority of my home State, and as law professor and legal and strategic consultant. I will end on a personal note.

2. The current crisis, or malaise

Speaking about the current crisis, or crises, I do not intend to describe origins of the malaise we are in now. Others have done so with great expertise. Let me confine myself to giving a perspective on the situation, and on what I consider an adequate academic response.

Design faults or policy choices?

In the debate about the crisis, two different approaches are taken. One is to impute the crisis to flaws in the design of EMU and place all the blame there. This is the side of populists who consider the euro the source of all evils, imposed upon them by 'the elite' in a dark plot of globalisation and Europeanisation, alien to the people (*das Volk*), meaning – of course – the nation since this view rejects the existence of a European people. Such views are also held by respected researchers and politicians, and judges, especially in Karlsruhe. The other approach, epitomised by *Financial Times* journalist Martin Sandbu, is that EMU was properly designed but the wrong policy choices were made. His view is that, with different choices, the current design will function and there is no need for major changes which will not be acceptable, anyway. In this respect, Martin Sandbu falls into the same trap he rightly accuses his opponents of, namely of thinking in impossibilities rather than possibilities. It is his positive, energising perspective that earned him a place above this contribution, alongside Albert Einstein's famous quote about how the same way of thinking that is the source of current problems will not enable us to rise above them: a situation I see around us at

present, with repetition *at nauseam* of doctrinarian tenets that adherents of the policy consensus keep adhering to. Also, some of the policy choices that Sandbu rightly criticises resulted directly from design flaws. Let me give two examples.

(1) Had banking supervision been unified and centralised in Europe before the crisis, we wouldn't have had the disperse but similar approach of each Member State guaranteeing its banking sector individually, leading to the sovereign doom loop: a joint approach might have prevented this outcome.

(2) The absence of central economic governance goes a long way in explaining the austerity-driven approach followed: cutting budgets makes sense for individual States that have overspent or cannot fund themselves but, collectively, there is ample room for fiscal stimulus in the Eurozone.

In this debate, I take a middle perspective. I see both *policy choices* and *design flaws* behind the current crisis. And I consider that both have to do with our state of mind, a non-legal perspective that I venture to make. Of course, lawyers should contribute from their expertise: the law, its interpretation and development. But lawyers are also humans, and should be allowed to share their insights that do not fit nicely into the category of thinking in distinctions: law versus economics, politics versus science and academia, the government versus business, the state versus the citizen, the Member States versus the European Union. One may validly embrace a wider perspective, beyond distinctions, on which I'd like to cite Shakespeare's[8] Hamlet: "there is nothing either good or bad, but thinking makes it so".

Now, I will share my thinking making distinctions, acutely aware that they are not the ultimate truth but just one perspective.

[8] William Shakespeare, *Hamlet*, Act 2, scene 2, 239–251.

Design faults

The design of EMU has proved woefully inadequate when a crisis hit that no one considered possible. The imbalance between monetary and economic union, without central budgetary authority or effective coordination of economic policies, leaving the ECB alone to address any major crisis effectively, is, in my view, a central fault line. This imbalance was purposely adopted as the correct way to introduce monetary union, in part for sovereignty reasons. Member States were reluctant to share more policy areas and even included a separate provision in the Treaty on Functioning of the European Union (TFEU): Article 5 TFEU that sets economic policy coordination apart from exclusive[9] and shared competences[10]. The imbalance between 'E' and 'M' in part reflects the 1980s' abundant faith in the disciplining effects of markets. It would be through market discipline that economic policies would be disciplined and, mildly coordinated in the Ecofin Council, a balanced outcome would result. As the *Delors Committee Report* (1989) already acknowledged, in a passage making the case for budgetary policy restraints in the Treaty, "market views about the creditworthiness of official borrowers tend to change abruptly and result in the closure of access to market financing. The constraints imposed by market forces might either be too slow and weak or too sudden and disruptive."[11] Indeed, markets neither disciplined governments sufficiently nor could they be relied on to function properly: the efficient market hypothesis has been severely undermined at the height of the Great Financial Crisis (GFC). I refer to writing published in 2008 by George Soros[12] and George Cooper[13]. We now know: markets do not reflect underlying fundamentals and correct public actors effectively.

[9] Enumerated in Article 3 TFEU.
[10] Enumerated in Article 4 TFEU.
[11] Committee for the Study of Economic and Monetary Union, *Report on Economic and Monetary Union in the European Community*, 12 April 1989, paragraph 30.
[12] George Soros, *The New Paradigm for Financial Markets: The Credit Crisis of 2008 and What It Means*, 2008.
[13] George Cooper, *The Origin of Financial Crises: Central Banks, Credit Bubbles, and the Efficient Market Fallacy*, 2008.

Also, single banking supervision and resolution should, with the benefit of hindsight, have been adopted at the outset already. The disperse authority over banks, and the uncoordinated but largely identical response of State governments to the instability of their sections of the EU banking system made things far worse here than across the Atlantic. There, an immediate federal response resulted in positive outcomes for the taxpayer, with the Troubled Asset Relief Program (TARP)[14] under which the US Government purchased toxic assets from banks and increased their capital strength by buying their equity delivering a return of USD 14 bn. on an overall programme of USD 427 bn. Of course, the stimulus of around USD 150 bn. provided by the US administration[15] also helped America to recover from the GFC much quicker than Europe where austerity policies were imposed, and continue to be followed. (Note that the TARP and economic stimulus were adopted at the height of the crisis in October 2008, while Europe is struggling eight years afterwards.) This is partially due to the existence of a potentially large federal budget in the US and to the insistence in Europe that we look at States, and not at the whole, for which, as said, a more accommodating budgetary policy stance would have been acceptable. Alternatively, the restrictive budgetary policies that were followed and needed to be followed where public finances had gone completely astray, could have been countered by federal spending in the affected Member States. No authority, or budget, to do so existed. The result is felt sorely 'on the ground'.

'E' versus 'M' in the Werner and Delors blueprints

Both the *Delors Committee Report* and the *Werner Report* of 1970 on establishing EMU acknowledge that, even in the final stage of EMU, the central budget will remain weak

[14] Based on Public Law 110-343, 122 Stat. 376 ("An Act To provide authority for the Federal Government to purchase and insure certain types of troubled assets for the purposes of providing stability to and preventing disruption in the economy and financial system and protecting taxpayers, to amend the Internal Revenue Code of 1986 to provide incentives for energy production and conservation, to extend certain expiring provisions, to provide individual income tax relief, and for other purposes"), and including the Emergency Economic Stabilization Act of 2008, 122 Stat. 3765.
[15] Economic Stimulus Act of 2008, 122 Stat. 613.

in significance compared to national budgets[16]. They take different approaches on the Union-wide stance of economic policy. The Delors Committee's vision is that "the task of setting a Community-wide fiscal policy stance will have to be performed through the coordination of national budgetary policies."[17] The *Werner Report*'s insistence on budgetary control across the currency union by "the Community's centre of decision" (it does not specify whether this would be the Council, the Commission or another newly established organ) seems to have been validated as the better view. With remarkable foresight, the *Werner Report* describes the current state of affairs: "The margins within which the main budget aggregates must be held both for the annual budget and the multi-year projections will be decided at the Community level, taking account of the economic situation and the particular structural features of each country"[18]. As if its authors describe the state of affairs after the introduction of the six-pack and the two-pack on economic governance. The following observation has not materialised: "In order to be able to be able to influence the short term economic trend rapidly and effectively it will be useful to have at the national level budgetary and fiscal instruments that can be handled in accordance with Community directives". Instead, we may need Union-wide stabilisers functioning quasi-automatically through the introduction of Union-wide unemployment benefit financing. But this is a possible future direction. Back to the current situation.

Adverse policy choices

On the issue of a different policy choice, I agree with those who argue that the euro would not have come so perilously close to implosion if other policies had been adopted. The *sequencing of economic policy prescriptions* – placing austerity before

[16] *Report to the Council and the Commission on the realisation by stages of Economic and Monetary Union in the Community ("Werner Report")*, p. 11.
[17] Committee for the Study of Economic and Monetary Union, *Report on Economic and Monetary Union in the European Community*, 12 April 1989, paragraph 30.
[18] *Report to the Council and the Commission on the realisation by stages of Economic and Monetary Union in the Community ("Werner Report")*, p. 11.

structural measures – seems an obvious mistake. Others are more qualified to discuss the economic policies.

From my vantage point, two more remarks may be made on the policy choices.

State Governments insisted on taking their own decisions. Even if they adopted the same policies, they insisted on doing so themselves, on an individual basis and hardly uncoordinated at the start. Such dispersed rather than unified policy making in respect of bank guarantees and nationalisation goes a long way to explain the further crisis (the infamous sovereign/bank doom loop) and the long time it has taken for the recovery to really start. Even though the absence of strong federal authority may be a design flaw that enabled this dispersed policy-making, the *choice* was made to think of oneself first, and then – if at all – of the others. An infantile insistence by States to adopt their own policies did no good.

Whatever the need for budgetary corrections, the *overemphasis on austerity* has led to severe contractions and deplorable effects 'on the ground' for which, at least initially there has been *no compassion*. This has severely undermined the popularity of the euro and the legitimacy of the European Union.

Legitimacy issues

Thus, the crisis not only showed the deficiencies in EMU's design and the policy choices adopted but, also, showed markedly the *legitimacy issues*: accountability organised largely along national lines, with weak European Parliament oversight and the media debate confined to the national arena. The European Stability Mechanism (ESM)[19] even institutionalises the divide between creditor and debtor States, pitting the parliaments of Germany and other 'Northern' States that insist on agreeing to financing programmes, against the representatives of 'southern' States. This

[19] Treaty establishing the European Stability Mechanism, 2 February 2012. See: http://www.esm.europa.eu/.

disruption has been eloquently described, and deplored by former ECB Executive Board member Lorenzo Bini Smaghi[20]. The intergovernmental approach followed in establishing crisis mechanisms (ESM, TSGC or 'Fiscal Compact' Treaty[21], the Single Resolution Fund (SRF) mutualisation agreement[22]) leads away from joint responsibility vis-à-vis the common parliament and reinforces the dialectics already clearly discernible within the EU proper. Whilst dialogue with national parliaments has its proper place in the legitimacy of multi-level governance policies, as the appearances of the ECB President before national parliaments makes clear[23], *relying on State lawmakers to decide continent-wide issues is neither democratic nor effective: it will pit parliaments against each other and sharpen the divides instead of overcoming them*.

Other aspects of EMU's introduction need not bother us now but can be seen as clear fault lines:

(1) accepting Member States that were not ready, in terms of budgetary balance or adequacy of governance, into the euro area had a very negative impact;

(2) not securing a neutral changeover to the single currency has made the single currency unpopular even before the crisis erupted (*Teuro*: the expensive euro,

[20] Bini Smaghi, Lorenzo (2015) Governance and Conditionality: Toward a Sustainable Framework?, *Journal of European Integration*, 37:7, 755-768, DOI: 10.1080/07036337.2015.1079372: "The explicit involvement of national parliaments, especially in Germany, gives the impression that it is ultimately up to the latter to agree on whether another Eurozone country can access the ESM and receive financial assistance. This creates a direct opposition between countries, and their own people and media, which is very detrimental to the process of political integration. The ESM decision-making process should be made more similar to that of the IMF. This does not prevent national parliaments from being involved, but this should be at an early stage, in giving mandate to the respective national representatives in the institution rather as appearing to be the ultimate decision-maker and judge."

[21] Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, 2 March 2012, also referred to as the Fiscal Compact Treaty. See: www.consilium.europa.eu/, http://europa.eu/rapid/press-release_DOC-12-2_en.htm.

[22] Agreement on the transfer and mutualisation of contributions to the Single Resolution fund, 14 May 2014. See: http://www.consilium.europa.eu/en/policies/banking-union/single-resolution-mechanism/.

[23] Just recently, on 28 September 2016, before the *Bundestag*. Before, Mario Draghi spoke with national parliaments in Germany (2012), France (2013), Finland (2014) and Italy (2015).

Gefühlsinflation, perceived versus actual inflation) so that it easily became the scapegoat for all that went wrong since 2010.

The role of academics in ADEMU research

In the face of so much misery, what can academics do? A few ideas.

First, we should be scrupulous in our terms, not giving in to the use of words whose meaning is assumed, often wrongly. I refer to the debate about 'political union', 'transfer union', 'political will', and so on where concepts are considered to have a fixed meaning which apparently, very un-scientifically, does not need to be made clear. How often does one not hear the statement that 'it was foolish to introduce the single currency without political union'? This statement assumes a meaning of 'political union' that denies all the federal elements in the *current* design of the European Union. Awareness is called for that nations, governments and other abstractions that cannot be seen to have a separate physical existence, such as a tree, are human constructs. (I will come back to this a little later.) Speaking of trees: even these seemingly separate elements of nature have been found to be far more connected than we usually acknowledge[24]. Looking at humans, the same holds true: we experience ourselves as separate and call ourselves individual but are shaped by collective processes and form part of a whole called the universe. Albert Einstein, already quoted at the outset, gave adequate expression to this[25]. While speaking of Einstein, allow me another quote, very relevant in these times:

> *Nationalism is an infantile disease. It is the measles of mankind.*

[24] Peter Wohlleben, *The Hidden Life of Trees: What They Feel, How They Communicate - Discoveries from a Secret World*. See: http://www.peter-wohlleben.de/engl-home.html.

[25] Quoting Albert Einstein: "A human being is part of a whole, called by us the 'Universe' —a part limited in time and space. He experiences himself, his thoughts, and feelings, as something separated from the rest—a kind of optical delusion of his consciousness. This delusion is a kind of prison for us, restricting us to our personal desires and to affection for a few persons nearest us. Our task must be to free ourselves from this prison by widening our circles of compassion to embrace all living creatures and the whole of nature in its beauty."

Which brings me to a second point: thinking in 'fixed concepts'. There is a lot of what I call 'binary thinking', allowing only black and white. A case in point is the discussion about state and federation: either we have States or we have a federation. Apart from the fact that the countries of Europe have developed into Member States (Chris Bickerton wrote a book on state transformation in Europe, from nation-states to member states[26]), this approach fails to imagine not only *anything in-between* but, worse, *anything else*. What if we approached the EU while breaking clear of concepts taken from the past and look at it anew? Not as a 'country' or an 'international organisation' but as another form of organisation. Here, I cannot go into possible qualifications of the multi-level governance system the EU constitutes. Just let me quote Pavlos Eleftheriadis, who commented "that the EU did not fit the sovereignty paradigm and was, instead, a mixed entity with a mixed constitution."[27] A lot has been written in the realm of political science, philosophy and law on this[28]. In his book *Sapiens*[29], Israeli historian Yuval Noah Harari reminds us that 'nation' is a human construct, a collective way of thinking which makes cooperation across a large group of people possible. Similar constructs are a 'company', a 'church', and so on. We'd better be aware of this and refrain from attributing fixed qualities to it. And we may remember the novelty, in history, of some nations, here in Europe where German and Italian unification only occurred 150 years ago, and elsewhere (Africa since the 1960s being a prominent example of many nations forged out of colonial boundaries). Researchers in the ADEMU project may wish to take note of such wider considerations.

Thirdly, we are in need of a truly multidisciplinary approach as the crises can only be understood, and post-crisis arrangements can only validly be devised, when more than

[26] Chris Bickerton, *European Integration: From Nation-States to Member States*, Oxford University Press, 2012.
[27] Pavlos Eleftheriadis, *The moral distinctiveness of the European Union*, International Journal of Constitutional Law, Vol. 9 No. 3–4, 695–713, 2011.
[28] To mention just two names: Jürgen Habermas, *Zur Verfassung Europas. Ein Essay* (2011), and Joseph Weiler, *Deciphering the Political and Legal DNA of European Integration – An Exploratory Essay*, 2012. More references in my paper for the Rome conference, cited in footnote 1 above.
[29] Yuval Noah Harari, *Sapiens: A Brief History of Humankind*, 2014.

one perspective is adopted. We need to go beyond law and economics, and include political science, sociology, psychology, cultural anthropology, health studies and further disciplines to encapsulate a wider view of the policy measures adopted, and their effects on society. As Jones and Torres say in a recent article: "The euro area crisis cannot be understood without combining insights from a variety of disciplines"[30].

Fourthly, we need an alert awareness of one's own implicit assumptions in research. Making assumptions explicit, i.e. acknowledging the bias inherent in any human view and explaining which ones the researcher is prone to have, allows for proper discussion of the issues. I suggest that ADEMU researchers may wish to engage in a structured peer review process to uncover, and challenge, implicit assumptions in their research.

Fifthly, I propose that we need innovative academic research, free from political shackles, thinking afresh old problems and coming with new solutions. There are methods to foster imagination and reach layers of consciousness normally untouched by the thinking mind. These methods permit researchers to uncover potential and share ideas, always based on rigorous data and shared intelligence. One such approach, developed at MIT, is the *U Process*[31]. It has been used among academics and policy makers and provided a powerful tool in major transitions, both in societies (Guatemala after the civil war and South Africa in the transition from apartheid) and in business development (expanding an oil refinery at Royal Dutch/Shell). It may help get beyond the current thinking. Here, Einstein's adage is relevant: "We cannot solve our problems with the same thinking we used when we created them". Beyond traditional thinking, another approach is that of Eduardo de Bono: the six thinking hats emphasise the different modes of approaching an issue to help the organisation solve

[30] Erik Jones and Francisco Torres (2015), An 'Economics' Window on an Interdisciplinary Crisis, *Journal of European Integration*, 37:7, 713-722, DOI: 10.1080/07036337.2015.1079368.

[31] C. Otto Scharmer, *Theory U: Leading from the Future as it Emerges*, 2nd edition, 2016; Peter Senge, C. Otto Scharmer, Joe Jaworski, Betty Sue Flowers, *Presence: Human Purpose and the Field of the Future*, 2008.

an issue[32]. The idea behind the U Process is that the source from which we operate determines the outcome of our efforts. Getting to know that 'inner space' allows options that are there but remained unseen, to present themselves. This is what I can share in this lecture about the U Process. *I invite researchers and policymakers to dare to make this journey*. Here, the academic, and the political, become personal. One: making explicit one's assumptions, beliefs, and discovering the inner motives and go to Source. Two: applying one's core competences to develop and express oneself, thus helping to foster a society that functions better, and is more sustainable. Three: taking a servant attitude: being present to bring up the best, and to contribute.

To conclude on what academics can do: de-bunking myths through research, and restoring our capacity for awe and wonder even in research. I will go into EMU detail now and come back to this in my personal end note.

[32] See: http://www.debonothinkingsystems.com/tools/6hats.htm.

3. Economic governance

Economic governance has been strengthened considerably since the beginning of the crisis, notably through the so-called 'six-pack'[33] and 'two-pack'[34] sets of legal acts. However, the approach has remained the same: based on a fixed view of the issues (fiscal restraint, competitiveness) and on decades old templates. I suggest there are several improvements to be made. They concern:

A) State focus

B) Adversarial nature

C) Rules versus discretion

D) Transparency.

As the last one is the easiest to explain and remedy, I discuss these suggestions in reverse order.

[33] The 'six-pack' consists of the following legal acts reproduced in the Official Journal (OJ) No. 306 of 23 November 2011:
1. Council Regulation (EU) No 1177/2011 of 8 November 2011 amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure;
2. Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances;
3. Regulation (EU) No 1175/2011 of the European Parliament and of the Council of 16 November 2011 amending Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies;
4. Regulation (EU) No 1174/2011 of the European Parliament and of the Council of 16 November 2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro area;
5. Regulation (EU) No 1173/2011 of the European Parliament and of the Council of 16 November 2011 on the effective enforcement of budgetary surveillance in the euro area; and
6. Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States.

[34] The 'two-pack' consists of the following legal acts reproduced in the OJ L 140, 27 May 2013:
1. Regulation (EU) No 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area; and
2. Regulation (EU) No 472/2013 of the European Parliament and of the Council of 21 May 2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability.

Transparency of economic policy

The current economic governance labours from lack of transparency on two sides:

(1) the rules and procedures governing economic policy coordination and budgetary oversight are far too complex, too spread out and diffuse and impenetrable except for the expert, and

(2) the conditionality applying under an ESM programme is not adequately reflected in Union law. Before I elaborate, allow me to sing the praises of transparency as a quality of governance.

Transparency is a core quality of democracy and a condition for its proper functioning; it allows for informed debate in the European Parliament and in national parliaments. Transparency allows the affected citizen to defend herself or himself, knowing the origin of a State measure affecting them.

Transparency makes it harder for populists to delegitimise the EU by pointing at ridiculous or perverse measures that an already cynical audience may lap up without checking facts.

Transparency through including measures imposed as conditionality in an MoU, also in EU legal acts gives them primacy over national law and thus overcomes resistance from local vested interests in continuing malpractices that only outside creditors seem able to weed out.

Transparency of the general rules governing economic governance requires a complete revamp, making them intelligible whilst combining them in consolidated legal acts. The current hotchpotch of legal acts is unintelligible for the non-initiated. And even the EMU law expert is lost at times. Granted that budgets and economic imbalances are not easily regulated and a measure of technicality and opaqueness is inevitable, one may seriously question whether the regulation of budgets – the core

element of representative democracy ('no taxation without representation') – should be allowed to be scattered over more than twelve documents:

1. the TFEU (Articles 120-126)
2. the Protocol on the Excessive Deficit Procedure (EDP)
3. the European Council Resolution on the Stability and Growth Pact (SGP),
4. the preventive arm regulation (Regulation 1466/97, as amended),
5. the corrective arm regulation (Regulation 1467/97, as amended),
6. the budgetary frameworks directive (Directive 2011/85/EU),
7. the legal act on the effective enforcement of the SGP in the Euro Area (Regulation 1173/2011),
8. the legal act instituting the Excessive Imbalances Procedure (EIP) (Regulation 1176/2011),
9. the legal act providing for enhanced enforcement of the EIP in the EA (Regulation 1174/2011),
10. the first of the 'two pack' regulations, on the monitoring and assessment of draft budgetary plans (Regulation 473/201),
11. the Fiscal Compact Treaty (officially: the Treaty on Stability, Coordination and Governance in the economic and monetary union, of 2 March 2012),
12. the Commission communication on flexibility in the SGP (*Making the best use of flexibility within the existing rules of the Stability and Growth Pact*), and so on….

This implies that a student, or a citizen, needs to undertake extensive research, going back and forth from one legal act to another, to conclude what rules apply.

An overhaul of the economic governance texts is in order. Academic efforts at synthesising the complex variety into intelligible legal and economic language is what I call for, as a prelude to politicians' efforts at recasting the rules in a consolidated

rulebook. *Europe needs a Single Fiscal and Economic Governance Rulebook*, just as much as it needs a Single Rulebook for its banking union.

Moreover, when the Fiscal Compact Treaty and the SRF Mutualisation Agreement need to be integrated into the TFEU and, thus, EU law proper, an overhaul of the economic governance rules should be considered to reflect this preference for clarity and transparency. The inclusion of extra-treaty texts into the domain of EU law proper is also warranted, I submit, for the ESM Treaty and ESM rules which I advocate to bring into the TFEU and in secondary EU legislation in due course, as well.

Rules versus discretion

The current economic governance system is said to be *rule-based*. It is rules from the Treaty and the various legal acts cited before that are invoked to bring States into line with the Brussels consensus. Such rules, however, rely on the discretion that political bodies need to have in applying them. The reality is, therefore, far less rules-based than the theory would have it. This in itself undermines the legitimacy of the very rules. How often do we hear the complaint that rules on budgetary restraint are applied strictly to small States, or to States under a programme, whereas the larger ones, notably France, escape the hardship of 'Brussels oversight'? *There is a lack of equality between EU citizens in that those who reside in programme States are far more likely to be impacted by EU economic policy 'coordination' than those living in creditor States*.

Beyond this point of legitimacy, there is a real need for discretionary policies at the Euro Area level, instead of a blind following of 'rules'. Euro Area discretionary measures, i.e. decisions on expansionary or contracting budgetary policies for our society as our whole, are not yet on the menu. They should. (Even though the

European Fund for Strategic Investments (EFSI, also labelled the 'Juncker Fund')[35] and regional policies exist.) When promoting deeper EMU along the lines of the Five Presidents' Report[36] *we should explore the option of Euro Area-wide policy stances*, as one of the functions of a *Euro Area Treasury*, again suggested as a way forward by former ECB President Jean-Claude Trichet last week[37]. Further areas of research and actual policy development should, in my view, be the introduction of *automatic stabilizers* through *a basic EA-based unemployment benefit scheme*[38] and a *Euro Area fiscal capacity* that is debated in the European Parliament[39].

For the near future, *exploring to apply discretion instead of rule*s is worthwhile. I refer to the recent debate about the semi-automatic (rules-based) suspension of structural funds spending in Portugal and Spain because of these States' non-compliance with fiscal rules. The EUObserver reported[40] the announced intention of Jyrki Katainen, EU Commissioner for Jobs, Growth, Investment and Competitiveness, in the European Parliament last week, to suspend payments under the EU's so-called structural funds[41] to Portugal and Spain. This follows the adoption of Regulation 1303/2013 which[42], in

[35] Regulation (EU) 2015/1017 of the European Parliament and of the Council of 25 June 2015 on the European Fund for Strategic Investments, the European Investment Advisory Hub and the European Investment Project Portal and amending Regulations (EU) No 1291/2013 and (EU) No 1316/2013 — the European Fund for Strategic Investments, OJ L 169/1, 1 July 2015.

[36] See: *Completing Europe's Economic and Monetary Union*, Five Presidents' Report, at: https://www.ecb.europa.eu/pub/pdf/other/5presidentsreport.en.pdf.

[37] *Ex-EZB Chef Trichet schlägt EU-Finanzminister vor*, Die Presse, 7 October 2016.

[38] For an early proposal, see: http://glienickergruppe.eu/en/towards-a-euro-union/.

[39] On a Euro Area fiscal capacity, reference is made to the Draft Report on budgetary capacity for the Eurozone (2015/2344(INI)), submitted by the Committee on Budgets and the Committee on Economic and Monetary Affairs, Rapporteurs: Reimer Böge and Pervenche Berès, 4 May 20116, at: http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+COMPARL+PE-582.210+01+DOC+PDF+V0//EN&language=EN. See, also, the Opinion of the Committee on Constitutional Affairs for the Committee on Budgets and the Committee on Economic and Monetary Affairs on budgetary capacity for the Eurozone (2015/2344(INI)) Rapporteur: Paulo Rangel, 14 September 2016, at: http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+COMPARL+PE-580.732+03+DOC+PDF+V0//EN&language=EN.

[40] *'Kafkaesque' EU to freeze Portugal and Spain funds*, at: https://euobserver.com/economic/135348.

[41] This concerns the European Regional Development Fund (ERDF) and the European Social Fund (ESF), the Cohesion Fund, the European Agricultural Fund for Rural Development (EAFRD) and the European Maritime and Fisheries Fund (EMFF).

[42] Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the

Article 23, links disbursements under these funds to compliance with economic governance. Such suspension, first of 50% and, later, possibly of 100% of structural funds is intended to prod the Member State to take effective action in response to, *inter alia*, Council recommendations pursuant to Article 121 TFEU or the Economic Imbalances Procedure. The Commission may propose such suspension to the Council. Such semi-automaticity, voted for by the European Parliament when it adopted the relevant (Regulation 1302/2013), seems at odds with common sense and reinforces the crisis in States whose governments fail to respect the budgetary or other economic governance norms. It was called 'kafkaesque', bureaucratic, counterproductive and punitive. Which brings me to another element of our economic governance.

Adversarial nature of our economic governance system

Our economic governance system is adversarial in nature: *it puts the center against the nation state*. National governments need to abide by rules 'imposed' by Brussels, by these 'unelected bureaucrats' that constitute the Commission – the political body entrusted with executive action and guardian functions – as it is often misrepresented by media and politicians alike. When a State is alleged not to follow the budgetary rules, this leads to new calls for strict enforcement. See the "lambasting of the Commission on its application of the budgetary rules"[43] by Euro Group Chairman Jeroen Dijsselbloem, as reported in June 2016. Calls are then invariably also made for the application of pecuniary sanctions which has never been the case – except in respect of severe misrepresentation of budgetary figures by a Spanish regional authority last year[44]. My assessment of this approach is as follows: confrontational and

European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006, OJ L 347/320, 20 December 2013.

[43] *European Commission lambasted on policing of national budgets - Jeroen Dijsselbloem, president of the eurogroup, raises concerns that some countries are treated better than others*, Financial Times, 14 June 2016.

[44] Council Decision (EU) 2015/1289 of 13 July 2015 imposing a fine on Spain for the manipulation of deficit data in the Autonomous Community of Valencia, OJ L 198/19, 28 July 2015.

not very effective. It is high time to reflect whether Europe can do better, avoiding the current continuous conflicted relationship between the European and State capitals. Research on novel ways of interacting is called for. This certainly concerns budgetary oversight, yet extends to the larger realm of economic governance. Of course, a quantum leap towards Euro Area-specific economic policies jointly and democratically decided at the centre and implemented locally would remedy this defect of the adversarial nature of governance arrangements to a large extent.

State focus

This also applies to the fourth defect that I discern: the State focus of our economic governance system, nay even of the entire European project. When establishing governance for the continent at large, we have invoked the assistance of the nation States thereby almost automatically defeating our purpose. The very States whose *raison d'être* is continued dependency of its citizens and corporations of the political process in State capitals, are the instruments through which EU policies translate into effects 'on the ground'. This undermines these federal, continent-wide policies. Not only by obstruction but by dispersion of effort, through addition of layers ('gold-plating' of directives when implementing them, is a case in point) and by establishing the very hurdles that the policies intend to eradicate. Two examples to support this thesis.

Liberalising markets and allowing others to compete with incumbents, whether in the energy or public transport markets, has led to national champions being sought and to national markets to persist with larger Member States corporations at an advantage to break into the local markets of their smaller neighbours, without fostering the emergence of truly Europe-wide companies. We are learning this only slowly in the financial sector, where the boundaries have come down in supervision and the

potential for truly European banking groups is created, now that the supervisory approach is being unified in the Euro Area.

In the area of *free movement of persons*, we have relied on State agencies to provide for this, and failed miserably. Numerous are the hindrances that citizens encounter when they wish to exercise a basic right: to live and work where they please in the internal market. Whether it be anti-immigrant prejudice that local officials harbour, or lack of familiarity with 'the other' that lead employers, landlords or financial service providers to shun EU citizens from other States, the fact is that free movement of labour faces numerous obstacles that only the best educated, the most entrepreneurial or the most destitute and despairing can overcome. *I salute them here*.

Others have also remarked that persons live and work in 'national containers' whereas capital can move freely (except, that is, from Greece). I refer to the Ulrike Guérot's book on why Europe should become a republic[45], an essay that, for all its too easy descriptions and assessments, contains many truths about the European project and makes a valid call for a reconstitution of Europe's legal order to give equality to its citizens, beyond the confines of the nation State.

Excursion on free movement

Allow me two reflections on free movement. These are heartfelt utterances in the light of topical developments these days.

It has always struck me as odd that, in my home State and probably elsewhere, free movement is implemented through legal acts that first qualify the beneficiaries as 'aliens'. The Aliens Act[46] is the piece of legislation under which free movement of EU citizens is given form. As if we still consider our fellow EU citizens as 'alien'.

[45] Ulrike Guérot, *Warum Europa ein Republik werden muss – eine politische Utopie*, 2016.
[46] Available in English at: http://www.legislationline.org/.

Last week's Tory party conference showed the ugly face of the Conservative Party. Calls for registration of non-nationals working at British firms, and the implied suggestions that 'foreigners' take up British jobs, plus the clear indication that the status of EU nationals in the UK will be an element for negotiation, with the possibility of an 'amnesty' for most require a forceful response. On Twitter and on LinkedIn, I have suggested non-violent resistance to Theresa May and Amber Rudd[47]. Let the EU27 unilaterally declare that they will *not* make UK nationals pawns in negotiations, that we don't take people hostage, and grant the UK citizens in the other 27 EU States dual citizenship of the State they reside in.

Increased attention to regional developments in economic governance called for

Turning back to economic governance of the Euro Area, and the European Union, this is too State-focused, as well. Economic developments are assessed on a *nationwide* level thus overlooking *regional* differences, or convergence. Even in middle-sized States, economic circumstances vary among regions, let alone in the bigger Member States, where the level of economic activity may be more aligned between Northern Italy and Bavaria than between either region and the *Mezzogiorno* or *Sachsen-Anhalt*, or between Lisbon and Helsinki than between these cities and Madeira or Lapland. This *State focus, understandable as it is, strengthens national disparities at the expense of regional needs. It reinforces the national reflexes*. Can we perhaps envisage *more*

[47] Worrying and divisive language came from the Tory party conference this week. What approach to take vis-à-vis Theresa May's Government that seems to want to use the EU citizens living in the UK as pawns in Brexit negotiations with the continent and Ireland (the EU 27) on Brexit?
We should disarm Theresa May's Government by unilaterally declaring that UK citizens are welcome to stay and by renouncing to use citizens as pawns in the negotiations that follow the triggering of Article 50 of the Treaty on European Union: #britishwelcometostayineu.
Such a joint EU27 position, with the other Member States offering dual citizenship to all resident UK citizens, would be an act of non-violent resistance to the UK Government's apparent approach.
Using citizens as hostages of the negotiations is unworthy of the European ideal and reinforces divisiveness and division, which we have too much of in the world these days.
See: https://www.linkedin.com/pulse/welcome-stay-policy-eu-regarding-uk-citizens-ren%C3%A9-smits?articleId=6190007285662642176#comments-6190007285662642176&trk=prof-post.

emphasis on regional economic developments and guidance on these? I argue for a return to "*L'Europe des régions*" that European Federalists have pleaded in favour of.

These days, we see the idea of regional autonomy flourish beyond the traditional focal points, such as Catalonia, Québec or Scotland, with cities asserting their rights to regulate. Just last week, the Mayor of London, Sadiq Khan, toyed with the idea of regional visas to continue free movement of people into the metropolis, with other areas of England restricting inflows of immigrants. He also advocated different thinking; I quote him from the *Financial Times Report London and the World*[48]:

> *"Well, a London visa scares off people because it sounds difficult," Khan says. "But if you think about it in a different way — about London businesses having the ability to recruit talent — that's a different discussion. Nothing should be off the table."*

More focus on regions, when devising economic policies and assessing performance of the Euro Area is what I call for and, perhaps, more regional autonomy as a guiding principle.

The case against excessive State-focus explained from another angle

Let me state *the case against the State* from another angle. Policy choices need to be made at every level of governance: in the household, the enterprise, the municipality, the regional government, the State government, at the European level, and even at global level. There are issues that clearly go beyond the scope of action of actors at the lower end of this scale and need action at a more encompassing level. When organising governance with undue State influence, the political process will result in a preference, or policy choice, at the national level. The effort to reach a European policy choice is made more difficult when States have undertaken the weighing of interests and come to a national consensus: whether to favour the environment or industry has become

[48] *London and the World*, Financial Times, 3 October 2016.

an issue of national concern, and pride, both often difficult to overcome[49]. Suppose we would have organised policies such that each municipality, or region, is to weigh interests and then come together to adopt a national policy on any given matter: we would hardly have any German, French or Dutch policies of any meaning, as the city (or: regional) interests would vie for prominence and dilute any national outcome. This is exactly what we have at the European level. *Time to move on*.

[49] We see this clearly when State governments support their automobile industry against the common good of strict, Europe-wide enforcement of environmental standards: even cheating by companies can rely on government support when the industry is seen as a 'national interest'. Unfortunately, the national reflex is so strong that it sometimes even sways MEPs from particular Member States to defend their States' 'national interest'.

4. Monetary policy: mandate, widening limits, and external representation

Moving from economic and monetary policy, modesty is in order. Competence is the central plank of many discussions, and my competence is limited when it comes to economic analysis. From a legal perspective, I am inclined *to consider the ECB fully competent to enact any non-standard measure that is conducive to furthering its mandate of price stability for the entire Euro Area*. This mandate includes support for the single currency when it is endangered by speculation. It certainly includes cleaning the transmission channels of monetary policy so that centrally adopted decisions translate 'on the ground' in Portugal and Greece, as well as in Finland and Germany. This has been accepted by the European Court in the *Gauweiler* Case[50], of course and, subsequently and grudgingly, also by the German Constitutional Court.

Linking monetary policy measures to economic policy compliance, as is the case in respect of the eligibility of public sector bonds as collateral[51], in the OMT programme (announced but never implemented) and the asset purchasing programmes[52], is an incursion of the monetary authority into an area in which it is not competent. In my view, such an incursion is, however, acceptable for four reasons:

[50] Judgment of the Court (Grand Chamber) of 16 June 2015 in Case C-62/14 (*Peter Gauweiler and Others v Deutscher Bundestag*); ECLI:EU:C:2015:400.

[51] Article 8(2) of Guideline ECB/2014/31 of 9 July 2014 on additional temporary measures relating to Eurosystem refinancing operations and eligibility of collateral and amending Guideline ECB/2007/9 (recast), OJ L 240/28, 13 August 2014, which reads as follows: "The Eurosystem's credit quality threshold shall not apply to marketable debt instruments issued or fully guaranteed by the central governments of euro area Member States under a European Union/International Monetary Fund programme, unless the Governing Council decides that the respective Member State does not comply with the conditionality of the financial support and/or the macroeconomic programme."

[52] Article 3(2)(d) of Decision (EU) 2015/774 of the European Central Bank of 4 March 2015 on a secondary markets public sector asset purchase programme (ECB/2015/10), OJ L 121/20, 14 May 2015, provides: "(d) In the event of a review of an ongoing financial assistance programme, eligibility for PSPP purchases shall be suspended and shall resume only in the event of a positive outcome of the review." Article defines as follows: "(5) 'positive outcome of a review' means the later of the following two decisions: the decision by the Board of Directors of the European Stability Mechanism and, in case the International Monetary Fund co-finances the financial assistance programme, the Executive Board of the International Monetary Fund to approve the next disbursement under that programme, on the understanding that both decisions are necessary for the resumption of purchases under the PSPP."

1. These linkages serve the secondary objective of the Eurosystem, i.e. the ECB and the National Central Banks (NCBs) of the Euro Area, to support the economic policies in the European Union.
2. Economic policy prescriptions from the central bank may be considered legitimate as emanating from a major creditor perspective: with the ECB holding securities issued by State government, either as collateral or outright under asset purchase programmes, it has a legitimate interest in the creditworthiness of these States, a quality that certain economic policies can (re-)establish, in line with the consensus of economic policymakers at EU and global (IMF) level.
3. In periods of extreme stress, the central bank may be the only institution capable of taking effective action in respect of the interconnectivity of sovereign debt and banks. While a crisis as such does not give the central bank a widened mandate in adjacent policy areas, it does argue strongly for a broad interpretation of its mandate, even when such excursions would, in normal times, be legally far less acceptable.
4. The ECB's additional tasks in the area of financial stability, already enshrined in the TFEU and activated by the SSM Regulation, support this interpretation.

This finding of competence, arguing that the ECB acts within its mandate, *should not be read as an endorsement of the actual economic policies pursued* and so supported.

Also, the ECB's role in the so-called troika, i.e. its role under ESM conditionality enforcement, may be questionable once OMT were to be activated, as the Advocate General rightly argued in his Opinion[53].

[53] Opinion of Advocate General Cruz Villalón delivered on 14 January 2015 in Case C-62/14; ECLI:EU:C:2015:7.

Finally, the ECB, when acting in an ESM capacity, is subject to the Charter of Fundamental Rights, as the Court decided recently in the *Ledra Advertising* Case[54].

In this lecture, I cannot go deeper into the issues of *democracy and legitimacy* in the area of monetary union. Suffice it here, to remind you that, in my perspective, democracy is an ART: it implies Accountability, Representation, and Transparency. Especially in multi-level governance settings like the European Union and the Euro Area, these elements need to be blended in such a manner as to do justice to the will of the people *and* fully respect minorities and fundamental rights which are essential ingredients of a democracy that does not degenerate into tyranny of the ever changing majority in favour of this or that policy. Independence of the central bank, as the public authority entrusted with the provision of the public goods of price stability and the stability of the financial system, needs to be balanced with democratic imperatives. Also, access to facts and figures for informed debate is essential (an element of transparency). And, finally, the presence of a media space in which the citizens can interact without being confined to their national 'silos'. This touches upon *cultural aspects of integration* and policy-making: essential elements that merit full attention but for now go beyond the institutional and legal focus of my presentation.

External representation

The perennial postponement of single external representation undermines to the outside world the commitment to monetary union and the irreversibility of the euro. The single currency deserves a single representation in "international financial institutions and conferences"[55]. The 1998 proposal was retracted in 2015, to be

[54] Judgment of the Court (Grand Chamber) of 20 September 2016 in Joined Cases C-8/15 P to C-10/15 P (*Ledra Advertising Ltd and Others v European Commission and European Central Bank (ECB)*);
ECLI:EU:C:2016:701.
[55] Article 138 TFEU.

replaced with a proposal of gradual single representation. I find four faults with this latter proposal:

1. It allows too easily a State-centered membership approach because the IMF is based on “countries” , a concept that we may have to re-interpret in the light of developments since the 1933 Montevideo Convention and the status of EU Member States as less a ‘country’ and more like a constituent element of the European Union. My urging of researchers and policy-makers to adopt innovative interpretations of old concepts is also directed to the IMF and the Commission.
2. The recent Commission proposal envisages representation by the President of the Euro Group instead of by the Commission. To further democratic accountability *and* efficiency, I argue for the latter as EU’s voice on the world stage, alongside the President of the ECB.
3. The ECB’s role concerns my third issue with the proposal: it seems to neglect ECB independence and the incidence of Article 6 ESCB Statute on the euro’s external representation. Although the latter provision gives precedence to Article 138 TFEU, there is no derogation from the independence of the ECB. This supports my argument that the proposal is not in line with the ECB’s prerogatives .
4. As I argued in my thesis (1997)[56], even the payments and capital movements competence of the Union requires single representation at the IMF (which is the global overseer of freedom to effect current transactions). It is not ‘just’ the single monetary policy that argues for single representation at the IMF.

Emergency liquidity assistance

A subject closer to home is the provision of Emergency Liquidity Assistance (ELA), or the Lender of Last Resort (LOLR) function of the Eurosystem. Elsewhere, I have

[56] René Smits, *The European Central Bank – Institutional Aspects*, 1997.

advocated a different reading of the allocation of powers in this area[57]. Currently, ELA is considered a national competence exercised by NCBs under guidance from the ECB[58]. I consider this approach to be based on an erroneous reading of Article 14.4 ESCB Statute. The introduction of banking union is a strong reason for the ECB to embrace a full and direct role as monetary authority and prudential supervisor in the provision of ELA, at least in respect of significant credit institutions and banking groups.

[57] See the article in the forthcoming Research Handbook on Central Banking mentioned in footnote 3 above, in which I write: "Even if this allocation of responsibilities has worked during the crisis, it seems natural for the ECB to assume an ELA function of its own now that banking union has attributed to the ECB direct supervisory functions in respect of significant credit institutions[57]. Such a direct role would certainly be natural in respect of the significant institutions it directly supervises". An earlier publication discussed the issue more extensively: René Smits, *European supervisors in the credit crisis: issues of competence and competition*, Chapter 15 in Mario Giovanoli and Diego Devos (eds.), International Monetary an Financial Law in the light of the Global Crisis, 2010, pp. 305-327.

[58] *ELA Procedures*, 17 October 2013, at: https://www.ecb.europa.eu/pub/pdf/other/201402_elaprocedures.en.pdf?10cc0e926699a1984161dc21722ca841. For an extensive discussion of ELA, and arguments for adopting the line I defend here, see Christos Gortsos, *Last resort lending to solvent credit institutions in the euro area before and after the establishment of the Single Supervisory Mechanism (SSM)*, in the proceedings of the ECB Legal Conference 2015 *From Monetary Union to Banking Union, on the way to Capital Markets Union New opportunities for European integration*, 1-2 September 2015, pp. 53-76, at: http://www.ecb.europa.eu/pub/pdf/other/frommonetaryuniontobankingunion201512.en.pdf. Similarly, questioning the current practice are Rosa M. Lastra and Charles Goodhart, *Interaction between monetary policy and bank regulation: in-depth analysis*, European Parliament, Directorate General for Internal Policies, IP/A/ECON/2015-07, September 2015, at: https://polcms.secure.europarl.europa.eu/cmsdata/upload/7ed78074-0473-4f06-a6c4-c33748247625/DIW_FINAL.pdf.

5. Banking union: the need for singleness

Banking union is unfinished. The third element needs adoption (a European Deposit Insurance System, as proposed by the Commission)[59] and the first two need to be put on a firmer footing. There is a lot to be said about this element of EMU that attracts full academic interest among lawyers. Last week's Legal Conference of the ECB[60] and last month's conference on banking union at the Bologna Business School[61] were recent occasions that showed how much is being contributed. Here, my contribution will focus on one aspect only.

The *absence of truly single rules* is the most striking element I discern in the SSM and, of course, the same in the SRM, with various, un-harmonised national insolvency laws ultimately decide the application of the jointly applicable resolution arrangements. The 'no creditor worse off' principle of Articles 73-75 of the BRRD[62] implies that a counterfactual needs to be established for resolution plans, so that it can be ascertained how an insolvency would affect creditors, with the outcome determining the outer limits of what is possible under EU law.

If this sounds complicated and impractical, one may console oneself with the thought that resolution is not a day-to-day affair. How different it is with supervision, where Joint Supervisory Teams and ECB officials grapple with national laws that vary, with laws that have not (recently or fully) been translated into English, and with

[59] Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 806/2014 in order to establish a European Deposit Insurance Scheme, COM/2015/0586 final - 2015/0270 (COD), Strasbourg, 24 November 2015.

[60] *ESCB Legal Conference 2016*, 6-7 October2016; proceedings to be published later at: https://www.ecb.europa.eu/pub/pub/legal/html/index.en.html.

[61] European Banking Institute (EBI), *Reflections on the design and implementation of the European Banking Union*, at the *Università* degli Studi di Bologna and within the framework of 33rd annual conference of the European Association of Law and Economics, 17 September 2016, Villa Guastavillani, Bologna.

[62] See, also, recitals 5, 73 and 111 to Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms (…) (BBRD), OJ L 173/190, 12 June 2014.

interpretations of EU prudential supervisory law that sometimes are minimalist. Whereas national variations can, to a certain extent, be tackled – I refer to the ECB regulation and guidance[63] on options and discretions adopted this year after public consultation –, there remain core issues to be remedied. Let me give you two examples. I will elaborate on these tomorrow during the seminar on banking union.[64] Here, in the interest of time, they will only be just touched upon.

Bank holding regulation and supervision: Europe is behind

Based on limited research, I conclude that several EU State jurisdictions apply their own bank holding regulation to non-bank entities at the head of a banking or financial group. Others rely solely on implementing the relevant provisions of the Capital Requirements Regulation[65], or CRR (which goes beyond rules on capital adequacy to include liquidity and other risk oversight issues), the Capital Requirements Directive[66], or CRD-IV (a misnomer since this legal act also provides for authorisations, supervisory measures, administrative sanctions, and a lot more) and the Financial Conglomerates Directive[67], or FICOD. None of these three legal acts requires bank holding companies to register and be authorised, whereas certain national laws do require the (M)FHC to comply with consolidated requirements and to ensure compliance by group

[63] Regulation (EU) 2016/445 of the ECB of 14 March 2016 on the exercise of options and discretions available in Union law (ECB/2016/4), OJ L 78/60, 24 March 2016. *ECB Guide on options and discretions available in Union law*, at: https://www.bankingsupervision.europa.eu/legalframework/publiccons/html/reporting_options.en.html.

[64] *The European Banking Union and Its Instruments ï Experience from the First Years of an Interplay with National Banking Supervision and Resolution*, European University Institute, 11 October 2016. See: http://www.eui.eu/SeminarsAndEvents/Events/2016/October/TheEuropeanBankingUnionandItsInstrumentsExperiencefromtheFirstYearsofanInterplaywithNation.aspx.

[65] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, OJ L 321/6, 30 November 2013.

[66] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC, OJ L 176/338, 27 June 2013.

[67] Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate and amending Council Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC and 93/22/EEC, and Directives 98/78/EC and 2000/12/EC of the European Parliament and of the Council, Official Journal of the European Community, No. L 35/1, 11 February 2003, as amended, lastly by CRD IV; consolidated version (Document 02002L0087-20130717) available at: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:02002L0087-20130717.

members[68]. The EU-wide consensus on the application of aforementioned EU acts seems to be that any consolidated requirements addressed to the (mixed) financial holding company ([M]FHC) as bank holding companies are called in EU parlance, are actually imposed on the licensed credit institutions which need to ensure that the parent and other entities in the group comply. A deeply flawed approach, I submit. One that is at odds with more recent legal acts (the BRRD[69] and the SSM Regulation[70]), with my reading of legislative intentions and, crucially, with business practice, and with the approach in the Member States mentioned before. It is the parent that directs the functioning of the group, not the other way around. Thus, a joint approach to bank holding companies, to employ the usual word for parents of banking groups, is called for. One which holds them accountable for adequacy of capital, liquidity provisioning, risk management and supervisory relationships, and treats them as if they are subject to authorisation. Treating BHCs as core entities in the supervision of banking groups is also crucial for the single point of entry resolution of a banking group. The upcoming review of CRR and CRD-IV provides a welcome opportunity to elucidate this issue. Europe may be inspired by several African prudential regulations which unequivocally subject bank holding companies to authorisation and make clear that they need to

[68] Notably, Article L 517-5 of the French *Code Monétaire et Financier*, and the sections of this code referred to there, available at: https://www.legifrance.gouv.fr; Section 10 of the German *Gesetz über das Kreditwesen*, available at: https://www.bafin.de/SharedDocs/Downloads/EN/Aufsichtsrecht/dl_kwg_en.pdf?__blob=publicationFile; Sections 61 and 67 of the *Testo Unico Bancario Decreto legislativo 1° settembre 1993, n. 385* (Italian Consolidated Law on Banking – Legislative Decree 385/1993), available at https://www.bancaditalia.it/compiti/vigilanza/intermediari/Testo-Unico-Bancario.pdf; Sections 40, 50 and 56 of the Spanish *Ley 10/2014, de 26 de junio, de ordenación, supervisión y solvencia de entidades de crédito* (Act of 26 June 2014 on the supervision of credit institutions); and Section 250 of Belgium's *Bankwet/Loi bancaire* Law on the legal status and supervision of credit institutions, 25 April 2014; see: http://www.ejustice.just.fgov.be/cgi_loi/change_lg.pl?language=fr&la=F&cn=2014042508&table_name=loi and https://www.nbb.be/doc/cp/moniteur/2015/20151124_law25april2014en.pdf. I am obliged to Andrea Magliari, law assistant at the ECB, for assistance in compiling this information.

[69] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council, Official Journal of the European Union, No. L 173/190, 12 June 2014.

[70] Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010, Official Journal of the European Union, No. L 225/1, 30 July 2014.

abide by capital and other prudential standards[71]. So, for once, we may need to look south, rather than (only) westwards, to the United States, which has long applied bank holding supervision, to compare our legislation with the best available. Joint research with John Taylor on bank holding regulation from an African comparative law perspective, will be submitted for publication soon.

Practices on fit and proper testing varies on essential points

Again, if I am well-informed and, admittedly on the basis of limited research into a few jurisdictions only, I observe differences in the assessment of the suitability of bank directors and senior management as 'fit & proper'.

Under CRD IV, both executive and non-executive directors of banks, and of bank holding companies (!), need to be assessed by the supervisory authorities on a number of qualities. Knowledge and experience is one element, trustworthiness is another one. "Sufficiently good repute and (…) sufficient knowledge, skills and experience" is how Article 91(1) CRD IV describes the requirements, to which it adds a number of further standards, such as range of experiences and diversity in the board, sufficient time to devote to board membership, "honesty, integrity and independence of mind" to assess and challenge senior management decisions, adequate training. If these standards are not met at inception, no banking authorisation is to be given (Article 13(1) CRD IV). The FAP criteria need constant observance: CRD IV provides for supervisory measures and administrative sanctions if directors do not meet these criteria on an on-going basis[72].

[71] I refer to prudential rules applying in Kenya, Nigeria and South Africa, and to the recently adopted Prudential Framework applying in the West African Monetary Union of the CFA franc. See our forthcoming article.

[72] See, notably, Article 67(1)(p) which provides for supervisory *sanctions* in case a director who is not fit or proper is appointed or remains a member of a bank's board. A sanction may include the withdrawal of the bank's authorisation (Article 67(2)(c) CRD IV). Prior to applying sanctions, the supervisory authority may impose supervisory *measures* (Article 102, referring to Article 104 CRD IV) to ensure compliance of the bank with the CRD IV or the CRR.

The differences I observe relate to national supervisory practices of FAP testing. Some NCAs accept appointments of directors and assess *ex post* whether they are suitable, others insist on *prior* vetting[73]. Informal procedures may apply which – in my home State – have been criticised as leaving the candidate without recourse if the credit institution withdraws the application for an informal FAP test once the supervisor has given a negative nod. In the Netherlands, a group of outside experts has been entrusted with reviewing the FAP process of the central bank (DNB, the National Competent Authority) and the conduct of business authority (Authority Financial Markets, or AFM). This committee is to report by year's end[74].

On its Banking Supervision website, the ECB deplores the lack of uniformity of FAP assessment across Europe and argues for this element to be included in the update of CRD IV after the *CRR and CRD IV review* which closed last Friday[75], a call I wholeheartedly subscribe to.[76]

[73] It seems the competent authorities in the United Kingdom, Luxembourg and the Netherlands insist on *prior* assessment whereas, apparently, in France, Italy, Germany and Greece, an *ex post* assessment seems to be accepted, implying that a board member or senior executive functions without the supervisory authority having pronounced on his or her suitability under the fit and proper criteria. I consider this at variance with the requirements of CRD IV. Again, beyond my own research, I am grateful to Andrea Magliari, law assistant at the ECB, for assistance in compiling relevant information.
[74] See: https://www.dnb.nl/nieuws/nieuwsoverzicht-en-archief/persberichten-2016/dnb341390.jsp.
[75] See: http://ec.europa.eu/finance/bank/regcapital/crr-crd-review/index_en.htm.
[76] At: https://www.bankingsupervision.europa.eu/about/ssmexplained/html/fap.en.html: "Our aim is to ensure a fair and consistent fit and proper assessment process across all euro area countries. Banks have to know what to expect. We would therefore like to see the fit and proper process become part of the revision and update of CRD IV so that the same rules are applied throughout Europe."

6. Societal considerations

During this presentation, a lot has been said already about the need for connection of the law, and of research in the area of law and economics, to be embedded in interdisciplinary approaches and to make explicit assumptions upon which research and world views are based. Therefore, this part of the presentation can be relatively brief. It concerns the societal embedment of research. I consider it crucial for ideas and structures to flourish for the benefit of society and its constituent members, and for those around us: animals, other sentient beings as Article 13 TFEU recognises them to be[77], and nature as a whole.

Holistic approaches are to be preferred to ones that construct niche alterations that go unnoticed 'on the ground', or become harmful to those affected by them. Of course, these admonitions concern the divide between the 'elite' and the others, too widely assumed and discussed to go into here and now. While differences in assessment of the effects of policies, and of their usefulness or desirability, are certainly admissible in academic discourse and policy debates, the societal effect is to be taken into consideration always.

Of utmost important are the outcomes of new arrangements and fresh policies: they should be humane. It is encouraging that scholars dare publish a book with a title *The Human Face of the European Union*[78]*.* Of course, here assumptions and definitions are core: what are HUMANE policies? Please, allow me to quote here, as I did in Rome in January one of the editors of this book Nuno Ferreira, from Liverpool University. He

[77] For an essay on the recognition of animal welfare in competition law, see my *Sustainable Competition Law Enforcement: Animal Rights – An Essay on Integrating Other Sentient Beings' Interests in the Work of a Competition Authority* in Dirk Arts, Wouter Devroe, René Foqué, Karel Marchand, Ivan Verougstraete (eds.), Mundi et Europae Civis Liber Amicorum Jacques Steenbergen, 2014,
pp. 533-542.

[78] Nuno Ferreira and Theodora Kostakopoulou (eds.), *The Human Face of the European Union* (Cambridge: Cambridge University Press, 2016.

argues, and I would support him, for "a human-centred analysis", in which 'humaneness'[79] ('*humain*', '*menschlich*') is central. Ferreira defines this as follows: "[h]umaneness is the corrective of humanity when it is not at its best". He cites Jeremy Rifkin's empathic civilisation vision of a collaborative and caring world, and his characterisation of the European Union as "as a cooperative and networked space, where '[m]ultilevel governance networks are like giant laboratories for the exploration of empathy'."[80]

[79] The word humane also forms an acronym: HUMANE: Help Us Make A New Europe, as James Organ, quoted by Nuno Ferreira, found.

[80] Jeremy Rifkin, *The European dream, How Europe's Vision of the Future Is Quietly Eclipsing the American Dream*, 2004.

7. A personal note

Having become so personal already, and arguing that the political, and academic, are always also personal, please allow me a last personal note.

First, what do I have to offer to you, academic researchers and policymakers? To serve as a bridge between the expertise on EMU and imaginative, creation of solutions.

Also, I would welcome a role in the structured peer review process to uncover, and challenge, implicit assumptions in ADEMU research that I suggested should take place.

We cannot expect the 'world out there' to change, to become a better place without changing ourselves.

Quotes from Mahatma Gandhi[81] and Albert Einstein[82] reveal the same attitude.

The Delphi Oracle injunction *γνωτι σεαυτον* is relevant here: know thyself. Self-knowledge will enable us to slowly peel off the layers of conditionality of our past, our ancestors and our upbringing, and free the inner core to express itself. Access to unbounded imagination and creativity opens up. Then, we can become co-creators of reality, making it resemble more the utopia promised in holy scriptures[83], enabling messianic times to materialise.

René Smits
10 October 2016

[81] *You must be the change you wish to see in the world.*
[82] See the quote in footnote 25 above.
[83] *W*hich are often read as signalling the coming of a Saviour (Messiah), or the past birth and future return of One. I wonder whether they may be read as calling upon each of us to help to bring forth Messianic times.