HSE-Skolkovo International Laboratory for Law and Development
Workshop on Monetary Sovereignty Moscow, 25/26 May, 2015

Discussion points

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1. The project of the workshop inquires: (1) The institutional arrangements restricting the monetary sovereignty (2) Policy proposals that may strengthen monetary sovereignty. Further theoretical and practical considerations are outlined in the exposé of the workshop. In the present paper I discuss the EU legislation regarding the exercise of the monetary sovereignty in the Eurozone under the light of the Greek financial crisis. I will try to use the Greek case as paradigm, suitable to bring onto surface several aspects regarding the international exercise (or: management) of the monetary sovereignty. Greece, as each and every one of the members of the Eurozone, has ceded her right to coin money [their *ius cudendae monetae*] to Eurozone under the conditions provided by the Treaty of Maastricht (and, later on, the Treaty of Lisbon). By the Treaties of Maastricht and Lisbon the Member States of the EU have inserted in the constitutive Treaties of the EU respectively regulations governing the macroeconomic structure of the EU and the political management of the Eurozone.

The institutional framework of the common European currency (euro)

2. The institutional framework of the genesis and the overall configuration of the common currency, aptly characterized as "*macroeconomic constitution*" of the European Union", initially enshrined in the Treaty of Maastricht in 1992 [=TEU], has been taken up by the Treaty of Lisbon [TFEU] seven years after the introduction of the euro. In addition, the Treaty of Lisbon has introduced a separate set of arrangements relating with the countries of the Eurozone, basically the functioning and the decision making procedures of

the Euro group (Art. TFEU 136, 137, 138 TFEU and the Protocol provided by Art. 137 TFEU). A "*stability mechanism to be activated if indispensable to safeguard the stability of the euro area as a whole*", an institution that both the Maastricht and Lisbon Treaties have failed to provide for, has been introduced in 2011 by a hasty and rather anxiously taken effectuated revision of Ar. 136 TFEU, is result of the actual crisis. This amendment has retroactively given a textual legal basis for the establishments of the mechanisms of "financial support" of the Eurozone countries in risk of sovereign default (Greece, Ireland, Portugal, Cyprus and, in relation only with the banking sector, Spain).

3. The institutional road to the common currency was opened by the cryptic new formulation Art. 2 of the EEC Treaty and the new Art. 3a that the Maastricht Treaty has put into the EEC Treaty. Art. 2 TEU introduces the idea of the monetary union together with the idea of the economic union. They are not introduced as a purpose per se. Together with the "*common market*" and the "i*mplementation*" of the long catalogue of common policies and activities enumerated in Art. 3 and those referred to in Art. 3a the "*economic and monetary union*" is set as a means to promote "*throughout the Community a harmonious and balanced development of economic activities, sustainable and non-inflationary growth respecting the environment, a high degree of convergence of economic performance, a high level of employment and of social protection, the raising of the standard of living and quality of life, and economic and social cohesion and solidarity among Member States*."

Art. 3a TEU clearly –and strategically- distinguishes the economic from the monetary aspect. An "*economic policy*" will be adopted –it remains unclear exactly by whom. The economic policy "*is*" –"is" not "will be"- "*based on the close coordination of the Member States' economic policies*". "*Concurrently*" with the activities related to the economic policy, Art. 3a states that these activities *"shall include the irrevocable fixing of exchange rates leading to the introduction of a single currency, the ECU, and the definition and conduct of a*

single monetary policy and exchange rate policy the primary objective of both of which shall be to maintain price stability and, without prejudice to this objective, to support the general economic policies in the Community, in accordance with the principle of an open market economy with free competition." Further on, Art. 3a establishes "*guiding principles*" for both the Member States' and the Community's "*activities*" with regard to the economic and monetary policy; these principles are "*stable prices, sound public finances and monetary conditions and a sustainable balance of payments."* This approach (and its wording) has been retained by the Lisbon Treaty in the TFEU.

Of specific importance are the conditions set by the Maastricht Treaty for the participation in the (at that time unnamed yet) new currency. This participation is conditioned on four criteria, which the Member States asked to fulfil, in view to achieving a "*high degree of sustainable convergence*" [Art. 109 j TEU]. The criteria are laid down in the Protocols of Convergence Criteria and on Excessive Deficit Procedure attached to the Treaty of Maastricht and further developed by the European Monetary Institute (an institution later substituted by the ECB) in 1995 and 1996, aimed (and were supposed) to ensure that the level of economic homogeneity among the perspective participants to the common currency, deemed necessary for the viability of this currency was achieved and was stable. As per the convergence criteria inflation rate should not exceed by more than 1.5 % that of, at most, the three best performing Member States in terms of price stability; the ratio of the annual general government deficit relative to gross domestic product (GDP) at market prices, should not exceed 3% at the end of the preceding fiscal year and neither for any of the two subsequent years (however, deficits being "*slightly above the limit*", will as a standard rule not be accepted, unless it can be established that either: "1) The deficit ratio has declined substantially and continuously before reaching the level close to the 3% limit" or "2) The small deficit ratio excess above the 3% limit has been caused by exceptional circumstances and has a temporary nature); the ratio of gross

government debt relative to GDP at market prices, should not exceed 60% at the end of the preceding fiscal year; -the Member State, participating in the Exchange Rate Mechanism [ERM] of the European Monetary System, should have respected the normal fluctuation margins provided for by the ERM without severe tensions for at least the last two years before the examination", i.e. no unacceptable devaluations of the national currency before its integration to the euro should have appeared; "the long-term interest rates (average yields for 10- year government bonds in the past year) should not exceed more than 2.0% the average of the similar 10-year government bond yields in the three best performing Member States in terms of price stability", i.e. in the three Member States with the lowest Harmonized Index of Consumer Prices inflation [HICP – an indicator of inflation and price stability applied by the European Central Bank].

The criteria have been detailed in the Stability and Growth Pact. Decided in June 1997 by the European Council, the Stability and Growth Pact and aiming to provide for both "*prevention and deterrence*" consists of its constitutive Resolution and the Council Regulations 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies and 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure. Both Regulations have been issued on July 7th 1997, and both have been twice amended, in 2005, before the crisis, towards more flexibility, and in 2011, after and partially in to the crisis, towards more strictness.

It was on the application (or: misapplication) of the Stability and Growth Pact, i.e. on the criteria set by the Treaty of Maastricht, that the common currency -the euro, as it was officially baptized by the European Council in Madrid on 16th December 1995- came into existence. On 1rst January 1999 the euro replaced the European Currency Unit [ECU] as the accounting currency on 1 January 1999, while physical euro coins and banknotes entered into circulation on 1rst January 2002.

4. The Lisbon Treaty of 2007 [=TFEU], fully along the lines of the Maastricht Treaty, keeps the exclusive competence of the monetary policy of the Union for the Member States whose currency is the euro [Art. 3, par.1, c TFEU], but not the economic policy, which (notwithstanding special provisions to be applied to the Eurozone Members) remains in the domain of the Member States. Economic policy becomes a matter of coordination along "*particular broad guidelines*" to be adopted by the Council, and so are also the employment and social policies (for the latter no guidelines are provided) [Art. 5 TFEU]. TFEU, taking up the correspondent dispositions of the Maastricht Treaty, identifies "*stable prices, sound public finances and monetary conditions and a sustainable balance of payment*s" as "*guiding principles*" of the "*activities of the Member States and the Union*" regarding the both the monetary policy and the economic policies [Art. 119, 3 TFEU]. Member States are urged to "*regard their economic policies as a matter of common concern*" [Art. 121, 1 TFEU]. A (overtly mistrustful) procedure is laid down for the Council to adopt "t*he broad guidelines of the economic policies of the Member States and of the Union*" [Art. 121, 2 TFEU]: on the basis of a recommendation of the Commission, the Council reports to the European Council and informs the European Parliament, the European Council draws conclusions on the basis of the report and the Council adopts the guidelines in the legally nonbinding form of recommendation [Art. 121, 2-3 TFEU]. Non consistent Member States or Member States that "*risk jeopardizing the proper functioning of economic and monetary union*" face a warning recommendation and, but risk no more than to see this recommendation against made public [Art. 121, 4 TFEU]; multilateral surveillance is provided, on the results of which the President of the Council and the Commission report to the European Parliament [Art. 121, 5 TFEU], which "*may adopt detailed rules*" for this surveillance [Art. 121, 6 TFEU]. The assistance clause for natural disasters of exceptional occurrences beyond the state control [Art. 122 TFEU] remains as in the Maastricht Treaty, and so does also the no bail-out clause [Art. 125 TFEU] and a clause urging the states to avoid excessive

governmental deficits complemented with a no less reluctant procedure of monitoring and surveillance "*of the budgetary situation and of the stock of government debt in the Member States with view to identify gross errors*" the clause and procedure for the avoidance of excessive deficits [Art. 126 TFEU]. In the chapter on monetary policy, "*to maintain price stability*" is elevated as "*the primary objective*" of the European System of Central Banks [Art. 127 par. 1 TFEU], the first basic tasks of which is "*to define and implement the monetary policy of the Union*" [Art. 127 par. 2 TFEU]. The European Central Bank "*shall have the exclusive right to authorize the issue of euro banknotes within the Union*" and may approve the issuance of euro coins by the Member States [Art. 128 TFEU]. For the rest, the modes of functioning of the ESCB and the ECB are set, [Art. 129 – 132 TFEU], while a procedure is set for the European Parliament and the Council to lay down the measures necessary for the use of euro as a single currency [Art. 133 TFEU].

The interrelation between monetary and fiscal (more generally: economic) policies

5. The new currency was meant to be the common European *fiat money*, i.e. the money made legal tender for all participating states by their decision. Fiat money has neither intrinsic value nor "*fixed value in terms of an objective standard*." The value of the European currency depends on the strength of the issuing countries' economies [and is backed by the issuers' commitment to refrain from printing too much money so as to make it worthless]. Being not linked to physical reserves, fiat money risks to lose value by inflation (and become worthless by hyperinflation).

Several economy-related policies have impact on money. The monetary policy (alias: the exercise of monetary sovereignty) refers to the exclusive right of the state (or, in the case of the Eurozone, of the group of participating states) to issue currency, as well as its right to control the supply of currency (by the use of interest rates and reserve requirements) and to

apply an exchange rate and exchange control policy. The monetary policy is applied by a central bank, equipped with the appropriate powers[1]. Fiscal policy refers to state revenues and expenditures, i.e. taxation and government spending and is applied by the government. Economic policy, a second-order concept[2], is understood to include also other policies, either motivated by economic considerations (such as an industrial policy) or not (such as social policy, education policy ect). Or, simply, monetary policy refers to the creation and management of money, while fiscal and economic policies refer to the production, acquisition and distribution of the wealth to which money is expected to correspond.

6. Although fiscal policy does not refer to the creation of money, it is not unrelated to the monetary policy. "*[B]ad fiscal policy can endanger monetary and financial stability, as has been demonstrated by several economic crises in the past and present. The fact that structural IMF conditionality has been frequently used to impose severe restraints on, among other things, a debtor state's fiscal rigour, is a powerful demonstration of both the latter's impact on monetary and financial stability and of the major incursions made into domestic sovereignty for the sake of monetary and financial stability. Other examples of this intrinsic link can be found in the context of the European Union's (EU) Stability and Growth Pact (SGP) [...]*"[3]

In other words, no sound monetary policy can be conducted without taking into the proper account the fiscal and economic policies.

The separation of the exercise of the monetary policy from the fiscal policy: a fundamental asymmetry in the euro edifice

[1] Zimmermann 3-4, Kaarlo and Klaus, The Eurozone crisis, a Constitutional Analysis Cambridge, University Press 2014, 30-31
[2] Tuori & Tuori, 31
[3] Zimmermann, 4

7. The fundamental decision of the Maastricht Treaty was to separate the agent of the monetary policy form the agent of the fiscal policy. The monetary union, characterized by the common currency which is set as the irrevocable process, falls within the exclusive competence of the Union, the economic policies rest within the sovereign domain of the Member States with some incitement to avoid budgetary externalities, to come up to common guiding principles and not to disrespect them too much. The drafters of the Treaty were perfectly aware of the risks entailed by the divergence and discrepancies between the economies and the fiscal policies of the perspective participants in the new currency. Their institutional answers were the conversion criteria and the Stability and Growth Pact. Their pragmatic answer was the way they have implemented the Stability Pact.

The differentiation between the agent of the monetary policy and the agents of the fiscal and economic policies in the realm of one single currency has been identified as "asymmetry"; "*Europe must deal also with the structural asymmetries that make it very difficult to manage a single monetary policy*."[4] For the monetary policy "*asymmetry would mainly mean that fiscal policy, in particular deficit-financed consumption, may induce inflation and inflation expectations.*"[5] In addition, astonishingly, no crisis management provisions have been adopted, as if a mystical power could guarantee that no crisis will erupt, never.

8. Asymmetries are dangerous. As typically observed, "*A currency area can only be viable if it can absorb asymmetric shocks […], and if [...] it offsets the loss of interest and exchange rates as an adjustment variable. There is no federal budget mechanism to compensate the losers [...]. Additionally, there is no real European economic government. The Euro Group [...] is in reality a ghost of*

[4] Frédéric Teulon, Beyond the EMU Crisis: The Financial and Political Issues σε [τόμο με τα πρακτικά της] 6th International Finance Conference on Financial Crisis and Governance, Tunisia, March 2011], Cambridge Scholars' Publishing, 2011, 355
[5] Kaarlo @ Tuori, 52

intergovernmental coordination [the EU budget is very small, and the Pact of Stability and Growth is no longer respected.]”[6]

9. The Stability and Growth Pact, which was the political and legal commitment designed to create the convergence necessary for the viability of the common currency has not been respected either. The majority of the Euro-countries have been accepted in the Euro without meeting the criteria.

Negative effects of the Maastricht structure on states participating in the common currency

10. It was the structure of the common currency that encouraged debauches in overborrowing and overspending. To put it the wording of Harvard Professor Martin Feldman,

“[...] when a county has its own monetary policy, it can respond to a decline in demand by lowering interest rates to stimulate economic activity. But the ECB must make monetary policy based on the overall condition of all the countries in the monetary union. This creates a situation in which interest rates are too high in those countries with rising unemployment and too low in those countries with rapidly rising wages. And because of the large size of the German economy relative to others in Europe, the ECB's monetary policy must give greater weight to conditions in Germany in its decisions than it gives to conditions in other countries”, i.e. the ECB endorsed a tough anti-inflationary policy, which resulted to rapidly rising ratios of public and private debt to GDP in several countries, including Greece, Ireland, Italy, and Spain. Despite the increased risk to lenders that this implied, global capital markets [...] assumed that a bond issued by one government in the European Monetary Union was equally safe as a bond issued by any other government in the union, ignoring the "no bailout" provision of the Maastricht Treaty. As a result, the interest rates on Greek and Italian bonds differed from the rate on German bonds by only a small fraction of a percent.

[6] Teulon, 355

Before the monetary union was put in place, large fiscal deficits generally led to higher interest rates or declining exchange rates. These market signals acted as an automatic warning for countries to reduce their borrowing. The monetary union eliminated those market signals and precluded the higher cost of funds that would otherwise have limited household borrowing. The result was that countries borrowed too much and banks loaned too much on overpriced housing. [...]

When, in early 2010, the markets recognized the error of regarding all the eurozone countries as equally safe, interest rates began to rise on the sovereign debts of Greece, Italy, and Spain. Market dynamics put in motion a self-reinforcing process in which rising interest rates led countries to the brink of insolvency. In particular, the fear that Greece might have trouble meeting its debt payments caused the interest rate on Greek debt to rise; the expectation of higher future interest payments implied an even larger future debt burden. What started as a concern about a Greek liquidity problem -- in other words, about the ability of Greece to have the cash to meet its next interest payments -- became a solvency problem, a fear that Greece would never be able to repay its existing and accumulating debt. That pushed interest rates even higher and led eventually to a negotiated partial default, in which some holders of Greek sovereign debt agreed to accept a 50 percent write-down in the value of their bonds."[7]

As Feldstein had noted already from the beginning of the crisis,

"*The structure of the EMU that created the euro actually encourages members to run large deficits. [...] Since EMU countries share a currency, no market feedback mechanisms are in place to warn when a country's deficit is getting dangerously high. Since Greek bonds were regarded as a dose substitute for the euro bonds of other countries, the interest rate on Greek*

[7] Martin Feldstein, The Failure of the Euro. The Little Currency That Couldn't, Foreign Affairs Essay January/February 2012 Issue Europe Economics, p.

debt did not rise as the country kept on borrowing, until, that is, the markets began to fear default.”[8]

Hybris and nemesis

11. The hybris of the overoptimistic confidence in the expediency of the institutional foundations of the common currency could not but entail the pragmatic nemesis. In the words of an economist no less than Barry Eichengreen, *“[...] in creating the euro [the Europeans] closed all avenues for resolving these problems. There was no possibility of devaluating the national currency because there was no national currency to devalue. There was no scope for regaining the devaluation option because there was no provision for exiting the Eurozone. There was no banking union to accompany the monetary union. In the absence of a single bank supervisor and a mechanism for winding up bank banks, there was no way of forcing national regulators to recapitalize or liquidate insolvent financial institutions. There was no procedure to restructuring the debts of troubled governments – no sovereign bankruptcy code. There was no mechanism for providing emergency assistance to governments or consensus on the design of the associated policy conditions. There was not even agreement that the European Central Bank should act as lender of last resort, injecting credit as needed to stabilize the financial system.”*[9]

12. The political and institutional initiatives the Eurozone developed after the outburst of the crisis, in haste at the beginning and with some panic, more calmly later on, are nothing but the flip-side of the deficiencies and shortcomings of the original sin in the construction of the common currency.

A paradox of the Greek Constitution: the antistrophe of sovereignty

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[8] Martin Feldstein, "For a Solution to the Euro Crisis, Look to the States" The Washington Post, May 18, 2010, as quoted in Hartmut Fischer, Elliot Neaman, and Shalendra D. Sharma,Why the Greek Meltdown Became a Euro-Zone Crisis, 12 Whitehead J. Dipl. & Int'l Rel. 43 2011, p. 50 footnote 24

[9] Barry Eichengreen, Hall of Mirrors. The Great Depression, the Great Recession and the Uses –and Misuses- of History, Oxford University Press, 2015, 337

13. Art. 28 par. 3 of the Greek Constitution reads:

"*Greece, by law [to be] voted by the absolute majority of the total number of Members of Parliament shall freely proceed to limitations regarding the exercise of her national sovereignty, inasmuch as this is dictated by an important national interest, does not affect the human rights and the foundations of the democratic form of government and is effectuated on the basis of the principles of equality and under the condition of reciprocity*."

The disposition is unique, because its wording deconstructs [or: reverses] anything classical regarding the notion of sovereignty. In short, the disposition admits

(1) Than the national sovereignty of Greece might not serve Greece's important interests. But by its classical constitutional approaches –any of them-, sovereignty cannot be conceived as anything less than the supreme power an independent state disposes. To conceive the voluntary limitation of the exercise of this paramount power as something possibly able enhance the pursuit of national interests is equivalent to conceiving suicide as a form of medicine, able to restore [bring back] our health.

(2) therefore: if the Parliament (which is the representative of stands for] the sovereign) so decides, somebody [or something] else, outside of the realm of the Greek sovereignty, will more effectively take care of important Greek interests. This is so, because the self-imposed withdrawal from the exercise of sovereign powers is not meant to leave a vacuum and cannot leave a vacuum anyway.

(3) The voluntary concession of the Greek sovereignty is not without limits: the human rights and the foundations of the democratic form of government should not be affected by the self-imposed withdrawal from the exercise of a sovereign power (this is a limit of "substantial" character), and is effectuated on the basis of the principles of equality and under the condition of reciprocity (this is a limit of "procedural" character). This last paragraph of the disposition seems to suggest that

Greece, to serve better important national interests of her, imposes herself voluntary withdrawal from the exercise of sovereign powers, on condition that others (evidently to serve their national interests better) self-impose to themselves the same withdrawal, and on condition that all the participants in this endeavor do not affect the human rights and the foundations of the democratic form of government.

The rationale of Greece's austerity program and the "surrender" of the Greek monetary sovereignty

14. Immediately after the elections of September 2009, the newly elected Greek government has discovered that Greece is practically in default. A Greek default would have disastrous consequences for the Euro, the Eurozone and for the particular economies of the other states of the Eurozone. This would most certainly trigger even wider negative consequences worldwide. Therefore Greece the other Euro-countries would not be allowed to default.

15. Basically, the Greek "recovery" project is founded on the following equilibrium: loan facilities at relatively law interest rates would be secured for Greece under the condition that Greece would adopt an implement a tight program of the most strict austerity and with a large variety of social reforms, deemed by Greece's creditors necessary for her "recovery". There are several limitations of the monetary sovereignty (but also of the political sovereignty) involved

(1) Greece **has to accept** the conditions set by the rest of the Euro-countries (and the EU).

(2) All other Euro-zone countries **had to be involved** in "resolving" the Greek problem [and, later on, also the Portuguese, the Cypriot and the Irish]; and so they did, even unwillingly. The relatively unknown case of Slovakia is most significant: the Slovak Parliament has initially rejected the bail-out project for Greece [on the very plausible basis that the Slovaks have no reason at all to pay for richer co-Europeans like the Greeks. Slovakia

has eventually changed her attitude as a result of unbearable pressures and at the cost of a governmental change.

A clear threat: "*Get your (monetary) sovereignty back*"!

16. Actually, i.e. literally the days and the weeks after the rise of a radical left party in government in Greece, Greece's return to her monetary sovereignty is perceived by the Greeks as a catastrophe. Greece's withdrawal from the Euro and the reiteration of the national currency –the drachma- would have economic and then political and then social implications against which the monetary sovereignty of Greece can do nothing. Greece is negotiating the further surrender of her sovereignty, while the Eurozone is pressuring Greece by menacing her to give it back.

The completion of the antistrophe

17. While basically eliminating the space for autonomous political/democratic deliberation offered by the Constitution, our international partners/creditors spared no word of appraisal and of the highest respect to our constitutional *forms*. Most characteristically, Olli Rehn, then Vice President of the Commission responsible for Economic and Monetary Affairs and the Euro, solemnly repeated before the European Parliament a proclamation taken up from the official texts:

> "*The program of the economic reform is a program owned by Greece. The troika has helped in its design […] on behalf of those who finance the Greek state by loans of vast magnitude [...] the EU-IMF troika can facilitate, enable and support –but at the end of the day, it is Greeks themselves who need to take the action to reform their country and curry the responsibility for it*."[10]

[10] Press release of the European Commission on European Parliament's the Joint Hearing on Greece, held in Brussels, March 27, 2012, to be found through www.europa.eu

In short, the garments of our sovereignty remained intact, while its soul and body are inhabited by others and not the sovereign. This ended up to an antistrophe: the sovereignty, the constitutional sovereignty, came to submit all its might and powers to the service of somebody else's priorities, and not to its nominal holder, from whom it had been severed. In short, the external features of the exercise of our sovereign powers –the garments of our sovereignty- rest intact and protect somebody else's prerogatives form the internal value –the body- of our sovereignty. A fascinating reversal, isn't it?

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