Ollscoil na hÉireann, Corcaigh

National University of Ireland, Cork

The Origins of a Flawed Monetary Paradigm in Europe: Recurring Patterns, Regressive Repercussions and the Role of Law

Thesis presented by

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for the degree of

Doctor of Philosophy

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2020

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Declaration

This is to certify that the work I am submitting is my own and has not been submitted for another degree, either at University College Cork or elsewhere. All external references and sources are clearly acknowledged and identified with the contents. I have read and understood the regulations of University College Cork concerning plagiarism.

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Acknowledgements

I would not have been able to write this thesis without the help and support of several people. I would like to thank my supervisors Maria Cahill and Fidelma White for their invaluable critique and insightful comments. I have learned so much from both of them. I would also like to thank Conor O' Mahony, Patrick O' Callaghan and Bénédicte Sage-Fuller from the School of Law for their encouragement, help and guidance during the course of my research. In addition, I would also like to thank members of other faculties who supported me in the writing of this thesis: Emmanuelle Schon-Quinlivan from the Department of Government and Politics, John Considine from the Department of Economics, Gabriel Doherty from the School of History and James Fairhead from the Business School. I would also like to thank a number of my peers from the School of Law – Anthony, Allen and Irene whose friendship have been a source of comfort and support throughout my doctoral studies. Most of all, I would like to thank my wife, Sally, to whom I dedicate my thesis.

This thesis consists of 90, 102 words

Abstract

The financial and Eurozone crises represented the culmination of approximately forty years of neoliberal economic policies. The financialised economic environment facilitated an unprecedented flow of capital and an unparalleled accumulation of private debt that would ultimately and, predictably, prove unsustainable. At the heart of that economic paradigm was the flawed understanding of the nature and operation of money and its interaction with markets and governments. This thesis is concerned with the manner in which the law facilitated that monetary conception. The legal historical analysis undertaken identifies the key components and theoretical foundations traditionally associated with the doctrine of monetary sovereignty and notes the cycle of monetary abuse associated with the production of currency that leads inevitably to economic instability. Moreover, the reconfiguration of public finances in Britain, in the seventeenth century, paved the way for the development of financial markets during a period of intense legal activism. The establishment of a political norm was established that would prioritise the property rights of government creditors, based on a legal conception of the naturalisation of markets, placing the interests of financial elites beyond the reach of the state insulating them from democratic challenge. Despite the brief abandonment of this form *laissez-faire* capitalism after 1945, it re-emerged in a more extreme form within the neoliberal paradigm. Those re-emergent values were incorporated into European Economic and Monetary Union (EMU). The legal architecture of the single currency, based on a flawed legal conception of money, severed the link, traditionally found at the national level, between the authority to raise revenue through fiscal authority and the issuance of currency by monetary authorities. Nonetheless, the architects of EMU displayed an unshakeable belief in the efficiency of markets and were convinced that the emphasis on budgetary restraint and price stability would ensure success. In their deference to the prevailing economic orthodoxy, political and institutional actors did not pay sufficient attention to the growing imbalances between Member States and the accumulation of unsustainable levels of private debt. With the onset of the Eurozone crisis, the cause was misleadingly attributed to the fiscal profligacy of peripheral Member States. That narrative provided the justification for the introduction of legal measures that would ensure fiscal consolidation. Those measures merely upheld a set

of contestable political and economic interests which represented the abandonment of the normative disciplinary function that the law should have in balancing the interests of the market and the society in which it functions. In turn, the CJEU acquiesced to the political decisions taken by the executive in order to maintain the existing order rather than challenge the validity of those decisions. In that deference, the Court employed a considerable degree of interpretative latitude in which the teleological was prioritised over the literal that weakened the constraints on policymakers and provided the justification for the discretionary allocation of losses that were borne by EU citizens.

Much of the analysis of the Eurozone crisis has understandably been dominated by scholars of political economy and/or pure economics. Legal analysis has tended to focus on the constitutional transformation resulting from the legal responses to the crisis. This thesis represents a departure from those approaches. The use of an historical methodology provides a different perspective when compared to the current literature which tends to be ahistorical in nature. The longitudinal view that it provides, regarding the development of the law in monetary matters, shows that the Eurozone crisis was not an atypical event but a continuation of a cycle that occurs when policy makers revert to a form of laissez-faire capitalism designed to constrain the state with the disciplinarian nature of liberalised financial markets.

Table of Treaties, Statutes and Cases

International and EU Treaties

EU Legislation

British Legislation

National Cases

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List of Abbreviations

EC	European Community
ECB	European Central Bank
EEC	European Economic Community
ECOFIN	Economic and Financial Affairs Council
ECU	European Currency Unit
EFSM	European Financial Stabilisation Mechanism
EFSF	European Financial Stabilisation Mechanism
EMS	European Monetary System
EMU	Economic and Monetary Union
EPU	European Payments Union
ERM	Exchange Rate Mechanism
ESCB	European System of Central Banks
ESM	European Stability Mechanism
EU	European Union
IGC	Intergovernmental Conference
IMF	International Monetary Fund
MoU	Memorandum of Understanding
NCB	National Central Bank
OEEC	Organisation for European Economic Coordination
SEA	Single European Act
SGP	Stability and Growth Pact
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
TSCG	Treaty on Stability, Coordination and Governance In the Economic and Monetary Union

Introduction

The economic and monetary environment leading up to the financial crisis of 2008, in both the US and Europe, is reminiscent of the board game Monopoly. As a child, usually during the Christmas holidays, my family and I would play the game. The money would be distributed, in accordance with the rules, and we would begin playing the game with a sense of optimism and good humour. We were keen to buy properties and develop them with the erection of houses and hotels thereby increasing their rentable value. Of course, the other players were trying to achieve the same objective. As the game progressed, the demand for money increased in order to pay the rents due when landing on another player's property. As the number of houses for sale reduced, we would try to outbid one another for them driving the price of the properties up. The atmosphere would become more competitive. As we continued, the wealth would be concentrated in fewer and fewer hands and the erstwhile good humour now became more bad-tempered as those short of cash were forced to sell their properties at heavily discounted prices.

The game invariably ended in arguments and recriminations with those who lost swearing they would never play again. There was a sense of victimhood and a desire not to be put in that position again. The game is fundamentally unfair and should have been left in the cupboard to gather dust. However, equally invariably, as time passed and memories faded, Christmas rolled around again, and we would decide to play the game one more time thinking that events would unfold differently. We would forget, momentarily, that the rules of game ensure the same results every time it is played. The game was designed to promote the growth of inequality as it progresses.[1]

[1] M. Pilon, "The Secret History of Monopoly: The Capitalist Board Game's Left-wing Origins," The Guardian 11th April, 2015. Available at: https://www.theguardian.com/lifeandstyle/2015/apr/11/secret-history-monopoly-capitalist-game-leftwing-origins (last accessed 20/06/20).
The game was invented by a political activist, Elizabeth Magie in 1903. Magie was an outspoken critic of the norms and policies of the day. She was inspired by the work of Henry George, a nineteenth century progressive political economist, who rallied against the destitution and inequality he had witnessed amid growing wealth. In its original iteration, Monopoly, then known then as the Landlords' Game, could be played with either of two sets of rules. It could be played under the 'Monopolist' rules with which everyone is familiar nowadays. However, it could also be played using the 'Prosperity' rules under which everyone gained due the redistribution of taxes paid on the acquisition of a property. The aim was to demonstrate the difference between the two systems of governance. Regrettably, the Prosperity rules were abandoned and nowadays the game is only played with the Monopolist rules.

In reality, banks are able to take deposits and lend money into existence. If the game were played taking account of these factors, it would be an almost perfect depiction of how many western economies operate.[2] The amount of money owed would quickly grow to levels that exceed the amount that is in existence, driving up property prices leading to cash shortages for debtors.[3] In short, default is inevitable. Similarly, the bank would also get into trouble if it does not have enough cash for withdrawals at the same time as debtors lack the ability to pay the bank.

With the emphasis on individualism, we are told that we are the masters of our own destiny, rational actors, optimising our economic self-interest within the market, which itself is self-regulating and able to maintain its own equilibrium. Like Monopoly players, during the credit expansion part of the cycle, there is a sense of exuberance. Those market participants are overly optimistic, overestimating the probability of positive outcomes while underestimating the chances of negative outcomes. The market acts as a form of coercion; people feel compelled to participate fearing that they might lose out to others if they do not get in early enough. They do not notice the increasing concentration of wealth and power. When the market collapses, those who lose are expected to take personal responsibility while institutional interests are protected. Proponents of the prevailing economic system argue that it has nothing to do with the way in which the market is constructed or organised. Indeed, according to received wisdom, the free market economy is a separate, self-sustaining entity that operates regardless of government and is, therefore, beyond its reach, ignoring the level of legal intervention that has taken place to shape it.

The question is, however, why do we, at a societal level, like disenchanted Monopoly players, have such short memories? Why are we seemingly unable to learn the lessons of the past? Of course, the answers to these questions are multi-faceted and may be approached from a number of different angles. The key, however, to understanding the ongoing faith in the current political and economic paradigm is to recognise the importance and effectiveness of a particularly powerful narrative that is couched in neoliberal ideology.

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[2] G. Lubin, "Ray Dalio Explains the Economy in Terms of the Game 'Monopoly'," Business Insider, 13 March, 2012. Available at: https://www.businessinsider.com/ray-dalio-explains-the-economy-in-terms-of-the-game-monopoly-2012-3?r=US&IR=T (last accessed 20/06/20).

[3] Ibid. According to the rules of the game, the Bank is not able to fail. If it runs out of cash, promissory notes can be written in order to fund the purchase of assets.

There was a concerted effort by the neoliberal school to dismantle many of the features associated with the settlements numerous western states made with the citizenry in the post-war era. Members of the Mont Pèlerin Society bided their time and refined their message until the opportunity arose that would allow them to dominate political and economic discourse.[4] The neoliberal movement has weaved multiple narrative strands concerning the nature of money and fiscal policy that have had the effect of entrenching vested economic and financial interests. The stories told not only shape our perception of the contemporary economic environment but also our perception of past events. It purports that it is based on pragmatism and a particular view as to how the economy, and, therefore, society which is subordinated to it, should work. Those who question its adverse economic and societal effects are simply told that there is no alternative.

When the system crashed, it took many of its supporters by surprise.[5] One might have thought that with the onset of the financial crisis, the most significant economic event of the last eighty years, that the political discourse might have taken a different direction. However, it was at this point the neoliberal narrative went into overdrive and shaped both the political and legal responses to it. In Europe, it said, the crisis was the result of excessive

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[4] L. Cornelissen, "'How can the people be restricted?': The Mont Pèlerin Society and the problem of democracy, 1947-1998," 43(5) History of European Ideas (2017), pp. 507-524, p. 507-508. The Society was founded by F. A. Hayek in April 1947. Its members were of the opinion that western civilisation was under threat due to the growth in collectivist policies in many economies and the decline of liberal ones. In addition to Hayek, other members included Walter Eucken, Ludwig von Mises, Karl Popper, Lionel Robbins and Milton Friedman. The Society's key task was the production of a new liberal political and economic philosophy that avoided the problems associated with classical liberalism. Once developed, these principles were to be disseminated through an extensive network of media, research institutions, think tanks and public intellectuals.

[5] D. Orrell, "Why we missed the storm," World Finance 23 November, 2018. Available at: https://www.worldfinance.com/banking/why-we-missed-the-storm (last accessed 20/06/20).
Ben Bernanke, in his 2009 commencement address stated: "Like weather forecasters, economic forecasters must deal with a system that is extraordinarily complex, that is subject to random shocks, and about which our data and understanding will always be imperfect… Mathematicians have discussed the so-called butterfly effect." Similarly, Nobel Laureate, Paul Krugman, remarked in 2015 that the crash "came as a shock to me as to almost everyone." In his appearance before the Committee on Oversight in Washington, former Federal Reserve Chairman, Alan Greenspan stated: "Those of us who have looked to the self-interest of lending institutions to protect shareholders' equity (myself especially) are in a state of shocked disbelief."
The chairman of the Committee asked him: "You found that your view of the world, your ideology, was not right, it was not working?" Greenspan responded: "That's precisely the reason I was shocked because I'd been going for forty years or so with considerable evidence that it was working exceptionally well." In fact, during the period 1970-2017, there had been 151 systemic banking crises around the globe. See L. Laeven, F. Valencia, "Systemic Banking Crises Revisited," IMF Working Paper WP/18/206 (2018). Available at: http://financial-stability.org/wp-content/uploads/2019/08/2018-09_IMF_systemic-banking-crisis-revisited.pdf (last accessed 20/06/20).

spending by governments and they would now have to live within their means. Losses had to be socialised as systemically important financial institutions could not be allowed to fail.

More than a decade since the beginning of the Great Recession, its effects are still being felt. Central banks around the world have undertaken successive rounds of quantitative easing (QE) in order to stimulate economic growth. The money supply has been increased to such an unprecedented level that the policy itself could contribute to further financial instability.[6] The level of debt in relation to gross domestic product (GDP) is now higher than it was immediately before the crisis and there is a possibility that in the event of interest rate rises, the true state of financial institution's balance sheets might reveal that the value of their assets have been overstated.[7] It is quite possible that the era of "too big to fail" is over.[8]

A. Methodological Approach

Based on the preceding section, this thesis offers a critical analysis of the role of law in the evolution of the modern monetary environment. It offers an analysis of British monetary and fiscal reforms that began in the seventeenth century and, in particular, how they facilitated the inculcation of certain (contestable) economic and political values that would ultimately underpin the establishment of the single currency. This thesis aims to address three interconnected questions regarding the nature of money as a legal institution:

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[6] International Monetary Fund "Global Financial Stability Report: Lower for Longer" October 2019. Available at: https://www.imf.org/en/Publications/GFSR/Issues/2019/10/01/global-financial-stability-report-october-2019 (last accessed 20/06/20). Chapter One of the Report notes that whereas financial conditions have eased, they appear to be based on the provision of additional monetary policy accommodation resulting in historically low interest rates causing investors, looking for higher yields, to inflate certain classes of assets. This has had the effect of building up further financial vulnerabilities. Debt has risen and has been used for financial risk taking. The International Monetary Fund (IMF) identified that corporate sector vulnerabilities that have increased in "several systemically important economies." and highlights concerns over those companies whose income is insufficient to service their loans. As a result, banks and non-bank financial institutions have significant exposures as a result of that lending. (p. 25).

[7] Bank of International Settlements, "Ten Years After the Great Financial Crisis: What has Changed?" BIS Papers No. 103 (2019), p. 2-3. Accounting rules allow loans to be valued at their full value providing those loans are being serviced. In addition, since the crisis, the amount of loss-absorbing capital has increased by a factor of two. However, the market value of equity is less than the book value and, thus, European banks remain especially vulnerable.

[8] Ibid, p. 6.

1. What are the legal origins of monetary sovereignty and to what extent does its exercise, in historical and contemporary terms, determine political and economic relations between state and non-state actors?
2. To what extent is the exercise of monetary sovereignty dependant on the its relationship with national fiscal capacity and what are the effects of the resultant institutional arrangements?
3. To what extent are these historical developments reflected in the legal architecture of European Economic and Monetary Union and what are the implications for participating states and their citizenry?

In order to address these questions, a two-stage process was adopted: the analysis contained in answering questions one and two provides the basis for the examination of the third question. This thesis adopts an historical legal methodology. Legal history, undertaken in this form, is not applied history, that is historical methodology simply applied to law, as a subdiscipline of both law and history, but as a method undertaken to enable the critical analysis of law.[9] The historical legal method, therefore, can be used as a tool in the exegesis of contemporary law.[10]

In the study of the evolution and origins of monetary sovereignty, the historical methodology provides a perspective that contextualises this area of legal development that mere contemporary doctrinal analysis would not provide. Critical analysis in this form allows an understanding of not only how the law developed in relation to monetary matters but also why.[11] Moreover, historical legal analysis provides the space for the development of an account of legitimacy on which the critique is founded:[12] analysis of the legal origins of the modern monetary environment, measured against competing economic interests, allows for the questioning of the legitimacy of those values as they are represented today. This is especially pertinent when the interaction between law and the political is taken into account. The methodology employed demonstrates not merely the changes in the content

[9] M. D. Dubber, "New Historical Jurisprudence: Legal History as Critical Analysis of Law," Critical Analysis of Law Vol. 2(1) (2015), pp. 1-18, p. 2.
[10] D. Ibbetson, "Historical Research in Law," in (eds. P. Cane, M. Tushnet) *The Oxford Handbook of Legal Studies* (Oxford University Press, Oxford, 2003), p. 865.
[11] Ibid Dubber, p. 3.
[12] Ibid, p. 14

of law but also the development of the mechanisms that allowed for its enforcement;[13] it notes that political history through jurisprudential development varied the nature of social and economic relations. Following the move from common law to a regulatory regime, the role of law was reimagined and explains the basis for the modern monetary environment which was based on the emergent liberal philosophy, new legal mechanisms were created that placed limits on the ability of government to act in such a way that adversely affected the interests of certain economic actors.

With the above in mind, it should be noted that there is a conventional distinction drawn between 'internal' and 'external' histories.[14] Whereas the former is concerned with the history of legal rules or lawyer's law, the latter examines legal history in terms of the effect of law and its institutions on society.[15] From an historical perspective, this thesis considers the interaction of the economic, political and legal in the framing of the modern monetary environment from both an internal and external perspective. In addition to the analysis of legal doctrine, the consideration of policy, which recognises the social function of law,[16] also provides an explanation for the continuing survival or re-emergence of old rules that are manifested in the modern political context.

The rise to prominence of the neo-classical school of economics, in the 1920s and 30s, led to a decline in interest in economics on the part of legal historians.[17] Neo-classical economists considered markets to be the natural order of things presuming that they had always existed and, therefore, their functioning did not rely on the law.[18] Economic theory developed in such a manner that was ahistorical, market oriented and the interaction between economic history and legal history was minimal. However, in the mid-1970s economic historians became more interested in law and legal history.[19] Douglass North

[13] R. Kreitner, "Legal History as Political History," in *The Oxford Handbook of Legal History* in (eds. M. Dubber, C. Tomlins) (Oxford University Press, Oxford, 2018), p. 138.
[14] D. Ibbetson, "Historical Research in Law," in (eds. P. Cane, M. Tushnet) *The Oxford Handbook of Legal Studies* (Oxford University Press, Oxford, 2003), p. 864.
[15] Ibid.
[16] Ibid, p. 869.
[17] R. Harris, "The Encounters of Economic History and Legal History," Law and History Review Vol. 21(2) (2003), pp. 297-346, p. 297
[18] Ibid, p. 300. Some economists recognised the operation of competition law as being the only relevant form of law as an exogenous form of market regulation. However, law was viewed as a constraint on the operation of markets, impeding efficiency, and certainly not a precondition for the operation of the market.
[19] Ibid, p. 304

noted the ahistorical approach of neo-classical economic theory was not equipped to deal with long-term transformation and argued that economic historians should supplement that theory with an emphasis on non-market institutions such as the legal system and the state.[20]

Traditionally, legal historians were concerned primarily in the study of changes in legal doctrine, focussing in particular on the judgments of the supreme courts and courts of appeal.[21] However, this was to change with the work of J. Willard Hurst.[22] Hurst's approach allowed for the study of legal change in the context of economic, social, political and ideological conditions as effected by legal and non-legal institutions.[23] It is not possible to ignore the constitutive role that the culture of economics has engendered[24] and its effect on the role of law. In order to understand the intellectual and political trends of the last half century – the rise of the free market, the crisis of the welfare state and the growth of globalisation – the lawyer and legal historian are obliged to engage with that culture. It provides a mechanism that allows an analysis that determines the extent to which legal history is influenced by economic imperatives.[25]

At this point it is important, regarding the appropriate methodological framework, to draw the distinction between the 'law *and* economy' and 'law *as* economy' approaches. The former was the dominant model until relatively recently. However, its critics argue that it creates a false distinction both in academic and material terms between the assessment of the influence of law on economics and vice versa.[26] Indeed, treating the two disciplines as ontologically distinct has facilitated/enabled the development of the narrative that the economy is separate from law.[27] It has, therefore, impacted on our contemporary

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[20] D. North, "Beyond the New Economic History," Journal of Economic History 34 (1974), pp. 1-7.
[21] Ibid, Harris, p. 323.
[22] Ibid.
[23] Ibid, p. 325.
[24] Ibid, p. 337.
[25] A. Flemming, "Legal History as Economic History," in *The Oxford Handbook of Legal History* (eds. M. Dubber, C. Tomlins) (Oxford University Press, Oxford, 2018), p. 209. The extent to which economic imperatives interacts with law is nuanced. Flemming notes that the historian Lawrence Friedman argued that law was not autonomous but a reflection of society. This is in contrast with the approach taken by Morton Horwitz who asserted a greater degree of autonomy of law from economics in relation to production but recognised the importance of economic interests in the changes of American law.
[26] Ibid, p. 214.
[27] C. L. Fisk, R. W. Gordon, "Foreword: "Law as…" Theory and Method in Legal History," 1 U.C. Irvine L. Rev. 519 (2011), pp. 519-541, p. 538.

understanding and analysis of the relationship between the law, state and economy. As Fisk and Gordon state:

> "One of law's amazing magical disappearing acts has been, over the last two centuries at least, to make it seem that the economy exists separately from law. While contemporary law and economics scholars, in company with political analysts and World Bank and International Monetary Fund officials, point out that the rule of law is necessary to, or at least helps support, efficient economies, the notions that law is distinct from economy, that the law may be necessary to a healthy economy but is not the economy, and that the law does things to the economy are so widespread as to seem indisputable."[28]

The legal historical methodology, adopted in this thesis, uses the 'law as economy' framework. It facilitates the analysis of legal history from both an internal and external perspective, noting the embeddedness of both law and economy.[29] Under the prevailing political and economic orthodoxy, the economy has been abstracted from the state.

This thesis, therefore, approaches both law and economics as two forms of governance and analyses, historically, the institutional mechanisms that established a certain social and political order in the monetary and fiscal spheres. As a result, this thesis challenges the deification of the market and its justification on the basis that it is a natural phenomenon, one which cannot be resisted, a natural force like gravity and, thus, the state should step aside and not interfere with its operation. The examination of the (historical) processes that seek to maintain the distinction between the state and the market, mediated through the law, offer an explanation of the contemporary monetary system and how certain vested economic interests are preserved and ultimately enshrined in the single currency.

Member States had divested themselves of those policy responses (both fiscal and monetary) that they would ordinarily have enjoyed had they not adopted the Euro. The question then arose as what precisely had Member States surrendered when they joined the single currency? The decision to adopt an historical legal method enabled the identification of the key components of monetary sovereignty and provided an insight, in

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[28]Ibid, p. 538-9.

[29] R. Birla, "Law as Economy: Convention, Corporation, Currency," 1 U.C. Irvine L.R. (2011), pp. 1015-1037, p. 1015.

legal terms, to both the responses to the crisis and its causes. The story that emerged demonstrated the role that the law played in creating the modern monetary environment and also how it laid the foundations for the creation of a monetary fiction that would ensure the protection of elite economic interests at the expense of the citizenry. The model that emerged from Britain, starting in the late seventeenth century, established a set of institutional arrangements, by means of legal intervention, that were underpinned by a particular ideological conception of the political economy. Many of the values associated with that conception were inculcated in the single currency following the ascent and domination of monetarist/neoliberal thinking.

The study of the institutional arrangements and their effects within the monetary realm tend to have been neglected by legal scholars.[30] This was not always the case. The 14th century jurist and theologian, Nicholas Oresme[31] had discussed the ethics of currency production noting the effects on individuals and the community. Jean Bodin, known primarily for his development of absolutist sovereignty, also developed a normative conception of monetary matters.[32] However, following the shift towards a market-based economic model, founded on liberal theory, the production of currency was, to an extent, depoliticised. Money was deemed to arise from economic interactions in the market and was not generated by law.[33] As a result, money and discussion of it became a matter for economists. Thus, modern monetary policy has become a technocratic exercise with little democratic oversight. The current orthodoxy suggests that money is created on the basis of an injection of high-powered money into the financial system that is multiplied through bank lending.[34] Therefore, control of the money supply is determined by the reserve requirement with banks acting as intermediaries lending out deposits that savers have placed with them. The financial crisis and the Eurozone crisis demonstrated that this narrative is a myth.[35] Banks lend money into existence and central banks do not play any

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[30] Exceptions to this include: C. Proctor, *Mann on the Legal Aspect of Money* (Oxford University Press, Oxford, 2012); C. Desan, *Making Money: Coin, Currency, and the Coming of Capitalism* (Oxford University Press, Oxford, 2014); S. Gleeson, *The Legal Concept of Money*, (Oxford University Press, Oxford, 2018); C. D. Zimmermann, *A Contemporary Concept of Monetary Sovereignty* (Oxford University Press, Oxford, 2013).
[31] N. Oresme, *De Moneta*, translated by C. Johnson (Thomas Nelson Ltd., Edinburgh, 1956).
[32] J. Bodin, *The Six Books of the Commonwealth*, translated by M. J. Tooley (Basil Blackwell, Oxford, 1955).
[33] C. Menger, "On the Origins of Money," Economics Journal 2 (1892), pp. 239-55, p.251.
[34] J. Benes, M. Kumhof, "The Chicago Plan Revisited," IMF Working Paper WP/12/202 (2012), p.10. Available at: https://www.imf.org/external/pubs/ft/wp/2012/wp12202.pdf (last accessed 30/06/20).
[35] Ibid, Benes and Kumhof, "The Chicago Plan Revisited."

meaningful role in the determination of the money supply through the setting of interest rates.[36]

The thesis maps out, therefore, an aetiology of the crisis from a legal perspective. The historical analysis demonstrates the method of construction of a monetary hierarchy that preserves certain entrenched economic and political interests due to the interconnectedness and interdependence of the financial markets and governments despite the assertion that they are separate. Accordingly, the thesis argues that the political and legal responses to the crisis remained subservient to that structure. Doctrinal analysis of the legislative measures and case law demonstrates a culture of deference wherein the law has submitted to the political which, in turn, has deferred to the economic. The thesis argues that measures undertaken were designed not to reform but reinforce a certain conception of the political economy. Building on contemporary literature, it is argued that the move towards increased economic integration and governance, in the aftermath of the crisis, is designed to support the flawed monetary conception examined in earlier chapters. The thesis challenges the substantive nature of the crisis legislation by reference to current economic scholarship examined from a legal perspective. It demonstrates that, in pursuit of systemic self-preservation, the disproportionate allocation of losses felt by deficit states' citizenry was the price paid for the preservation of elite interests. The thesis argues that the measures undertaken were ideologically driven and based on controversial, and to a degree, discredited economic assumptions in which the theory used as justification for policy decisions was often contradicted by observable reality. Moreover, it is argued emergency governance, where a more flexible approach is taken to interpret the existing rules, undermined the rule of law within the EU whilst simultaneously undermining democratic legitimacy.

B. Literature Review.

Much has been written about the Eurozone crisis. Naturally, the analysis tends to have been dominated by scholars of political economy and/or pure economics.[37] In contrast, legal

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[36] Ibid.

[37] Prominent contributions include: A. Mody, D. Sandri, "The Eurozone Crisis: How Banks and Sovereigns Came to be Joined at the Hip," Economic Policy Vol. 27(70) (2012), pp. 199-230; G. Hannsgen, D. B. Papadimitriou,

analysis has tended to focus on the constitutional transformation brought about by the responses to the crisis.[38] This thesis represents a departure from these approaches. The use of an historical methodology provides a perspective that differs from the current literature which is ahistorical in nature. It provides a birds-eye view of the development of the law in relation to monetary matters that shows that the Eurozone crisis was not an atypical event but the continuation of a cycle that occurs when policy makers revert to a form of *laissez-faire* capitalism designed to constrain the state with the disciplinarian nature of liberalised financial markets.

As noted in the preceding section, for historical and economic reasons, legal scholarship concerning the nature of money and its production has, to an extent, been the subject of neglect. There is, therefore, no canon of material that can be drawn upon. That being said, interest in the legal nature of money has increased in recent years.

Money in the Western Legal Tradition[39], edited by David Fox and Wolfgang Ernst, has proved a valuable resource. Covering the period between the high medieval Europe through to the

"Fiscal Traps and Macro Policy after the Eurozone Crisis," Public Policy Brief, No. 127, Levy Economics Institute (2012); A. Nölke, "Economic Causes of the Eurozone Crisis: The Analytical Contribution of Comparative Capitalism," Socio-Economic Review Vol.14(1) (2016), pp. 141-161; L. P. Feld, E. A. Köhler, D. Nientiedt, "Ordoliberalism, Pragmatism and the Eurozone Crisis: How the German Tradition Shaped Economic Policy in Europe," Vol. 2(3) European Review of International Studies (2015), pp. 48-61; S. Storm, C. W. M. Naastepad, "NAIRU Economics and the Eurozone Crisis," International Review of Applied Economics Vol. 29(6) (2015), pp. 843-877; J. Frieden, S. Walter, "Understanding the Political Economy of the Eurozone Crisis" Annual Review of Political Science Vol. 20 (2017), pp. 371-390; S. Bulmer, "Germany and the Eurozone Crisis: Between Hegemony and Domestic Politics," Vol. 37(6) Western European Politics (2014), pp. 1244-1263; B. Eichengreen, N. Jung, S. Moch, A. Mody, "the Eurozone Crisis: Phoenix Miracle of Lost Decade?" Journal of Macroeconomics Vol. 39 Part B (2014), pp. 288-308; E. Brancaccio, "Current Account Imbalances, The Eurozone Crisis and a Proposal for a European Wage Standard," International Journal of Political Economy Vol. 41(1) (2012), pp. 47-65; Y. Varoufakis, S. Holland, "A Modest Proposal for Resolving the Eurozone Crisis," Intereconomics Vol. 47 (2012), pp. 240-247.

[38] M. Ioannidis, "Europe's New Transformations: How the EU Economic Constitution Changed during the Eurozone Crisis," Common Market Law Review Vol. 53(5) (2016), pp. 1237-1282; P. Craig, "Economic Governance and the Euro Crisis: Constitutional Architecture and Constitutional Implications," Oxford Legal Studies Research Paper No. 30 (2014); K. Tuori, K. Tuori, *The Eurozone Crisis: A Constitutional Analysis*, (Cambridge University Press, Cambridge, 2014); *Beyond the Crisis: The Governance of Europe's Economic, Political and Legal Transformation*, eds. M. Dawson, H. Enderlein, C. Joerges (Oxford University Press, Oxford, 2015); *Constitutional Change Through Euro-Crisis Law*, eds. T. Beukers, B. de Witte, C. Kilpatrick (Cambridge University Press, Cambridge, 2017); N. Scicluna, "EU Constitutionalism in Flux: Is the Eurozone Crisis Precipitating Centralisation or Diffusion?" Vol. 18(4) European Law Journal (2012), pp. 489-503; N. Scicluna, "Politicization without Democratization: How the Eurozone Crisis is Transforming EU Law and Politics," Vol.12(3) International Journal of Constitutional Law (2014), pp. 545-571; B. De Witte, "Euro Crisis Responses and the EU Legal Order: Increased Institutional Variation or Constitutional Mutation?" Vol. 11(3) European Constitutional Law Review (2015), pp. 434-457; M. Dawson, F. de Witte, "Constitutional Balance in the EU after the Euro-Crisis," Vol. 76(5) Modern Law Review (2013), pp. 817-844.

[39] Oxford University Press, Oxford, 2016.

settlement agreed at Bretton Woods in 1944, it provides a history of the main topics in monetary law covering the past 800 years. However, this thesis goes beyond the period in question in its analysis of the Economic and Monetary Union, the Eurozone crisis and the responses to it. Simon Gleeson's *The Legal Concept of Money*[40] focusses on the conception of money from a legal and economic perspective examining new electronic payment mechanisms and the effect that they are likely to have in terms of macroprudential policymaking. Gleeson's work does consider some of the elements examined in this thesis, such as the role of money in the banking system but focusses on how the stability of financial institutions could be threatened by non-traditional currency forms. Claus Zimmermann's monograph, *A Contemporary Concept of Monetary Sovereignty*[41] notes that the concept of monetary sovereignty does not feature in any of the key instruments of international law, including the Articles of Agreement of the International Monetary Fund. Zimmermann argues that monetary sovereignty remains a dynamic legal concept with both positive and normative components and analyses the challenges faced by the international community particularly in the light of exchange rate misalignment charting the trend towards the continuing hybridisation of international monetary law. However, despite having some areas in common, this thesis departs to the extent that it is concerned not only with monetary sovereignty but also its relationship with the fiscal authority of the nation state and the implications that arise from it.

This thesis draws on the seminal work by Christine Desan. In her book, *Making Money: Coin, Currency and the Coming of Capitalism,*[42] she charts the monetary revolution that occurred in Britain in the late seventeenth century. For the first time, with the establishment of the central bank, the government would pay investors to lend it money in the form of bank notes that would then circulate as a public mode of payment.[43] In addition, the government licensed banks to multiply the supply of money by lending to borrowers.[44] As Desan, notes, "… in an unprecedented step, the government shared its monopoly over money creation." In the following centuries, the level of cash flowing through the domestic economy increased dramatically and memories of the problems associated with the earlier methods

[40] Oxford University Press, Oxford, 2018.
[41] Oxford University Press, Oxford, 2013.
[42] Oxford University Press, Oxford, 2014.
[43] C. Desan, *Making Money*, p. 2.
[44] Ibid.

of production (minting) faded.[45] One of the most important insights that Desan offers is the astonishing effect with which the British model was exported:[46] "The modern vocabulary of value – one commonly deployed across the globe today – here gains parochial roots, a historicized logic, a set of capacities that were unanticipated and escaped evaluation as they developed."[47] The values and institutional relationships, in fiscal and monetary terms, observable in the majority of western economies originated in Britain. Indeed, with the onset of globalisation and financialisation, it can be argued that those features have been amplified and strengthened as they became enmeshed in the international monetary system.

This thesis aims to build on this scholarship and extends that methodological approach to the analysis of Economic and Monetary Union in Europe. Starting with the insights of Christine Desan, together with the work of other authors, it analyses how the mechanisms that are associated with the modern monetary mechanism were internationalised and ultimately enshrined in the single currency combining many of the features associated with classical liberalism with European law.

C. Overview of Chapters.

This thesis consists of five chapters and is divided into two parts. Part I is comprised of Chapters One and Two and offers an historical legal analysis of the origins of the modern monetary and fiscal environment. Chapter One examines the nature of money within the legal architecture of the state. It demonstrates how the evolution of monetary sovereignty enabled the settlement of legal obligations between the citizenry and between the citizenry and the state. However, the legal, historical research shows that the monopoly over the production of currency was accompanied by the tendency to abuse that process. As the locus of control of the money supply shifted so did the ability to exploit that mechanism. The research analyses three periods of legal development: the absolutist era, the gold standard era and; the fiat era. Chapter One argues that these developmental periods, facilitated by law, created the components of the modern monetary environment. The

[45] Ibid, p. 3.
[46] Ibid, p. 6.
[47] Ibid.

absolutist era, in monetary terms, was characterised by the judicial recognition of the royal prerogative to alter the currency in accordance with the principle of nominalism which weakened the link between the face value of specie and its precious metal content. The debasement of coinage allowed the government to inflate the currency to pursue political objectives which often came at the expense of the citizenry. However, the link between currency and the precious metal was not completely abandoned. Emergent liberal theorists resisted monarchical abuse of currency arguing that money arose from the state of nature, operating within a market, and was, therefore, antecedent to state interference.

The Gold Standard era was characterised by the depoliticisation of control over the money supply through market mechanisms. However, the maintenance of an equilibrium regarding the balance of payments, required an internal devaluation affecting those most economically vulnerable. Chapter One argues that despite the demise of the Gold Standard, the values it promoted, in terms of restrictions on governments to inflate the money supply, continue to exist in the monetarist and neoliberal ideology inspired by classical liberal thought. It provided the theoretical basis for the introduction of the Euro in the era of fiat currencies, characterised by the more prominent role of central banks determining the level of the money supply. It is argued that reliance on this institutional arrangement is insufficient to restrict an increase in the money supply through credit creation in the commercial banking sector. It analyses the historic legal interventions that facilitated this process that would ultimately lead to the accumulation of unsustainable levels of private debt. It is argued that the fuelling of asset inflation by means of regulatory arbitrage was an abuse of money creation by the commercial banking sector.

Whereas Chapter One examines the components of monetary sovereignty, Chapter Two analyses the other side of the equation: the state's fiscal arrangements. It is argued that during a period marked by the reconfiguration of public finances in Britain during the latter half of the seventeenth century, the state developed a new model that facilitated the undertaking of long-term debt secured on the basis of future revenues. It was also a period when government developed an interdependence and interconnectedness with financial markets. The Chapter demonstrates that the influence of classical liberal thought, within the realm of public finances, established the prioritisation of the rights of government creditors over the Crown with the demise of sovereign immunity regarding the repayment of national debt. The recognition of liberal individualism realised the autonomy of the market that limited the government interference with it. This, the Chapter argues, guarantees the interests of financial elites and subjugates the rights of ordinary taxpayers. In order for the reconfigured system to work, a further institutional innovation was required. The establishment of the Bank of England introduced new forms of paper money that increased the money supply in a manner that was advantageous to both government and subscribers. As lender of last resort, the government developed an inexhaustible source of legal tender. However, it was also during this period that philosophical and economic concerns were raised concerning the levels of public debt. Despite the success of the arrangements that caused Britain to become a global economic force, suspicion of public debt continued to inform policy decisions. The values that underpinned that period re-emerged in a more extreme form in the 1970s and were asserted globally. Chapter Two argues that modern monetary, fiscal and economic policy, founded on the principles of liberalism, is designed to promote elite interests at the expense of those lower in the economic order. Indeed, the legal architecture of European Economic and Monetary Union is the latest iteration of those values.

Part II consists of Chapters Three, Four and Five. It offers a critical examination of the flawed monetary paradigm that underpins the single currency. Chapter Three analyses the route taken to the establishment of the single currency. It notes the gradual shift away from the relative financial and monetary stability of the post-war years. Initially, under the Treaty of Rome, increased economic and monetary coordination ensured sovereignty remained at the Member State level, recognising both the democratic link between government and the citizenry and the diversity of participating states. However, the instability of the 1970s saw the abandonment of Keynesianism and the dawn of monetarism. This, combined with the globalisation that followed, created the environment that would culminate in European Economic and Monetary Union. Chapter Three argues that, despite the honourable intentions of its architects, the single currency was founded on a flawed legal, monetary conception. Optimum Currency Area (OCA) theory, a descendant of the monetary theories of classical liberals, was cited as the model for the Euro. However, the Chapter demonstrates that the single currency does not comply with that paradigm. However, despite an awareness of those differences, its proponents were convinced that a centralised monetary policy would counteract those risks. The link between political sovereignty, money creation and fiscal authority was weakened by the formation of a stateless currency. The surrender of monetary sovereignty combined with the commitment to a higher degree of economic convergence, particularly with regard to 'sound' public finances, legally enshrined pro-cyclical fiscal policies in the event of recession that would have significant redistributive effects. The legal arrangements of the Euro, therefore, created a modern equivalent of the Gold Standard which is in direct contrast to the interwar economic and political conditions that the European project was designed to avoid.

Chapter Four examines the political and legal responses to the Eurozone crisis. It charts the misrepresentation of the causes of the Eurozone crisis in which deficit Member States were accused of fiscal profligacy which, in turn, provided the justification for the imposition of contractionary policies. This was accompanied by measures which ensured the disproportionate protection of government creditors' interests. Thus, Chapter Four offers a critical examination of the submission of the political to the economic by legal means and questions the efficacy of the structural adjustment programmes imposed on deficit Member States.

The practical manifestation of this approach resulted in the European Stability Mechanism (ESM) and its predecessors. In an attempt to avoid financial contagion, the Stability Mechanism represents the continuation of the belief in the logic of the market and the need to depoliticise monetary and economic policy. The Chapter identifies the inconsistencies inherent in those policy goals noting the adverse economic and democratic effects felt by those states due to the strict conditionality associated with the bailout programmes. Chapter Four argues that rather than facilitating the operation of financial markets, the ESM distorts their functioning regarding the pricing of sovereign debt. The Stability Mechanism's existence implies that risk would not be priced properly and, therefore, undermines the logic of the market as the fear of creditors losing their money is reduced as losses would be transferred to the public.

Having examined the nature of the bailout mechanisms, Chapter Four then considers the measures that mark the shift away from economic coordination to governance. Again, the enactment of those measures by means of international treaty and secondary legislation represent the deference to the economic hegemony. All the measures undertaken under the new economic regime are designed to convey a sense of credibility to the markets through the commitment to fiscal discipline. The Chapter argues that, in so doing, societal interests have been subordinated to the operation of the market and hindered the ability of Member States to achieve those normative societal values, such as social justice, human dignity and democratic participation, normally associated with the European project. The manner in which those provisions are drafted is sufficiently imprecise so as to render them essentially non-justiciable. The technocratic nature of budgetary assessment under the strengthened SGP is overly complex and offers limited democratic input at the national level. Chapter Four argues that there is no consensus concerning the causal relationship between fiscal consolidation and economic growth and, therefore, questions the nature of assessment on a technocratic basis. Indeed, it argues that the neoliberal principle of limiting the role of the state regarding public finances due to fears of intergenerational injustice is unfounded. The decision to run a deficit or surplus is a political and moral one and should not be reduced to a technocratic exercise due to its redistributive effects. Furthermore, the Chapter questions why, with the onset of the crisis, were budgetary provisions under the old SGP regime not applied? The answer seems to be that the interests of the market would have been adversely affected.

Chapter Five examines the role of the CJEU in the aftermath of the crisis. It argues that the judgements of the court, in its deference to the political decisions taken by the EU, weakens both democracy and the rule of law. The degree of interpretative latitude displayed by the Court facilitated the goals of financial stability and further economic integration discussed in the preceding chapter.

In *Pringle*[48] the Court prioritised the teleological over the literal approach in order to determine the legality of the ESM Treaty. Chapter Five argues that the Court's ruling is problematic to say the least. The use of the simplified revision procedure bypassed the participation of Member State representatives and parliaments which would have facilitated more detailed scrutiny of the measure. Similarly, the finding that the Mechanism does not increase the competences of the Union is difficult to sustain when it is clear that the Commission and ECB (and IMF) are performing roles under the Treaty that had not previously existed. Chapter Five asserts that the ESM was designed to circumvent EU law by

[48] *Pringle v. Government of Ireland* Case C-370/12

the use of international law. The Maastricht Treaty is committed to the no bail-out principle. The interpretation of it, albeit highly creatively, has the potential to undermine the integrity of the treaty-based system when allowing Member States to agree a Treaty to pursue objectives that would have been prevented under EU law.

The *Pringle* decision acted as a springboard for later decisions that would provide the justification for political decisions. In the *Gauweiler*[49]case, the Court upheld the right of the ECB to purchase bonds under the OMT programme on the basis that it would reduce volatility and enhance monetary policy transmission. Chapter Five argues that risk premia in the pricing of bonds reflects the opinion of the markets on Member States' fiscal restraint and interventions such as the ESM and OMT programmes distort that pricing. In addition, such programmes have the effect of minimising losses to bond holders. These decisions, based on objectives rather than effects, have increased institutional discretion with the extension of the political by judicial means.

Chapter Five notes that courts are prepared to apply legal rules less rigorously in times of crisis. In doing so, policymakers are able to adopt courses of action that ordinarily would be deemed unlawful. Judicial deference to the political can quite legitimately be attributed to the existential threats posed by the crisis. However, those political decisions were based on a particular and contestable understanding of the operation of the markets. As a result, a disproportionate allocation of losses occurred when alternative policies could have been followed. Judicial deference, in averting one danger, has created another. The weakening of the probity of the Court's reasoning has diminished institutional accountability across the EU.

The central aim of this thesis is to offer a critical analysis of the conceptual flaws that underpin the single currency. The financial and Eurozone crises represented the culmination of approximately forty years of neoliberal economic policies. The financialised economic environment facilitated an unprecedented flow of capital and unprecedented accumulation of private debt that would prove unsustainable. At the heart of that economic paradigm was the flawed understanding of the nature and operation of money and its interaction with markets and governments. This thesis demonstrates not only the manner in which the law

[49] *Gauweiler* EU:C:2015: 400 C-62/14.

facilitated that monetary conception but also the cycle of abuse associated with the production of currency and the financial instability it engenders. Ultimately, the legal responses to the crisis ensured and provided the justification for the discretionary allocation of losses that were borne by EU citizens in a manner that did not reform the values that form the basis for the current economic paradigm, but reinforced them.

Part I

The Legal Origins of the Modern Monetary Environment

Many of the features of the modern monetary environment can be traced back to the developments that occurred in Britain in the latter half of the seventeenth century. For the first time, following the establishment of the central bank, government paid investors with bank notes that would then circulate as a public mode of payment.[50] In a further development, the government licensed banks to multiply the money supply by lending to borrowers. As Desan, notes, "… in an unprecedented step, the government shared its monopoly over money creation."[51] The values and institutional relationships, established during this period are observable in the majority of western economies. To be sure, with the intensification of globalisation and financialisation, those characteristics have been amplified and strengthened and would go on to be inculcated in the single currency as Europe moved towards economic and monetary union. Chapters one and two examine the role of law in the development of those features.

Chapter One examines the evolution of monetary sovereignty. It argues that the monopoly over the production of currency tended to be abused and, as the locus of control over the money supply shifted, so did the ability to exploit that mechanism. Whereas the governmental ability to inflate the money supply was restricted in an attempt to depoliticise the production of currency, the development of commercial banking practices failed to restrict the increase in the money supply. The Chapter examines those historical legal interventions that facilitated that process that would ultimately lead to financial instability due to the accumulation of unsustainable levels of private debt. Whereas Chapter One considers monetary matters, Chapter Two considers the state's fiscal arrangements. The reconfiguration of Britain's public finances allowed for the undertaking of long-term debt secured on the basis of future revenues. The rise of liberal individualism realised the autonomy of the market and limited the ability of government to interfere with it. The chapter argues that those new institutional arrangements created a legal hierarchy that

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[50] C. Desan, *Making Money: Coin, Currency and the Coming of Capitalism* (Oxford University Press, Oxford, 2014), p. 2.
[51] Ibid.

prioritised the property rights of the investor/creditor class and subjugated the rights of ordinary taxpayers.

Chapter One

Monetary Sovereignty

The Instinct to Control and the Tendency to Abuse

Introduction

The emergence of monetary sovereignty[52] is inextricably linked with the development of the modern nation state and is, therefore, an extension of the exercise of national sovereignty. Within that constitutional framework, the modern political economy represents a complex interaction between economic, fiscal and monetary policies. In addition to the practical considerations associated with the management of public finances, this chapter demonstrates that that interaction contains a complex network of competing interests, the delineation of which has been defined ultimately through the historical operation of law.

From a national state perspective, the doctrine of monetary sovereignty has been founded on a functional account of money's economic purpose[53] and that economic purpose has been placed within the legal architecture of the state. More specifically, the essential ingredients, derived from a set of positive legal rules are: a) the right to issue currency in the form of banknotes and coins that are legal tender within its territory; b) the right to determine the value of that currency and change it,[54] and; c) the right to regulate the production and use of that currency.[55] In practical terms, the exercise of monetary sovereignty, allows for the setting of interest rates, the control of the supply of money, the setting of exchange rates and the control of financial regulation and supervision in order to maintain the integrity of the financial system.[56] Monetary sovereignty, therefore, is founded on the control of the creation and use of money within the legal and constitutional

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[52] C. Proctor, *Mann on the Legal Aspects of Money* (Oxford University Press, Oxford 2012), pp. 460-478. Monetary sovereignty is broadly defined as the power of the state to exercise exclusive control over its currency in terms of the authority to designate legal tender and the control of the issuance and retirement of that tender.

[53] Ibid, p. 10: According to Proctor, money is defined: a) as a medium of exchange; b) as a measure of value or as a standard for contractual obligations; c) as a store of value or wealth; and d) as unit of account.

[54]. F. Gianviti, "Current Legal Aspects of Monetary Sovereignty." General Counsel International Monetary Fund (IMF). Presented at the IMF Seminar on Current Developments in Monetary and Financial Law, Washington, D.C., May 24-June 4,2004. Available at: https://www.imf.org/external/np/leg/sem/2004/cdmfl/eng/gianvi.pdf (last accessed 15/04/20).

[55] Ibid, Gianviti.

[56] Kinley*, Money*, p. 25 et seq.

architecture of the state. In addition to those positive legal rules that establish territorial monetary authority, there is, in theory, a regulatory framework that is intended to act as a form of normative constraint on the creation of money that has the potential to affect the economic interests of the citizenry. Thus, intermediation by the state via the policies of the monetary authorities makes money a constitutional project.[57] It is argued that there is an institutional instinct to maintain control over matters concerning currency that forms the basis of monetary sovereignty. However, in the exercise of that authority, and as the locus of control has shifted, there is also a tendency to abuse the production of money. That has led to an inherent instability in the (private) financial system,[58] which, in the event of an economic shock, requires state intervention with the support of public finances: the socialisation of losses in this form places a disproportionate burden on those lower down in the economic order that they might not have otherwise suffered.

This chapter charts the role of law in the cycle of monetary control and abuse, demonstrating an historical pattern, cognisance of which means that the next financial crisis will not be a surprise but a continuation of that pattern. The chapter charts three eras of development, identifying the continuing and overlapping influence of each in the establishment of the contemporary monetary system.[59] The first era (1576-1605) is marked by the development of the doctrine of absolutist sovereignty during the early modern period in the late fifteenth century which established those norms that allowed for the sovereign determination of the form and value currency linked to its precious metal content. That link between the face value of currency and its precious metal content would ultimately be weakened, paving the way for the development of new forms of currency. The second era, starting in the late seventeenth century (1672-1945), is marked by the limits placed on the governmental ability to produce currency, the emergence of the role of the

[57] C. Desan, "Creation Stories: Myths About the Origins of Money," Harvard Public Law Working Paper No. 13-20 (2013), p. 1.

[58] H. Minsky, "The Financial-Instability Hypothesis: Capitalist Processes and the Behaviour of the Economy," Hyman P. Minsky Archive Paper 282. (1982), p.14. Minsky hypothesised that accumulation of non-government debt drives the economy towards crisis. Minsky's financial-instability hypothesis, developed in the 1960s, was derided by his colleagues. However, with the onset of the financial crisis in 2007/8, references to it became more common on financial websites and in financial and economic reports. See: John Cassidy, "The Minsky Moment: Subprime Mortgage Crisis and Possible Recession," The New Yorker, January 28, 2008. Available at: https://www.newyorker.com/magazine/2008/02/04/the-minsky-moment (last accessed 15/04/20).

[59] The adoption of an historical approach provides a means of analysis that not only identifies the origins of the features of the modern monetary system but also explains the enduring misconceptions that underpin its operation.

market and the theory which underpinned monetary policy decisions. The third era (1660-2008) is marked by the emergence of commercial banking practices, and the legally sanctioned mechanisms, that created the capacity to produce currency through the credit creation process, which would create the potential for financial instability.

1. The First Era: The Monarch and the Instinct to Control and Abuse

The money economy, as a constitutional project, allowed for the development of contract, in place of custom and barter, and in so doing promoted political freedom, mutual dependence and community interests.[60] The traditional view, therefore, is that in order to achieve those political, social and economic benefits, it was necessary for the exercise of monetary sovereignty to take place within the legal and constitutional structure of the state in order that the benefits of trade could be realised. To that end, economic and monetary policy is formulated through the choice of those legal rules and administrative structures that will maximise the value of that production.[61] The exercise of monetary policy[62] is sited at the intersection of a nation's legal, economic and political architecture. The locus of that authority was originally with the monarch. The noble instinct to maintain control over monetary affairs, in the pursuit of higher political goals, would have at times to give way to a degree of abuse of the monetary system that would have an economically deleterious effect on the broader community.

A: Absolutist Sovereignty

The origins of modern monetary sovereignty emerged in tandem with the development of the nation state, specifically during the early modern period (1450-1750).[63] Historically, the concept of monetary sovereignty developed to support the exercise of the royal prerogative to coin money by absolutist monarchs and thus the *locus* of both sovereignty and the power

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[60] Kinley, *Money*, p. 6-8. Kinley continued to identify the domestic significance of monetary policy with the cooperation of nations at the international level allowing for the transfer of capital which contributes to the reduction of industrial isolation that custom and national prejudice had fostered.

[61] R. Coase, "The Firm, the Market and the Law" (reprint of 1960 article) as quoted by J. H. Jackson in "Global Economics and International Economic Law," Journal of International Economic Law 1 (1998), pp. 1-23, p. 15

[62] The management of the money supply and interest rates in order to achieve macroeconomic objectives.

[63] It should be noted that the notion of monetary sovereignty had existed in earlier eras. For example, see R. Mundell, "Money and the Sovereignty of the State" Paper prepared for the International Economic Association Conference in Trento, September 4-7,1997: the Lydian Kings claimed a monopoly over the production of electrum coins, which was continued by the Persians at the end of the Lydian dynasty in 546 BC. Similarly, the Romans maintained a similar system of control of the production and valuation of coinage after 46 BC until the fall of Constantinople in 1204.

to exercise it were identical.[64] Therefore, a brief examination of sovereignty, of which monetary sovereignty is a characteristic, is required.

The doctrine of sovereignty had existed in Europe prior to the sixteenth century.[65] However it is Jean Bodin who, in *Les Six Livres de la République* (1576),[66] is considered to have been the first to offer a systematic expression of the concept of sovereignty in relation to the exercise of state power. [67] The doctrine of sovereignty allowed for the abstraction of a clarified general theory that ameliorated the complications associated with the established agencies of ruling in certain jurisdictions, that is, the establishment of a single and ultimate source of political authority within the state.[68] The development of an absolutist theory of sovereignty allowed for the centralisation of political power and that would ensure that its exercise on this basis could not be limited or divided.[69] The state, according to Bodin, should be primarily concerned with the maintenance of order under the sovereign.[70] In accordance with this conception, sovereignty consists of the identification of the highest unified power and is opposed to any notion of a subordinate decentralised power[71] distinguishing, within this hierarchy, the status of the ruler and the ruled.[72] The sovereign differs from those who

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[64] C. Zimmerman, *A Contemporary Concept of Monetary Sovereignty* (Oxford University Press, Oxford, 2013), (hereinafter referenced as Zimmerman, *Monetary Sovereignty*), p22. Of course, the doctrine of sovereignty has itself evolved since this period to a contemporary view of the state operating in the interests of the people either in the form of popular or parliamentary sovereignty. Nonetheless, the values established during the absolutist period with regard to the exercise of sovereign powers over money remain germane to its legal examination.

[65] See G. Mairet, 'Bodin Jean, 1530–1596 — *Les Six Livres de la République*,1576' in François Chatelet, Olivier Duhamel and Evelyne Pisier (eds), *Dictionnaire des Oeuvres Politiques* (1986), p. 99. as cited in S. Beaulac, "The Social Power of Bodin's 'Sovereignty' and International Law." Melborne Journal of International Law Vol.4 (2003), pp. 1-28, p. 18.

[66] Bodin's work was a reaction to the religious wars which beset France at that time, and in particular, the Saint Bartholomew's Day Massacre which he narrowly escaped. See: J.H. Franklin, *Jean Bodin and the Rise of Absolutist Theory* (Cambridge University Press, Cambridge, 1973), vii

[67] C. Merriam, *History of the Theory of Sovereignty since Rousseau (*Columbia University Studies in the Social Sciences, Columbia, 1900), p. 7.

[68] K. Hoekstra, "Early Modern Absolutism and Constitutionalism," Cardozo Law Review Vol.34(1) (2013), pp. 1079-1098, p. 1080.

[69] Ibid.

[70] R. Mundell, "Money and Sovereignty of the State." Paper prepared for the International Economic Association Conference in Trento, September 4-7, 1997. Whereas the formulation of sovereignty in pursuit of the maintenance of order might not be considered innovative by contemporary standards, it should be noted that there were competing theories at the time, such as those proposed by the Monarchomachs, which would undermine the order promoted by Bodin.

[71] S. Beaulac, "The Social Power of Bodin's "Sovereignty" and International Law," Melbourne Journal of International Law Vol.4 (2003), p. 1-28, p. 6.

[72] C. Merriam, *History of the Theory of Sovereignty since Rousseau* (Columbia University Studies in the Social Sciences, Columbia, 1900), p. 7.

may have absolute power for a limited time before reverting to the status of a private subject, as they are not sovereigns, but merely trustees. [73] The justification for the locus of authority in this form is found in the absolutist component of the doctrine. The definition of sovereignty in these terms links its perpetual nature with its absolute component in that the sovereign recognises that, after God, there is no authority greater than himself.[74] The exercise of sovereignty, therefore, is not entirely unqualified: the sovereign is subject to divine and natural laws and is under a duty of good faith to honour contracts as a guarantor from which the obligation of natural equity arises[75] based on and justified by a superior moral order which supersedes that which is temporal in nature. The sovereign, therefore, occupies the apex of the state hierarchy and is not subject to the commands of others and has the authority to give law to his subjects and to repeal or supress those laws deemed to be disadvantageous.[76] The result is a conception of political sovereignty driven by practical need to establish civil order and "the right to command and correlatively the right to be obeyed,"[77] in which a supreme source of legal authority is established within the territory, as a prescriptive norm under the rule of the sovereign.

B: Monarchical Control of Money.

The legal and theoretical framework for the operation of monetary sovereignty was developed in the wake of political and historical events which established a reality on which that framework was based, in other words, *ex post facto ius oritur*.[78] Thus, the power of the monarch was strengthened and centralised in terms of control over monetary matters.

Whereas early jurists and monetary theorists, such as Bodin, had identified the locus of monetary sovereignty[79] within the construction of a systematic framework of political

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[73] J. H. Franklin, *Jean Bodin on Sovereignty, Four Chapters from the Six Books of the commonwealth* (Cambridge University Press, Cambridge, 1992), p. 2.
[74] Ibid, p. 4.
[75] Ibid, p. 35.
[76] Ibid, p. 11.
[77] R. P. Wolf, *The Conflict Between Authority and Autonomy*. (Basil Blackwell, Oxford, 1990), p.20, as cited by Stanford Encyclopaedia of Philosophy available at: http://plato.stanford.edu/entries/sovereignty/ (last accessed 15/04/20)
[78] The law arises from fact, Zimmerman, *Monetary Sovereignty*, p. 9.
[79] It would seem that Bodin was in turn influenced by the work of Grimaudet, another proto-economist who had stated: "The value of money depends on the State; that is to say, in a monarchy, upon the prince, and in an oligarchy, upon the State, which alone has the right to coin money, or to.have it coined and to stamp a valuation upon it." F. Grimaudet, The Law of Payment (1560) as quoted in *The Fluctuations of Gold* Burt Franklin: Research and Source Works Series 722 (Lennox Hill Publishers, New York, 1900), p. 11.

sovereignty, they were also aware of the political uncertainty that can arise from monetary instability.[80] The recognition of the royal prerogative to coin money was regarded as being "...of the same nature with the law, and there is none but he which hath the power to make a law, which can appoint the value, weight, and stamp of the coin."[81] The conception of monetary sovereignty in this form allowed for the centralisation of the production, and the determination of the value of that currency, as a consequence of that prerogative, not only to maintain public faith in it, but also as a recognition of the continued authority of the sovereign. However, in recognition of that sovereign obligation under the principles of natural equity, Bodin also warned of the danger of the altering (the value of) the currency due to its role in the setting of prices and the consequence of possible contractual uncertainty.[82] Thus, the exercise of monetary sovereignty in this form constitutes a paradigm which traversed both the public and private spheres.[83] This represents the origin of what might be regarded a normative obligation on the part of the sovereign to maintain the integrity of the monetary system because the nature of that control has the potential to impact the economic inter-relationships on two levels: firstly, on the vertical, in terms of the individual to discharge their monetary obligations to the state in the form of tax and, secondly, on the horizontal plane as between individuals which allows for a consensus to arise as to the value of an item as a result of decentralized economic interactions among the citizenry.[84] This is reflected in the debates in the mid-sixteenth century, due to the economic instability created by the sovereign exercise of control, which became more focussed on the need for government to maintain a stable currency.[85] It is argued, that this represents the legal foundation that legitimated the exercise of centralised state power,

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[80] L. Desmedt, J. Blanc, "Counteracting Counterfeiting? Bodin, Mariana, and Locke on False Money as a Multidimensional Issue," History of Political Economy Vol. 42(2) (2010), pp. 323-360, p. 338.

[81] J. Bodiin, *The Six Bookes of the Commonweale* Translated by Richard Knolles (London, 1606) Book 1 Ch 10, p.175

[82] Ibid, p.687

[83] C. Desan, *Making Money, Coin, Currency and the Coming of Capitalism*, (Oxford University Press, Oxford, 2014), p.24. (Hereinafter referred to as Desan, *Making Money*).

[84] C. Desan, "Creation Stories: Myths about the Origins of Money." Harvard Law School, Public Law & Legal Theory Working Paper Series, Paper No. 13-20 (2013), pp. 1-3. This in contrast to the modern monetary narrative that asserts the neutrality of money in economic relations. As Desan notes, a study of the history reveals a different picture of money: it is not neutral, it does not arise out of "bipolar exchange." Money, like other forms of governance, can be structured in ways that are "democratic or dictatorial, stable or fragile."

[85] J. Parsons, "Money and Sovereignty in Early Modern France," Journal of the History of Ideas Vol 65(1) (2001), pp. 59-79, p. 62. In fact, French monetary theorists, whose thoughts would prove profoundly influential across the continent, laid the foundations for the mercantilist era and recognised the importance of money not only within the domestic context but also in terms of the multi-national system of trade.

under which rulers also claimed sovereignty over monetary matters, that allowed for the establishment of mechanisms which would control the production of money: whilst the locus of control at that time rested with the sovereign, it would go on to form the foundation of the modern monetary production system we witness today.

Theorists during this period, including Bodin, were cognisant of the importance of monetary policy in terms of its economic effects and therefore sought to define a consistent legal framework for the exercise of monetary sovereignty.[86] As a result, monetary sovereignty during this period consisted of the right to determine the unit of account,[87] the right to determine the legal tender proffered for the discharge of debt (see below)[88] and the right to control the production of money, or the right to determine the conditions for its production.[89] With the exercise of monetary sovereignty within these parameters, rulers were able to monopolize the certification of currency in a manner which suggested that the government were acting as a disinterested guarantor for the parties to a private transaction with regard to the weight, fineness and value of the money being exchanged.[90] The importance of that notion was later recognised by Emer de Vattel (1714-1767) who noted that the stamping of coin in the name of the state acted as a "... pledge of their value"[91] facilitating commerce and that the sovereign should, therefore, not underestimate its importance.[92] In order that confidence is maintained, money is coined in the name of the state or the prince, who are its surety.[93] This is of particular significance, it is suggested, in conceptual terms at least, as it recognises not only those positive legal components that determine the exercise of monetary sovereignty but also suggests a fiduciary commitment to maintain stability in terms of the preservation of purchasing power of the currency. However, the doctrine of monetary sovereignty had existed prior to the *de facto* legal framework described above, and therefore, sovereigns would continue to claim money as

[86] L. Desmedt, J. Blanc, "Counteracting Counterfeiting? Bodin, Mariana, and Locke on False Money as a Multidimensional Issue," History of Political Economy Vol. 42(2) (2010), pp. 323-360, p. 345.
[87] R. Mundell "Money and Sovereignty of the State." Paper prepared for the International Economic Association Conference in Trento, September 4-7, 1997, pp. 6-7
[88]Ibid.
[89] Ibid.
[90] B. Steil, M. Hinds, *Money, Markets and Sovereignty* (Yale University Press, Yale, 2009) (hereinafter Steil and Hinds *Money, Markets and Sovereignty*), p. 69.
[91] Emer de Vattel (1714 – 1767) *Droit Des Gens; Ou, Principes De La Loi Naturelle Appliqués A Ca conduit Et Aux Affaires Des Nations Et Des Souverains* (1758) Book 1 Ch 10, p. 105.
[92] Ibid.
[93] Ibid, p. 106.

their *ius* and *proprietas*[94] and would continue to exercise what was, in their view, their unfettered right to change the value of money.[95] In a commodity based monetary system, on which faith in it was based on the precious metal content of the coinage, the reduction of that content or the imprinting of a higher value on the coin, would enable the sovereign to profit. By engaging in such practices, rulers introduced to the world the concept of inflation.[96] The motivation for the alteration of currency was primarily one of profit, which in turn, was driven by the political imperatives of the time.[97] However, the employment of such practices were tantamount to an upwards transfer of wealth from those lower in the broader base of the political hierarchy as the debasement of currency, that is the reduction of its intrinsic value, would lead to price rises, and therefore negatively affect the purchasing power of the citizenry's money.

Whereas some of the reasons for the adulteration of coinage might be confined to the period in question,[98] others have a contemporary resonance: rulers were motivated to alter the value of currency in order to increase government spending, address deficits, deal with the disequilibrium in the balance of payments or address fluctuations in the rate of exchange.[99] Moreover, the attraction of debasement[100] was that it enabled the liquidation debts with a smaller sum of money, as allowed by the ruler's prerogative: the ability to create new currency at the same value, with a lower precious metal content, would allow

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[94] Right and property.
[95] C. Zimmerman, *Monetary Sovereignty*, p. 10.
[96] Steil and Hinds. *Money, Markets and Sovereignty*, p. 72 The rulers of the classical civilisations had been the first to experiment with currency debasement, that is, the reduction of the content of precious metals with the increased content of base metals or imprinting a higher value on the coin.
[97] A.Rolnick, F.Velde & W.Weber, "The Debasement Puzzle: An Essay on Medieval Monetary History," The Journal of Economic History Vol. 56 (1997), pp. 8-20. In addition, and closely related to debasement, seigniorage provided rulers with an important source of revenue which allowed the pursuit of political objectives. During this period, seigniorage operated as a tax under which the bullion submitted to the mint would be returned in the form of coinage containing less precious metal than was given. The amount retained was sent to the sovereign. This was in addition to the portion of precious metal retained to cover the costs of production, known as brassage. Thus, seigniorage represented the difference between the cost of production of coinage and its face value. The imposition of seigniorage was a great source of revenue for the monarchs, particularly as the volume of reminting increased following a debasement.
[98] C. Cipolla, "Currency Depreciation in Medieval Europe," The Economic History Review vol XV (1963), pp. 413-422, p. 415 et seq. Cipolla identifies, inter alia, the mismanagement of mints and the wear of existing coinage in circulation and clipping.
[99] Ibid.
[100] Prior to the establishment of modern banking practices, debasement was the standard form of inflation. See J. G. Hülsman, *The Ethics of Money Production*, (Auburn, Von Mises Institute, 2008), p. 89-91. For example, as Hülsman notes, in Britain from 1066-1601, the silver pound was debased on ten occasions by one third of its primitive value.

for the discharge of a greater amount of debt for the same amount of the commodity in question than would have been possible prior to the alterations.[101] Whereas inflation in this form might be viewed, from the perspective of the government, as a more efficient deployment of assets, in the form of precious metals, it would negatively affect the purchasing power of the money held by the populous, leading to price rises and economic instability.[102]

Inflationary practices, in the form of debasement, ultimately created a conflict between those monetary policies and the economic interests of the citizenry as debasement was considered a form of theft from a creditor.[103] With the sovereign control of currency, monetary manipulation allowed for the centralisation of production, a governmental monopoly that prioritised the pursuit of profits and political objectives overriding the everyday economic concerns of ordinary citizens.[104] The instinct to abuse the monetary base in pursuit of those objectives would inevitably be questioned from a normative perspective: whereas the sovereign lends legitimacy to the currency by way of its production, the currency itself is not the property of the sovereign, it is in fact the result of an exchange of labour for that currency which the citizen is free to dispose of as his right.[105] The adulteration of currency amounts to an expropriation of its intrinsic value.

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[101] J. Wheatley, *The Theory of Money and Principles of Commerce* (Bulmer and Co, London, 1807), p. 257.

[102] C. Elgin, K. Karaman and S. Pamuk, "The Determinants Of Debasements In Early Modern Europe" Bogaziçi University, Istanbul paper presented at the Conference "Accounting for the Great Divergence," The University of Warwick in Venice, May 22-24, 2014. See also: J.G.Hülsman, *The Ethics of Money Production* (Von Mises Institute Auburn, 2008), p. 89. The following two hundred years after the establishment of modern banking debasement of the pound occurred by a factor of 16.

[103] Steil, Hinds. *Money, Markets and Sovereignty*, p. 72. As Hostiensis (1190-1271) noted:

> "There is also fraud by those who hold lordship over a land and rule it, when they make a money of lesser weight and force it to be received at par with money of greater weight, or when they decry a good money and approve an equivalent money of lesser weight, so as to have the decried money at a good price, and then have it melted and coined at the same weight or even lighter weight, with the same imprint as the approved money."

As cited by T. Sargent, F. Velde *The Big Problem of Small Change* (Princeton University Press, Princeton, 2002), p. 92.

[104] L. Desmedt, J.Blanc, "Counteracting Counterfeiting? Bodin, Mariana, and Locke on False Money as a Multidimensional Issue," History of Political Economy Vol. 42(2) (2010), pp. 323-360, p. 342: The combination of debasements and seigniorage in France in the medieval and early modern period were to lead to periods of vast inflation and economic instability and prompted Bodin to question such practices by the sovereign. In so doing Bodin was one of the first to develop an early theory on the quantity of money in his work *Response to the Paradox of Malestroit* (1568).

[105] N. Oresme, *De Moneta of Nicholas Oresme* Translated by Charles Johnson (Thomas Nelson, London, 1956), p. 25.

C: The Legal Endorsement of the Monarchical Abuse of Currency.

Continued debasement of currency by sovereigns led to the weakening of the link between the intrinsic worth and the face value or extrinsic worth of the money. Under the metallistic regime which prevailed at the time, the object of a debt was a definite quantity of silver or gold. [106] The alteration or degradation committed by rulers meant that payments were frequently weighed where greater amounts were concerned.[107] Therefore, it was expected that a payment was made which reflected the intrinsic value of the amount owed.[108] However, the metallistic doctrine started to lose its influence as new monetary units in varying fractions and multiples began to be accepted by the community as they came to rely on the name of the coins.[109] The lack of certainty with regard to the intrinsic worth of the currency ultimately raised the question of whether it was possible to discharge a debt with a depreciated currency incurred before that depreciation occurred.[110] The British case of *Brett v. Gilbert*[111] would establish an important legal development within the doctrine of monetary sovereignty that was adopted in 1605. The court would go on to endorse the nominalistic principle which gave legal recognition to the right of the sovereign to determine the substance and value of the currency.[112]

The Privy Council held that it was the prerogative of the Crown to coin money as "it appertaineth to the King only to put a value upon coin, and make the price of quantity and

[106] A. Nussbaum, "Debts Under Inflation." University of Pennsylvania Law Review Vol.8, No.6 (1938), pp. 571-602, p. 605.
[107]Ibid. Nussbaum.
[108] Ibid.
[109] Ibid.
[110] Ibid.
[111] *Brett v. Gilbert* (1605), Davis 18.
[112]R. Natelson, "Paper Money and the Original Understanding of the Coinage Clause," Harvard Journal of Law and Public Policy Vol. 31(3) (2008), pp. 1017-1080, p. 1029 *et seq*. All References to the reporting of *Brett v. Gilbert* are those translated from *Anonymous, A Report of Cases and Matters in Law, Resolved and Adjudged in the King's Courts In Ireland, Collected and Digested by Sir John Davies*, 48 (1762), with those passages in latin having been translated by Natelson, Brett, the defendant, trading from Drogheda, purchased products from Gilbert who was trading from London for which he promised to pay £200, of which half was to be paid in Dublin "in sterling, current and lawful money of England." However, before the remittance of the first payment was due, the Crown, by Royal Proclamation, had issued a new coinage for Ireland which had consisted of an alloy of silver and base metal. This "mixt money" was to be used in place of the finer quality sterling silver coins. The creditor refused to accept the devalued currency in settlement of the debt. The issue at the heart of the case concerned the value of the currency offered in settlement and whether it was possible by way of Royal Prerogative to impose a nominal value on the currency thus allowing it to satisfy a debt, or whether the creditor was entitled to coinage of a certain quality.

to put a print to it; which being done the coin is current."[113] Furthermore, the Council held "... that as the King by his prerogative may make money of what matter and form he pleaseth, and establish the standard of it, so may he change his money in substance and impression, and enhance or debase the value of it, or entirely decry and annul it."[114] It was within the prerogative of the Crown to strike and regulate the value of coin as a matter of law thus claiming the right of seigniorage.[115] Resultingly, recoinages were acts of positive political assertion through which the regulation of monetary value would determine who would bear the costs of those reforms.[116] As such, the decision represents the confirmation of executive prerogative over money as an attribute of sovereignty within the monetary sphere. However, it is argued that whilst the legal endorsement of this principle reasserts and legitimates the sovereign instinct to control, it coexists simultaneously with an abusive instinct: the costs of such debasements were ultimately born by those lower down the economic and political hierarchy effectively through the imposition of an inflation tax.[117]

In addition, before arriving at its conclusion, the Court expanded on its reasoning, discussing the place of money within the constitutional order. The principles recognised by the Privy Council would reverberate across time and continue to have a lasting effect on the contemporary view of monetary sovereignty (in a manner that pre-empts the move towards fiat currencies).[118] The Court referred to Budelius' *De Monetis et Re Nummaria* (Cologne, 1590), whose work was founded on Aristotle's description of money: The value of money

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[113] Ibid, Davies, at 20-21, 80 Eng. Report, p. 509.
[114] Ibid.
[115]A. J. Rolnick, F. R. Velde, W. E. Weber, "The Debasement Puzzle: An Essay on Medieval Monetary History," Federal Reserve Bank of Minneapolis Quarterly Review Vol. 21(4) (1997), p. 8. Seigniorage is the profit accrued to the Crown as the result of difference between the declared face value of the coin and the sum of the minting and material costs.
[116] Desan, *Making Money*, p. 125.
[117] A. Sieroń, *Money, Inflation and Business Cycles: The Cantillon Effect and the Economy* (Routledge, New York, 2019), p. 104 *et seq*. There was an asymmetry of information between rulers who were aware that the nominal value of the coinage was greater than the amount of the precious metal content, and the citizens who did not have that knowledge. When the citizenry became aware of this inconsistency, they discounted them in relation to full-value coins which led to an increase in prices. This is known as the Cantillon effect (Named after Richard Cantillon, an Irish-French economist and author of *Essai sur la Nature du Commerce en Général*): Those who received the new money first, such as the public administration and the military, enjoy its full value. As the new money filtered down into the broader economy and as people became aware of the debasement, its purchasing power fell.
[118] J. A. Ritter, "The Transition from Barter to Fiat Money," The Economic Review Vol. 85(1) (1995), pp. 134-149, p. 135. Fiat currencies are those which are not backed by a tangible asset and are, therefore, not convertible.

was not naturally established "... but that it was determined by law or the conventional acceptance of society at large."[119] Moreover, Aristotle stated:

> "All goods must therefore be measured by some one thing ... Now this unit is in truth demand, which holds all things together (for it men did not need one another's goods at all, or did not need them equally, there would be either no exchange or not the same exchange); but money has become by convention a sort of representative of demand: and this is why it has the name "money" (νόμισμα)[120] – because it exists not by nature but by law and it is in our power to change it and make it useless."[121]

However, it is argued that the preceding sentence implies a degree of popular or societal oversight in monetary affairs; if the monetary authorities lack accountability, or whose machinations are not transparent, the potential for abuse, for either political purposes or for the entrenchment of economic interests, is heightened.

In examining the role of money, the court also considered the work of Dumoulin (1500-1566). Dumoulin distinguished coin from uncoined metal in that the form and substance of money is not a concern – it is the value that is assigned to it and its use within the terms of a contract that is based on that assigned value.[122] According to Dumoulin, the doctrine of nominalism provided for the exchange value and not the weight of the coinage being tendered.[123] This represents an important shift in the perception of money and it anticipated Adam Smith's comment that "what the borrower really wants, and what the lender really supplies him with, is not the money, but the money's work, or the goods which it can purchase."[124]

The reconfiguration of the conceptual framework of money in these terms contrasts with the prior view which had placed a greater degree of importance on the intrinsic worth of

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119 Desan, *Making Money*, p. 125.
120 From the Greek nómisma meaning the current use of a coin within a state as custom.
121 D. Fox, "The Case of Mixt Monies: Confirming Nominalism in the Common Law of Monetary Obligations," Legal Studies Research Paper, University of Cambridge, Paper No.11 (2010), p. 8. Aristotle, *Nichomachean Ethics,* trans. D. Ross (Oxford University Press, Oxford, 1988), V.5.1133$_a$7-1133$_a$11, cited later in the *Case* (1605) Davis 18, p. 25.
122 T. Sargent, F. Velde "The Big Problem of Small Change." (Princeton, Princeton University Press, 2002), p. 102.
123 Ibid.
124 [1776] book II, ch.4, p. 334.

coinage which would allow for the legitimation of debasements if the purchasing power of the coin remained the same.[125] Nonetheless, the doctrine of nominalism would ultimately lead to divorcing of the link between the intrinsic and extrinsic value of money. The decision in *Brett v. Gilbert* would never be displaced and it is argued that its logic combined with later jurisprudence (below) would create a legal tension which would be resolved with the creation of categories of money that identified its operation as a private matter and thus immune from public intervention as its creation would be delegated to autonomous authorities. More significantly, it would provide the legal justification for the issuance of fiat currencies. Indeed, the modern expression of nominalism is found in Knapp's *State Theory of Money* in which he describes money as "a creature of law"[126] as the State provides the means of enforcement of contractual debts and the form in which satisfaction of those debts takes place by defining legal tender. Thus, money is considered the creation of law arising from the legislative activity of the state, which in turn, allows it to determine the money supply in terms of inflation and its relationship with other currencies.[127]

The absolutist period provided the foundation for many of the features of the modern monetary system. The link between the intrinsic and nominal value of currency had been severely weakened as a result of judicial intervention. As an extension of state sovereignty, this allowed for the manipulation of the money supply in order to fulfil political, primarily military, objectives. However, it is argued that whereas the doctrine of nominalism, as the corollary of sovereign power over currency recognised the legal role of the state in monetary matters, it does not account for the development of different forms of stock recognised as state currency that make up the aggregate supply of money. Specifically, as will be seen below, the nominalist principle would go on to provide the foundation for the creation of money as a result of credit creation. More importantly, during the intervening period, the production of currency would be depoliticised, which would ultimately allow for

[125] T. Sargent, F. Velde, "The Big Problem of Small Change," (Princeton University Press, Princeton, 2002), p. 102 *et seq*. In the case of the change of the official value, it is not the coin itself that is of importance but the units of account it is worth. Therefore, repayment of the same number of coins, after an increase in the official value would be tantamount to an increase in what is owed. However, it should be noted that the concept of nominalism, as defined by Dumoulin, does not completely divorce the intrinsic and extrinsic values of coinage in that there must be a "just proportion between the official rate and the intrinsic content." Nonetheless, despite such a qualification, the doctrine of nominalism would ultimately lead to divorcing of the link between the intrinsic and extrinsic value of money.

[126] G. F. Knapp, *The State Theory of Money*, (McMillan, London, 1924), p. 1.

[127] Ibid, p. 142.

a shift in the locus of that control, whilst increasing the potential for abuse of the monetary system.

2. The Second Era: The Depoliticisation of the Control of Money.

Whereas the first era under discussion confirmed and strengthened sovereign control over the production of money, the second era is characterised by further legal developments that would shift the locus of control over that production. The legal conceptualisation of the role of the state in the denomination of the unit of account and its value provided a framework that allowed for monetary experimentation and the creation of new forms of currency, which in turn paved the way for the emerging practices within the commercial banking sector. As will be shown below, the weakening of the link between the intrinsic and face value of currency, combined with the depoliticisation of its production, would increase the money supply in the private banking sector. Thus, the nominalistic principle would continue to exert an influence. However, in the exercise of monetary sovereignty, money would continue to have a relationship with the commodities that underpinned it and would allow for the emergence of a monetary system in which the creation of currency would be delegated, together with the locus of control, to private economic actors, in a manner that would depoliticise its production.

A: The Shift in the Locus of Control of Currency Production.

Despite the recognition of the sovereign right to determine the unit of account and determine its value, a common problem, in monetary management from the early modern period to the nineteenth century, was the imbalance of values of different denominations of coins within the monetary system. This was due to the use of both silver and gold as commodity bases for the price setting of money (bimetallism). This occurred where the value of larger (gold) coins appreciated in value as compared with smaller (silver) denomination coins as the value of those smaller denominations fell to the extent that they were worth more as metal than coinage, which led to shortage of them.[128] The situation was exacerbated with the outbreak of war with France in 1689. As silver was worth more as bullion there was a trend of exporting it to the continent where it could fetch a higher price. In addition, it was necessary for the government to ship silver coinage to Flanders to pay English troops. The result was a domestic shortage of small denomination coinage which led to a rise in prices and counterfeiting.

The Privy Council commissioned a report, authored by Secretary to the Treasury, William Lowndes, to address the issue. Lowndes recommended the recalling of silver coins for reminting with a 25 per cent reduction of silver content whilst retaining its nominal value. Lowndes reasoning was that with a lower silver content the incentive to export coinage for melting down for bullion would be reduced.[129] However, Lord Somers, the Lord Keeper of the Great Seal and a trusted advisor to the King, was unsatisfied with these recommendations. Consequently, he sought alternative opinions from others, most notably from John Locke.[130] Locke was fundamentally opposed to Lowndes' findings. Locke argued that coinage had an intrinsic, natural value that legislators were unable to determine by the enactment of positive laws as man held gold and silver in particular esteem which was reflected in the value determined by the market that created a standard against which the value of other goods is measured.[131]

Locke's view prevailed and, under the Recoinage Act 1696, silver coins were recalled for reminting. The recall included those silver coins that had been clipped and which, therefore, had a reduced silver content. They were reminted according to that intrinsic value at the old standard. The practical effect was that silver currency's face value was reduced to £2.5 million from £4.7 million based on its silver content.[132] However, the results were quite catastrophic: with the higher silver content, the reminted coins were quickly melted down

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[128] Steil, Hinds. *Money, Markets and Sovereignty*, p. 79-80.

[129] W. Lowndes, "A Report containing an Essay for the Amendment of the Silver Coins," (London, 1695), repr. in J. R. McCulloch (ed.) *A Select Collection of Scarce and Valuable Tracts on Money* (London, I856), p. 206. Available at: https://oll.libertyfund.org/titles/mcculloch-a-select-collection-of-scarce-and-valuable-tracts-on-money (last accessed 15/04/20).

[130] Locke, previously the Secretary to the Board of Trade, remained a member and served as its most influential member until 1700. See Stanford Encyclopedia of Philosophy: John Locke. Available at: https://plato.stanford.edu/entries/locke/#LockLifeUpHisMeetLordAshl1666 (last accessed 15/04/20).

[131] J. Locke, "Some Considerations of the Consequences of the Lowering of Interest and Raising the Value of Money," (London, 1691), p. 32.

[132] A. Feavearyear, *The Pound Sterling. A History of English Money*, (Oxford University Press, Oxford, 1963), p. 136.

and sent abroad as bullion, leading to a shortage of currency for everyday transactions, and ultimately leading to a devaluation that benefitted landlords and creditors but caused a disproportionate hardship for debtors and tenants whose obligations increased.[133]

The purpose of the preceding explanation is to provide a factual background that sought to justify the shift in the locus of control over monetary policy. The increasing influence of liberal thinking, specifically, the influence of John Locke's writings, affected governmental policy in monetary matters. Depreciations had continued to take place and this weakened the claims of creditors which Locke equated to a "publick failure of justice" which arbitrarily "gave one man's right and possession to another…"[134] This was in conflict with liberal thought which had anticipated the discovery of the right to property ownership through the capitalist labour theory of value resulting from the combination of labour with the materials of labour.[135] As an extension to this principle, money was to be viewed as a commodity, as a non-perishable, durable good, that could be used by mutual consent and would allow it to operate as a store of value.[136] Therefore, according to this account of the status and function of money as a commodity and therefore a designated measure of value, it is able to operate as a medium of exchange in economic transactions allowing members of a community to agree on what is acceptable tender in the settlement of debts.[137] The significance of this belief is that in recognising the economic interactions of individuals, and the consent that actors placed on the commodity in question, Locke suggested that money arose from the state of nature[138] and that, therefore, existed before government, which is a justification in seeking to limit the power of government.[139] The effect of this reasoning would be ultimately to place the treatment of money as a matter which Parliament would

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[133] Ibid, Feavearyear.
[134] J. Locke, "Further considerations concerning the raising the value of money" as cited by Desan*, Making Money*, p. 372.
[135] J. O'Brien, "John Locke, Desire, And the Epistemology of Money," British Journal for the History of Philosophy Vol. 15(4) (2007), pp. 685-708, p.690. Locke states that man "...has a property in his own person; this is something that nobody else has any right to. The Labour of his body and the work of his hands, we may say, are strictly his. So when he takes something from the state that nature has provided and left it in, he mixes his labour with it, thus joining it to something that is his own; and in that way he makes it his property." J. Locke, *Second Treatise of Government* (1690), Chapter 5 on Property, para. 27. Available at: http://www.earlymoderntexts.com/pdfs/locke1689a.pdf (last accessed 15/04/20).
[136] J. Locke, *Second Treatise of Government* (1690), Chapter 5 on Property, para. 46 – 47.
[137] J. Tobin, "Money," in The New Palgrave Dictionary of Economics, ed. S. N. Durlauf and L. E. Blume (London, Palgrave Macmillan, 2008) p.3 et seq.
[138] John Locke, *Second Treatise on Civil Government*, Chapter 5, para. 27, paras. 46-47. Available at: http://www.earlymoderntexts.com/assets/pdfs/locke1689a.pdf (last accessed 15/04/20).
[139] J. O. Appleby, *The Relentless Revolution: A History of Capitalism* (W.W. Norton & Co., London, 2010), p. 122.

consider to be beyond its political control, and in so doing, elevate the interests of the merchant class as the agents of economic development through the operation of markets.[140]

The delegation of control of monetary matters to the market in this form was based on a faith in its ability to find its own equilibrium, as a force of nature, and that legislators' attempts to influence would prove futile. The Recoinage Act 1696 established this as a key principle, siting the control over money in the markets whilst abusing the interests of those lower down in the economic hierarchy.[141] More significantly it would prove aspirational in the reiteration of those principles and a faith in the efficiency of markets that would form the basis of monetarism/neoliberalism that would be replicated on a global scale.

B: The Gold Standard and the Potential for Abuse.

The response to this instability was a change of policy using a single commodity anchor, such as gold or bills which could be redeemed in gold and the supply of smaller denominations which were convertible at a fixed rate.[142] This was known as the Standard Formula. Ultimately, as a result, the Coinage Act of 1816 was passed which legalised the Single Standard which was to be based only on gold[143] and in so doing, entrenched Locke's ideas. Other nations were to adopt the gold standard (for example, Germany in 1871 and the United States in 1873) By the end of the century, Britain, France, Germany and the United States were all adopting an approximation of the standard formula under the gold standard.[144] Thus, a symmetry existed in the adoption of the monetary regime associated with the gold standard.[145] It was an example of coordination at the transnational level through the adoption of a standard at the level of national law in the regulation of national currencies.[146] It represented the recognition of a common set of principles in relation to the

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[140] Desan, *Making Money*, p. 370.

[141] Ibid. As Desan states: "…Parliament's determination to treat money as a matter outside of political control was far from transient."

[142] For example, four quarters for a gold dollar.

[143] B. Steil, M. Hinds. *Money, Markets and Sovereignty*. (Yale University Press, Yale, 2009), p. 81.

[144] Ibid.

[145] E. Baltensperger, T. Cottier, "The Role of International Law in Monetary Affairs,*" International Law in Financial Regulation and Monetary Affairs* Eds. T. Cottier, J. Jackson, R. Lastra (Oxford University Press, Oxford, 2012), p. 366.

[146] Ibid Baltensperger, Cotter.

governance of monetary and economic policies and similarly, the end of the gold standard represented the end of the international consensus.[147]

Under the gold standard, the currency of a country was convertible into gold which in turn meant that the currency had a fixed exchange rate with the currency of other countries which were also fixed by reference to convertibility at the same standard.[148]
The main advantage associated with the Gold Standard was that it prevented countries issuing uncontrolled paper currency because its production was limited by the physical reserves of gold held by that country.[149] Thus, under the gold standard countries had limited controls on the exercise of monetary policy as the supply of money was affected by the flow of gold between countries.[150] As Ely notes, "With all of its shortcomings, the gold standard has the great advantage that its variations, largely the result of the play of the forces of the market, are beyond the arbitrary control of the government."[151]

However, following the onset of the Great Depression, the fixed exchange rates under the Gold Standard had the effect of transmitting economic shocks between countries and the commitment to that policy prevented countries from pursuing stimulus policies through monetary expansion.[152] With the absence of the availability of the appropriate policy responses governments were only able to oversee an internal devaluation adversely affecting the interests of workers which had the effect of contracting economies further. Therein lies the paradox of the depoliticization of monetary policy and the production of currency: governments, in an attempt to prevent the short-term political incentive associated with expansionary monetary policies, had in effect, surrendered to the voluntary imposition of a lack of capacity to respond to economic shocks. The subsequent impact was disproportionately burdensome on the ordinary citizenry (in a manner reminiscent of the effects of the Recoinage Act 1696) and, in those terms, a repetition of the abusive nature of monetary policy.

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[147] Ibid, Baltensperger, Cotter.
[148] J. J. Chung, "Money as Simulacrum: The Legal Nature and Reality of Money." Hastings Bus. Law Journal, Vol.5 (2009), pp. 109-170, p. 118-119.
[149] Ibid.
[150] Ibid.
[151] R. T. Ely, et al., *Outlines of Economics* (Macmillan, New York, 1893) p. 259.
[152] M. D. Bordo, E, U. Choudhri, A. J. Schwartz "Was Expansionary Monetary Policy Feasible During the Great Contraction? An Examination of the Gold Standard Constraint," NBER Working Paper No. 7125 (1999), p. 4.

Towards the end of World War Two, the Bretton Woods Agreement was concluded in New Hampshire in July 1944. It was intended to avoid the exchange-rate instability experienced during the 1920s.[153] It aimed to prevent the recurrence of policies associated with the failure of the Gold Standard in its revised form during the inter-war period. Specifically, its architects were acutely aware of the problems caused by competitive currency devaluations and trade restrictions designed to increase trade surpluses[154] and sought to avoid them.[155] The Bretton Woods system intended to create a post-war institutional structure which would aid domestic stability without triggering mutually destructive polices.[156] However, the collapse of the Bretton Woods Agreement in 1971, following a series of speculative attacks on the dollar,[157] and a desire by President Nixon to fulfil public spending commitments represented a shift to fiat currencies not backed by a tangible asset.

This in turn, allowed for an inflation of the money supply in many western economies, facilitated by the institutional practices of the central banks and the concept of fractional reserve banking through the modern operation of credit creation, which would ultimately

[153] S. Hall, G. Hondroyiannis, P. Swamy and G. Tavlas, "Bretton-Woods Systems, Old and New, and the Rotation of Exchange-Rate Regimes." The Manchester School Vol. 79(2), pp. 293-317, p. 297.
[154] Ibid. See also A. Giovannini, "Bretton Woods and Its Precursors: Rules versus Discretion in the History of International Monetary Regimes." in *A Retrospective on the Bretton Woods System: Lessons for International Monetary Reform* M. Bordo and B. Eichengreen, (eds.) (University of Chicago Press, Chicago, 1993), p. 105-106.
[155] J. Ruggie, "International Regimes, Transaction, and Change: Embedded Liberalism in the Postwar Economic Order," Vol. 36 No. 2 International Regimes (1982), pp. 379-415, p. 387. Ruggie notes that the U.S. representative at the Bretton Woods conference, Harry Dexter White, had wrestled with the issue of buffering the national economy from external disturbances whilst maintaining international relations. He stated: "The path, I suspect, may lie in the direction of centralized control over foreign relations and trade." His British counterpart, John Maynard Keynes, had reached the conclusion that "to suppose there exists some smoothly functioning automatic mechanism of adjustment which preserves equilibrium of only we trust to the methods of *laissez-faire* is a doctrinaire delusion which disregards the lessons of historical experience without having behind it the support of sound theory."
[156] Ibid, Ruggie, p. 393. Keynes had also proposed an International Clearing Union, a bank that would issue its own currency which would be the unit of account between nations. Each country would have an overdraft facility with its bancor account amounting to half the average value of its trade over a five-year period. Countries with a trade deficit would be charged interest and be obliged to reduce the value of its currency. However, countries with a trade surplus more than half the size of its overdraft facility would also be charged interest and obliged to increase the value of its currency. Any excesses beyond the value of its permitted overdraft would be confiscated. See: L. J. Ussher, A. Haas, K. Töpfer, C. C. Jaeger, "Keynes and the International Monetary System: Time for a Tabular Standard?" Vol. 25(1) European Journal of the History of Economic Thought (2017), pp. 1-35
[157] P. M. Garber, "The Collapse of the Bretton Woods Fixed Exchange Rate System" in *A Retrospective on the Bretton Woods System: Lessons for International Monetary Reform*, M.D. Bordo, B. Eichengreen (eds.) (University of Chicago Press, Chicago, 1993), p. 463 *et seq*.

finance asset bubbles that have been a common economic and financial feature in recent times.[158]

The evolution of the monetary order under the Gold Standard, whilst public in practice, was primarily concerned with commercial rather than civic purposes.[159] The structure of the Gold Standard established a norm that money should be considered a commodity beyond the reach of the state, consecrating the claims of creditors and legitimating new forms of credit instruments.[160] Ironically, the system championed by Locke would not be maintained.[161] With the abandonment of the bimetallic standard, new forms of currency filled the monetary gap.[162] Bank notes, currencies from country banks and other forms of credit acted as supplements for the asset (gold) held on reserve.[163] Ultimately, monetary reform in Britain allowed for the development of commercial banking practices that legitimated the private sale of currency to individuals and led to a real increase in the money supply.[164]

3. The Third Era: Commercial Banking and the Instinct to Control and the Tendency to Abuse.

The third era (1660-2008) is characterised by the development of commercial banking. The reforms discussed above created a monetary environment in which the production of the majority of money would be delegated to private financial institutions. The influence of liberal thought led to the development of the market economy in which the role of government would be limited thus respecting the individual sovereignty of (rational) economic actors. That narrative was reinforced by the operation of law in the sphere of monetary policy with intervention limited to the maintenance of financial and price stability allowing for economic interactions within markets to operate independently of the state.

158 A. Turner, "Lessons from the Crisis and from Classic Economic Texts" Speech at South African Reserve Bank, 2/22/12, available at: http://www.fsa.gov.uk/static/pubs/speeches/1102-at.pdf/ {last accessed 15/04/20).
159 C. Desan, *Making Money*, p. 414.
160 Ibid, p. 16.
161 Ibid, p. 17.
162 Ibid.
163 Ibid.
164 Ibid, p. 361.

The justification for that policy is that it prevented government from manipulating monetary policy in order to achieve short-term political gains through the inflation of the money supply. However, through a series of legal interventions, the reality was that money creation within the commercial banking sector amounted to the delegation of monetary sovereignty, and therefore control, allowing government to benefit indirectly from the inflation of the money supply which gave the illusion of economic well-being among the citizenry.

A: Common Law and the Instinct to Control Money

The development of commercial banking practices, facilitated by common law jurisprudence, allowed for the inflation of the money supply through the credit creation process. This contrasts with the orthodox view,[165] based on the preceding historical sections, that through the operation of markets, banks were merely financial intermediaries that allocate capital from depositors to borrowers, and in so doing, maintained a level of monetary equilibrium and, therefore, maintained the relative purchasing power of the currency. Thus, according to this view, such practices were not considered inflationary and therefore did not require government intervention.[166] However, these principles have tended to lead to the inflation of certain asset prices, creating bubbles which, when they collapse, have tended to allocate losses to those lower in the economic hierarchy.

In Britain, following the Country Bankers Act 1862, the Bank of England's monopoly was weakened in relation to the issuance of currency and the number of currency-issuing institutions grew.[167] Subsequently, the institutional arrangements that emerged represented a meeting of the public and private spheres with the creation of "outside money"[168] by government in the form of notes, coins and other reserves[169] designed to

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[165] "Money Creation in the Modern Economy," Bank of England Quarterly Bulletin Q1 (2014), p. 2.

[166] Ibid': "Rather than banks receiving deposits when households save and then lending them out, bank lending creates deposits."

[167] It is not intended to explore the wide variety of banks for the purposes of this chapter: For a detailed examination of these institutions see: M. Collins, *Money and Banking in the UK: A History* (Croom-Helm, London, 1988); J. D. Turner, *Banking in Crisis: The Rise and Fall of British Banking Stability, 1800 to the Present* (Cambridge University Press, Cambridge, 2014).

[168] L. White, "Competitive Money, Inside and Out." Cato Institute Vol. 3(1) (1983), pp. 281-304, p. 282.

[169] Bank Charter Act 1844 (7 & 8 Vict. c. 32) s. 10. The Bank of England became the sole issuer of currency in the United Kingdom.

stabilise the issue of "inside" money by private institutions on the basis of fractional reserve banking on loan deposit accounts.[170] The development of fractional reserve banking originated with the practices of the goldsmith bankers. By the time of the Restoration, in 1660, the goldsmiths in London had emerged as bankers, storing commodity money as deposits on behalf of customers and issuing receipts in the form of notes, orders and bills. These instruments were known collectively as demandable debt. The advantage of this practice was that it avoided the costs of protecting and moving specie, as the receipts became a representation of the money on deposit and acted as a form of currency in their own right.[171] Furthermore, the goldsmith-bankers were the first to lend the funds deposited in the form of transferrable paper instruments in excess of the amounts deposited based on the rationale that few depositors would redeem those instruments in the form of specie.[172] Thus, the specie held on deposit represented a fraction of total claims that could be made on them. The issue of such instruments in excess of the amount held on deposit forms the foundation of modern money creation through the process of credit extension.[173] In entering contracts on this basis individual borrowers were converting the resource of future productivity, namely the repayment of the principle with the addition of interest, in return for a currency that could be used in the present.[174]

For this practice to be justified in legal terms, the status of deposits was crucial for the development of fractional reserve banking. In short, depositors transferred an authority to re-invest deposits at the bankers' discretion. The legal ownership of the loaned property was transferred.[175] This practice originated with the goldsmiths entering into deposit contracts (*depositum confessatum*), which was essentially a loan disguised in order to avoid

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[170] Ibid White, "Competitive Money, Inside and Out." Cato Institute, 3 (1983). Money created in this fashion is known as "inside money."

[171] S. Quinn, "Goldsmith-Banking: Mutual Acceptance and Interbanker Clearing in Restoration London," Explorations in Economic History Vol. 34(4) (1997), pp. 411-432, p. 416.

[172] D. K. Clark, "A Restoration Goldsmith-Banking House: The Vine on Lombard Street". In C. Seymour (Ed.), *Essays in Modern English History: in Honour of Wilbur Cortez Abbott* (Harvard University Press, Harvard, 1941), p. 4.

[173] R. A. Werner, "Can Banks Individually Create Money out of Nothing? – The Theories and the Empirical Evidence," International Review of Financial Analysis Vol. 36 (2014), pp. 1-9, p. 1.

[174] Desan, *Making Money*, p.398. Desan suggests that the permissive attitude towards the bankers grew from the insecurity before and during the Civil War where the practice of leaving funds on deposit became established (p.392).

[175] J. Kim, "How Modern Bank Originated: The London Goldsmith-Bankers' Institutionalization of Trust," Business History Vol. 53(6) (2011), pp. 939-959, p. 943.

the ban on usury and under the Roman legal rules on deposits.[176] As the banking industry evolved such practices were veiled in secrecy and not fully understood until the 19th century when closer legal and economic analysis was undertaken.[177] The ability to create money in this fashion has been legally justified in the development of common law.

The principle had been long recognised by the courts: in *Bretton v. Barnet*[178] the deposit-taking of money was viewed as a loan transaction. The justification for this principle was based on the distinction between goods and money with the court stating "...for if a horse be delivered to be redelivered, there the property is not altered, and therefore detinue lies, for they are goods known: but if money be delivered, it cannot be known, and therefore the property is altered, and therefore a debt will lie."[179] The rationale for this statement lies in the fungible nature of money which, when deposited with a bank, becomes part of the total funds held by that institution. As money is mutually interchangeable, the only obligation on the part of the bank is to provide the sum requested.

More specifically, in the later case of *Foley v. Hill*,[180] the court stated that:

> "The money paid into the banker's, is money known by the principal to be placed there for the purpose of being under the control of the banker; it is then the banker's money; he is known to deal with it as his own; he makes what profit of it he can, which profit he retains to himself, paying back only the principal, according to the custom of bankers ... The money placed in the custody of a banker is, to all intents and purposes, the money of the banker, to do with it as he pleases; he is guilty of no breach of trust in employing it; he is not answerable to the principal if he puts it into jeopardy, if he engages in a hazardous speculation; he is not bound to keep it or deal with it as the property of his principal..."[181]

In short, the money deposited with the bank becomes the property of it and can be employed in accordance with normal banking practices, such as lending to borrowers. The

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[176] J. Huerta De Soto, *Money, Bank Credit and Economic Cycles* (Ludwig Von Mises Institute, Auburn Alabama, 2012) p. 64-71.
[177] J. Schumpeter, *History of Economic Analysis* (Routledge, London, 1954), p. 1080.
[178] Ow. 86. Mich. 41 & 42 Eliz. (1598).
[179] Ibid.
[180] *Foley v. Hill* (1848) 2 HLC 28, 9 ER 1002, para. 37.
[181] Ibid.

importance of this statement is that it represents an *ex post facto* justification for the practice based on the equating of an irregular deposit contract with the loan contract. [182] The Irregular Deposit Contract (deposit of fungible goods) places an obligation of safekeeping on the depositary and differs from a regular deposit contract in that the goods deposited become indiscernibly mixed with others of the same type and quality.[183] Thus, ownership is transferred to the depositary and in terms of settling the account the depositor is entitled to receive the exact equivalent (in terms of quantity and quality) of what was originally transferred[184] due to the fungible nature of the goods.

A *mutuum*[185] contract is an agreement for a loan for consumption. As a result, it allows the borrowing of certain fungible goods and the borrower is obliged, at the end of a specified term to return an equal quantity and quality of goods (*tantundem*). This is typical of money loan contracts.[186] Critics argue that the key distinction between the deposit contract and the loan contract is concerned with the availability of the goods loaned. An irregular deposit account should be based on the continuous availability of a *tantundem* which in turn implies an obligation of a 100 percent cash reserve. [187] This is distinguished from a money loan contract where the transfer of possession (ownership) is defined by a term and the transfer of availability to the borrower.[188] Huerta de Soto is dismissive of the argument of availability of repayment of money on deposit concluding that fractional reserve banking would not be able to survive without a central bank with the ability of providing liquidity. The exchange of compliance with governmental legislative structure in return for the backing of a central bank is artificial and creates a paradox: the violation of property rights in return for guaranteed deposits.[189]

The assertion that the legal justification of fractional reserve banking constitutes a fiction and, consequently, amounts to an infringement of the depositor's property rights is controversial. Nussbaum stated that with regard to the relationship between banker and

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[182] J. Huerta de Soto, *Money, Bank Credit, and Economic Cycles*. (Ludwig von Mises Institute, Auburn Alabama, 2012), p. 117.
[183] Ibid, p.5.
[184] Ibid.
[185] A mutuum contract is one for loan or consumption.
[186] Ibid, p. 3.
[187] Ibid, p. 9.
[188] Ibid, p. 19.
[189] Ibid, p. 152

depositor: “No trust proper or bailment is involved. The contrary view would lay an unbearable burden upon banking business.”[190] Rozeff also attacks the Rothbard’s view citing Macleod’s *Theory and Practice of Banking* (1866) as authority.[191] Rozeff, in asserting individual economic sovereignty, relies on freedom of contract, suggesting that depositors have the choice of fiduciary media in which to place their confidence.[192] Under fractional reserve banking, depositors make deposits knowing that the bank intends to make use of that money and that, therefore, they know they may lose some of their deposits.[193] They are free to minimize these risks by the purchase of insurance or other “risk-shifting” mechanisms.[194] This, of course, implies that the level of market awareness and information supply mechanisms are sufficient to enable an informed choice, an aspect that was not replicated by the financial industry itself in its attempts to reduce risks. The ethical arguments against fractional reserve banking are perhaps more persuasive. It has been argued that money creation under the fractional reserve system seizes “the output of the economy from the genuine producers” and, that therefore, government should have the monopoly over its production.[195] However, if that were the case, there would be nothing to prevent government from creating money for its own benefit and that of favoured citizens.[196] Therefore, the link with a commodity such as gold means that no one can create money from nothing in order to acquire resources from producers. Money is gained on the market by producing goods and services and therein lies its value if linked to a commodity as it places restrictions on the quantity of money and therefore maintains its value.[197] However there is no political will to impose a restriction on the production of money in such terms.

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[190] A. Nussbaum, *Money in the Law, National and International* (Foundation Press, Brooklyn, N.Y., 1950), p. 105.
[191] M. Rozeff, “Rothbard on Fractional Reserve Banking. A Critique.” The Independent Review Vol. 14(4), (2010), pp. 497-512, p. 499.
[192] Ibid.
[193] Ibid, p. 500.
[194] Ibid, p. 501.
[195] M. Rothbard, “The Case for a 100 Percent Gold Dollar,” in *In Search of a Monetary Constitution* L. Yeager (ed.) (Harvard University Press, Harvard, 1962), pp. 94-136. This is because paper money has no intrinsic value and new units of account can be created at minimal additional cost.
[196] Ibid, Rothbard.
[197] Ibid.

B: Commercial Banking and the Tendency to Abuse.

The increase in the production of inside money[198] forms the basis of competitive money production and constitutes the majority of aggregate currency. Deposit creation in this form accounts for 94% of the bank-based supply of money (as opposed to the monetary base of 6%).[199] The rise of competitive currency in this form amounts to the privatisation of money production, and the delegation of control over its production, and it has been suggested that it is undemocratic in nature in that commercial banks decide on lending depending on the profitability of those lending opportunities.[200] Of course, this is not novel. The goldsmiths issued private currency in the form of receipts in the process of gold warehousing. However, this has led to instability in the monetary system. The pro-cyclical nature of fractional reserve banking has been criticised for that instability[201] with the increase of money during the "fair weather" and its subsequent contraction during the "foul weather" and that, therefore, there is a role for government in defining and regulating the value of a monetary unit.[202] This is in contrast with the orthodox view that the creation of money through this process is self-limiting. The common law justification for the creation of currency through fractional reserve banking provided the foundations on which the modern commercial banking system is based. The notion that money creation through this process is limited to a multiple of that proportion held in the form of deposits is also a fiction. To quote the Bank of England Quarterly Bulletin:

> "For the theory to hold, the amount of reserves must be a binding constraint on lending, and the central bank must directly determine the amount of reserves. While the money multiplier theory can be a useful way of introducing money

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[198] Inside money consists of the creation of money in the private sector in the form of deposits for loan accounts. This is opposed to the creation of "outside money" created by government in the form of notes, coins and other reserves which is designed to stabilize the market created by inside money. See L. White, "Competitive Money, Inside and Out." Cato Institute Vol. 3(1) (1983), pp.281-301.

[199] C. Desan, "Money as a Legal Institution" in D. Fox and W. Ernst, *Money in the Western Legal Tradition* (Oxford University Press, Oxford, 2016), p.34.

[200] "Money Creation in the Modern Economy," Bank of England Quarterly Bulletin Q1 (2014), p. 3.

[201] H. Simons, "Rules versus authorities in monetary policy," Journal of Political Economy Vol. 44(1) (1936), pp. 1-30, p.14.

[202] H. Brennan, J. M. Buchanan, "Monopoly in Money and Inflation," Hobart Paper #88 Institute for Economic Affairs (1988), p. 7.

> and banking in economic textbooks, it is not an accurate description of how money is created in reality."[203]

The right to issue currency within the territory is a sovereign right. In the exercise of that right, the sovereign may determine its name, face value and other features. However, it goes beyond the supply of coins and banknotes as a territorial representation of sovereign state. It has been suggested that the central bank, with the delegated power to extend credit to operators within the territory, namely commercial banks, which will in turn use that facility to finance their own operations, through the extension of credit to the public, operates to control the money supply.[204] However, the notion that the central bank controls the quantity of loans and deposits through the control of central bank money is a misconception.[205] The reality is that banks do not need to hold central bank reserves in order to make a loan to a borrower.[206] Banks make the loan and then borrow reserves, either on the interbank market or from the central bank.[207] The targeting of short-term interbank interest rates by the central bank, therefore, takes place ex post thereby validating the inside money creation.[208] As a result, the regulatory structure built around commercial banking, since Basel I,[209] was also built on this misconception. The reality is that neither capital and reserve requirements, or a central bank limit on the amount of reserves available to commercial banks act as a restraint on lending.[210] The approach adopted by the Basel Committee on Banking Supervision has not succeeded in preventing financial crises as financial intermediation theory does not provide an accurate description of reality.[211] It is argued, therefore, that financial institutions succumb to the tendency to abuse the

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[203] "Money Creation in the Modern Economy," Bank of England Quarterly Bulletin Q1 (2014), p. 3.
[204] Ibid.
[205] Ibid, p. 4.
[206] B. Braun, "Speaking to the People? Money, Trust and Central Bank Legitimacy in the Age of Quantitative Easing," MPIFG Discussion Paper No. 16 (2012), p. 12.
[207] Ibid.
[208] Ibid.
[209] Basel I (1988) was issued by the Basel Committee on Banking Supervision setting minimum capital requirements for banks.
[210] R. A. Werner, "Can Banks Individually Create Money out of Nothing? – The Theories and the Empirical Evidence," International Review of Financial Analysis 36 (2014), pp 1-19, p. 2.
[211] Ibid, Werner.

mechanisms of money creation driven primarily by the overriding objective of increasing shareholder value.[212]

C: Money, Government and the Voluntary Limit on its Capacity to Act

The development of the apparent limits placed on the exercise of governmental power in monetary matters are justified on the purported protection of property rights with the view that money is a private matter antecedent to government based on the economic interactions of individuals in the market, reflecting the functional account of money within the legal architecture of the state. Therefore, a country's monetary arrangements can either promote or undermine that protection.[213] As a result, the role of monetary authorities has traditionally been considered to maintain price stability, that is the preservation of the value of the currency, as a desirable public good.[214]

However, today seigniorage assumes the form of revenue government receives from the designated creation of fiat currency. By allowing its growth it imposes an inflation tax because holders of cash must add more in order to restore the purchasing power eroded by inflation.[215] Thus, the institutional arrangements affect the "disposition of wealth from the public and the distribution of wealth by government between individuals."[216] Governments favour this approach as it attracts less political resistance than more overt forms of taxation.[217] As Horwitz commented: "Political actors are almost always willing to take the short-run illusion of economic well-being that inflation creates and pass the costs on to the future, whether those cost bearers are the citizenry or political actors, including their future selves."[218] The emergence of these behaviours is linked to the historical evolution of political monetary policy management that has allowed governments to modify private-

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[212] R. J. Jackson, "Stock Unloading and Banker Incentives," Columbia Law Review Vol. 112(951) (2012), pp. 951-990, p. 952. There has been a trend to remunerate bankers increasingly in stock based on the view that stock-based pay packages align with the interests of shareholders. However, these bankers, along with shareholders more generally, aim to build a diversified portfolio and prefer to sell their bank stock. Thus, it is their interest to ensure high stock values.

[213] R. L. Hetzel, "The Case for Monetary Rule in a Constitutional Democracy," Federal Reserve Bank of Richmond *Economic Quarterly* Volume 83(2) (1997), pp. 45-66, p. 51.

[214] T. Cottier, R. M. Lastra, C. Tietje, (eds.) *The Rule of Law in Monetary Affairs* (Cambridge Univerisity Press, Cambridge, 2014), p. 563-564.

[215] Ibid.

[216] Ibid.

[217] G. Selgin and L. White, "A Fiscal Theory of Government's Role in Money," Economic Inquiry, Vol.37(1) (1999), pp. 154-165, p. 156.

[218] S. Horwitz, "Do we need a distinct monetary constitution?" Journal of Economic Behaviour & Organization Vol. 80(2) (2011), pp. 331-338, p. 335.

market arrangements in order to enhance revenue opportunities in the exercise of monetary sovereignty.[219]

The practical manifestation of these arrangements allows for the increase of the nominal quantity of currency than would ordinarily have been produced on the free market.[220] Whereas this differs from the modern definition,[221] it is appropriate in terms of the historical analysis in that it distinguishes governmental creation of money from the natural production of commodity money through mining and minting which is in itself self-regulating in terms of production and which would recognise limits on the government exercise of sovereignty in terms of its obligation to the citizenry in monetary terms.[222] The free market operates through social cooperation conditioned with the respect of private property rights. Therefore, inflation through the credit creation process undermines the property rights of the citizenry[223] and can therefore be considered abusive in those terms.

Conclusions.

The vestiges of absolutist sovereignty remain with the continuing influence of the nominalistic principle which weakened, and ultimately severed the link between the intrinsic and extrinsic value of money, paving the way for the development of new forms of currency. The depoliticisation of the production of currency, in the form of the Gold Standard, was an attempt to limit government abuse in the monetary realm. However, those attempts created the potential for further abuse when money's production was delegated to private actors. Whereas, the collapse of the Bretton Woods agreement would see the rise of the central banks as arbiters of the money supply, their conception of the nature of banking and money, and its role in the economy, was misplaced. The focus on price stability maintenance through the setting of interest rates did not prevent the increase of the money supply that fed speculative activity. Indeed, the increase of bank deposit money, facilitated by the credit creation process, raises the potential for speculative bubbles. Set against a background of deregulation and a shift to a financialised economic model, the pattern of financial instability was repeated.

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[219] Ibid, Selgin and White.
[220] J.G. Hülsman, *The Ethics of Money Production* (Ludwig von Mises Institute, Auburn, Alabama, 2008), p. 85.
[221] In normal economic and political discourse inflation tends to be defined by the rise in prices of a predetermined range of goods.
[222] Ibid, Hülsman, p. 86.
[223] Ibid, p. 85.

Ultimately, such policies create a financial environment that allows for the accumulation of private debt, secured on the promise of future productivity and based on assets that are overvalued. Consequently, in the event of an economic shock and in a deflationary economy, borrowers are unable to service those loans. Within a legal framework that protects creditors, those losses are eventually born by the public and rewards imprudent lending by institutions that are motivated by profit and the increase of shareholder value. It is not possible to have apolitical money. It is a political project that mediates economic relations within society. It is not sufficient to delegate its control to technocratic management unless those policies are judged against a set of normative standards that serve the broader societal interest.

Chapter Two

Market Sovereignty

The Rise of the Creditor Class and the Entrenchment of Financial Interests

Introduction

Whereas Chapter One was concerned with monetary sovereignty and the production of currency, Chapter Two analyses the other side of the economic equation: the fiscal state. The central aim of the chapter is to examine, from an historical perspective, the role of law in the organisation of public finances. In today's advanced western economies, powerful fiscal states borrow funds, gather taxes and spend on politically prioritised projects.[1] The way in which states established systems of modern public finance is not only a key question in economic history but also has significant implications for current political debates.[2]

The (contestable) values inculcated in the neoliberal hegemony that prevail today, at both the national and global level, can be traced back to those developments in England during the 17th and 18th centuries. The current belief that markets are more efficient and should be left to regulate themselves,[3] with little or no governmental intervention,[4] the notion that taxes represent an assault on property rights,[5] the belief that public spending is injurious to the interests of future generations and,[6] the emphasis on individualism and self-reliance and a mistrust in the ability of government to enhance the living standards of the citizenry[7] are all rooted in the philosophical, economic and political developments of this period in Britain.

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[1] M. Dincecco, *Political Transformations and Public Finances. Europe, 1650-1913* (Cambridge University Press, Cambridge, 2011), p. 1.
[2] Ibid.
[3] P. De Grauwe, "The Banking Crisis: Causes, Consequences and Remedies," CEPS Policy Brief No. 178 (2008), p. 2.
[4] Ibid.
[5] D. Hart, "Frédéric Bastiat on Legal Plunder," Foundation for Economic Education, 29 August 2012. Available at: https://fee.org/articles/frdric-bastiat-on-legal-plunder (last accessed 10/06/20).
[6] M. Auerback, "Who is getting robbed? The REAL intergenerational theft," Roosevelt Institute 18 February 2010. Available at: https://rooseveltinstitute.org/who-getting-robbed-real-intergenerational-theft/ (last accessed 10/06/20).
[7] See: The Mont Pelerin Society Statement of Aims. Available at: https://www.montpelerin.org/statement-of-aims/ (last accessed 10/06/20).

Indeed, the model developed in Britain would go on to be employed across the globe today.[8]

The chapter starts with an analysis of the philosophical foundation on which reform of public of British public finances was based. It then considers the manner in which that reconfiguration took place. In economic and administrative terms, it allowed for the accumulation of debt to finance the state's military objectives.[9] In so doing, the legislature created the first state budget, preventing the Crown from borrowing without parliamentary consent and developing the concept of state rather than royal debt. However, It is argued that these reforms did little to enhance the economic interests of the ordinary citizenry; the events in question amounted to a rebalance of power among England's elites paving the way for the development of the financial markets that would significantly enhance the economic and political interests of those higher in Britain's social order. Moreover, those changes were accompanied by the increasing influence of liberalism that enshrined a political norm that would prioritise the property rights of those elites, ensuring they would be maintained and supported by the state's commitment to service those debts based on the future revenues received from the ordinary citizenry. The chapter then goes on to argue that the justification for this reordering was founded on a contrived narrative based in the flawed conception of the naturalisation of markets. This ensured that the status of both the market and the interests of certain economic and financial actors would be put beyond the reach of the state. To that end, this period of legal activism, having established those norms, would protect them from democratic challenge, further entrenching those interests within a form of market sovereignty. That entrenchment, it is argued, was then followed by a period of legal inertia: the separation of the legal, political and the economic spheres would limit the operation of law as markets were deemed to be a natural and self-regulating phenomenon. However, the unleashing of the forces of liberal capitalism prompted fears concerning the levels of public debt. The chapter examines the debate that has

[8] Desan, *Making Money*, p. 6.

[9] P. O'Brien, "Fiscal Exceptionalism: Great Britain and its European Rivals. From Civil War to Triumph at Trafalgar and Waterloo," London School of Economics, Working Paper No. 65/01 (2001), p. 8. O'Brien notes that prior to James II leaving the throne, the Stuarts had appropriated approximately 3% to 4% of the national income in the form of tax and spent £2 million on the armed forces. By the time of Waterloo, taxation had risen "by a multiplier of fifteen" and the state serviced "... a national debt which amounted to 207 times the national income."

contemporary resonance in that there was a fear that the use of financial stimulus, through public spending (and borrowing), would prove too tempting to governments as a political expedient that would ultimately undermine liberty. It is suggested that those arguments are specious: there was, in fact, a fear that property rights of those elites would be adversely affected. The chapter examines the historical and legal roots of these developments. The reconfiguration of public finances created an environment that allowed for the rise of the creditor and investor class whose rights would be prioritised within the legal order.

Furthermore, it is argued that despite the short-lived abandonment of *laissez-faire* capitalism after World War Two that placed restraints on the operation of capital and allowed for the development of the social state, the ideas established during the classical liberal era would re-emerge in a more extreme form within the neoliberal paradigm. The reiteration of the values established during this period would be transposed to the global level prioritising the interests of the financial and economic elites. Ultimately, states weaken their financial sovereignty whilst maintaining their own currencies, as they interact with financial markets, because state money is inextricably linked with private financial assets that can be converted into state money.[10] Consequently, in the event of an economic shock, legal activism is aimed at ensuring the costs are borne by those lower down in the economic order by means of legislative enactment and a sense of inertia is maintained in order to protect markets from legal encroachment.

1. The Philosophical Foundation for the Prioritisation of Creditors' Rights.

The legal activism concerning the remodelling of public finances was undertaken in a political climate influenced heavily by early liberalism, in particular, the philosophy of John Locke, as society, having abandoned feudalism, began to move away from absolutism. At the heart of liberalism was a conception of legitimate government that was obliged to

[10] K. Pistor, "From Territorial to Monetary Sovereignty," The Center for Law and Economic Studies, Colombia University School of Law Working Paper No. 591 (2017), p. 2.

protect individual property rights and which allowed the market to operate separately, and without interference, from the state.[11]

According to Locke's view, the world was given to men in common, by God, in order to utilise it to "… the best advantage of life and convenience."[12] As a consequence, the combination of individual labour with the use of natural resources allows him to create property[13] and, thus, exclude the rights of others to it. Man's only obligation was to ensure that those natural resources were used before they spoiled.[14] The solution to this potential problem is found with Locke's conception of money: as a durable store of value it could be used, by mutual consent with others, in the exchange for perishable goods when needed.[15] This, therefore, allowed for the individual's accumulation of capital. As a consequence, the determination of property rights in this context allowed for the imagining of markets in capital land and labour, which was of course, the political intention that the commercial classes were attempting to achieve at that time.[16]

As a result, the legislature would only have the power to enact laws with society's consent and by its authority.[17] Therefore, it cannot act arbitrarily[18] in a manner which attacks those property rights as those rights are binding on the legislators as well as others:[19] the purpose of government is to preserve that property.[20] Clearly there is a cost associated with that protection. However, taxation should only be imposed with the consent of those who enjoy that protection.[21] Therefore, without that consent, the state is infringing the law of property and putting it into "a state of war with the people." [22]

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[11] N. Behnegar, "Locke and the Sober Spirit of Capitalism," Society Vol. 49 (2012), pp. 131-138, p. 133. Bertrand Russell described Locke as the "most fortunate of all philosophers. He completed his work in theoretical philosophy just at the moment when the government of his country fell into the hands of men who shared his political opinions." B. Russell, A History of Western Philosophy (George Allen & Unwin, London, 1946), p. 605
[12] John Locke, *Second Treatise on Civil Government*, Chapter 5, para. 26. Accessed online: http://www.earlymoderntexts.com/assets/pdfs/locke1689a.pdf (last accessed 25/04/20).
[13] Ibid, para. 27.
[14] Ibid, para 46.
[15] Ibid, para. 47
[16] M. Blyth, "Austerity: The History of a Dangerous Idea" (Oxford University Press, Oxford, 2013), p. 105.
[17] Locke, Second Treatise, Ch. 11, para. 134.
[18] Ibid, Ch. 11, para. 135.
[19] Ibid.
[20] Ibid, para. 136.
[21] Ibid, para. 140.
[22] Ibid, Ch. 19, para. 222.

The liberal stance in Britain is understandable given recent history with the expropriation of property by the monarch and the attempted default of debts to creditors. However, it is argued that with regard to property rights, liberal thought represents (and remains) a masterful piece of political misdirection. It is clearly aimed at supporting the property-owning classes of which parliament was composed. Whereas it is couched in terms of the people of the commonwealth, it does not mention those who were without property which comprised the majority of the population who, without the extension of suffrage, were unable to give their consent. It is designed, therefore, to preserve the capital of the merchant and financial classes and promote further accumulation of it.[23] The reconfiguration of the system of public finances would go on to enshrine these values and protect the interests of those economic actors who financed government projects.

2. The Reconfiguration of Public Finances

A: The Need to Reset the System

Much is made of the significance of the Glorious Revolution.[24] Indeed, it did represent a significant constitutional shift. However, the financial model created in the period following the Glorious Revolution was exported to such an extent that it created the modern lexicon of political norms that presided over the management and administration of public finances.

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[23] S. A. Bell, J. F. Henry, L. Randall Wray, "A Chartalist Critique of John Locke's Theory of Property, Accumulation and Money: or, is it Moral to Trade Your Nuts for Gold?" Review of Social Economy, Vol. 62 (1) (2004), pp. 51-65, p. 65. According to Locke, the use of a durable money allowed the industrious to accumulate wealth without adversely affecting the interests of others. As a result, a disproportionate distribution of resources emerged. This forms the basis for the modern neoclassical defence of inequality. As the authors point out: "The invention of money did not and cannot provide a justification for the amassing of property beyond that which one can effectively work with one's own labor. Money exists simultaneously as credit and debt; and credit-debt relations are necessarily prejudicial. Creditors are in a privileged position, and privilege for some must necessarily "prejudice" others."

[24] J.I. Israel, *The Anglo-Dutch Moment: Essays on the Glorious Revolution and its World Impact* (Cambridge University Press, Cambridge, 1991) p. 105. The adjective "Glorious" is used in order to signify the lack of bloodshed associated with the landing of William III. Cf G. M. Trevelyan, *The English Revolution, 1688 1689* (Oxford University Press, Oxford, 1938), p.9 "The true glory of the revolution lies not in the minimum of violence which was necessary for its success, but in the way of escape from violence which the Revolution Settlement found for future generations of Englishmen." And at p.10 "Whig and Tory, having risen together in rebellion against James, seized the fleeting moment of their union to fix a new-old form of government, known in History as the Revolution Settlement."

Moreover, it created a set of capacities that were both unforeseen and escaped appraisal at the time.[25]

This change was facilitated by a set of legal interventions that allowed for the development of state capacity which included not only creditor protection (legal capacity), but also the ability of the state to finance itself (fiscal capacity).[26] That constitutional reordering resulted in a financial settlement that allowed for the undertaking of long-term debt, secured on the basis of future revenues.[27] This was founded on that philosophical shift, away from absolutism, to an increased emphasis on liberal individualism, private ordering and a view that the state should step aside from the operation of markets.

From the beginning of the seventeenth century government expenditure was rising rapidly.[28] The cost of warfare was also increasing and conflict was becoming something of a financial disaster.[29] Under Elizabeth's reign Crown lands worth over £800,000 had been sold in order to finance the Spanish and Irish wars. Yet despite this, James still inherited debts and had to sell land worth £775,000, with the cumulative effect of a reduction in income from crown lands by twenty-five per cent between the years of 1603 and 1621.[30] Charles I was also forced to make further sales of lands of a value of £650,000 to finance further conflicts in repayment of loans.[31] As Lord Treasurer Middlesex, financial adviser to James informed the king that in selling land "he did not only sell his rent, as other men did, but

[25] C. Desan, *Making Money, Coin, Currency and the Coming of Capitalism*, (Oxford University Press, Oxford, 2014), p.6. (Hereinafter referred to as *Making Money*).
[26] T. Besley, T. Persson, "The Origins of State Capacity: Property Rights, Taxation, and Politics," The American Economic Review*,* 99**,** (2009), pp. 1218-44, p. 1220.
[27] T. Besley, T. Persson, "State Capacity, Conflict, and Development," Econometrica Vol.78(1) (2010), pp. 1-34, p. 3.
[28] C. Hill, *The Century of Revolution 1603-1714* (Norton & Co., New York, 1961), p. 46.
[29] Ibid, Hill, p. 47.
[30] Ibid.
[31] Ibid. After the suspension of Parliament in 1629, Charles I was forced to undertake military action with recourse to other sources of revenue. In addition, the monarch had also imposed forced loans from his subjects, a practice which sparked a debate about not only the nature of public finances but also individuals' rights under the regime. In the Five Knights Case, also known as Darnell's case, citation 3 How. St. Tr. 1 (K.B. 1627), the defendants were imprisoned for refusing to pay towards a forced loan in the year 1626-1627, and sought relief in the King's Bench under a writ of habeas corpus. As a result of the legal strategy employed by the King the legal question revolved around the issue of the Royal Prerogative of imprisonment as the crown was keen to avoid the issue of the forced loan. Ultimately, the loan refusers were released in December 1627, with the King conceding that "... a parliament was the proper way to supply for the necessities of war." See: J.A. Guy, "The Origins of the Petition of Right Reconsidered" The Historical Journal, 25 (2) (1982).

sold his sovereignty, for it was a greater tie of obedience to be a tenant to the king than to be his subject."[32]

Indeed, after the Republican Interregnum, Parliament began to take greater control over the authorised uses of public funds through the enactment of Appropriation Bills and to audit the use of those funds thus introducing the first of England's state budgets.[33] In pursuance of that objective, Parliament also implemented measures to prevent the Crown from borrowing without its consent leading up until the point in 1693 when William III gave assent to the bill that established the Bank of England, and in so doing acceded to the principle of national rather than royal debt.[34] As a result, the House of Commons was to gain three powers that constituted the "power of the purse," allowing the legislature to enforce control of executive spending through the withholding of consent and the authority to deny, amend or approve new taxes, new sovereign debt, and the state's annual expenditures.[35]

Under William III's reign, financial concerns were not limited to the funding of the Nine Years War (1689-97), in order to curb the ambitions of Louis XIV, but also the potential instability of the regime following the dethroning of James II.[36] It was considered that the methods used by his predecessors, such as forced loans and the expropriation of property were not desirable. This was reflected in the increased control of public finances by Parliament, and its relationship with the sovereign, reflected in the maxim by the end of the seventeenth century that "... when kings were not in need of money, they were not in need of parliament."[37] As a result, the gradual increase of control of government finance became the cornerstone of the constitution.[38] Despite the enactment of the Triennial Act 1694, the

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[32] Ibid, Hill p. 47

[33] G.W. Cox, "Reluctant Democrats and their Legislatures," in *The Oxford Handbook of Legislative Studies* (eds. S. Martin, T. Saalfeld, K.W. Strom), (Oxford University Press, Oxford, 2014), p. 698.

[34] Ibid, Cox.

[35] Ibid, Cox.

[36] A.L. Murphy, "The Financial Revolution and its Consequences," in R. Floud, *The Cambridge Economic History of Modern Britain* (Cambridge University Press, Cambridge, 2014), p. 323.

[37] Ibid, Murphy. See also H. G. Roseveare, *The Financial Revolution 1660 – 1750* (Routledge, New York, 1991) p. 30 -31: with William III on the throne, MPs had declared in parliamentary speeches that they had been too lenient with Charles and too generous to James. Roseveare notes the parliamentary debates at the time where MPs reflected on previous interactions with the monarch noting that if Revenue was granted to the Crown for three years Parliament will be secure but "if you leave the thing indefinite, you will have, I believe, little or no use of a Parliament in the future."

[38] Ibid, Roseveare.

Bill of Rights 1689 and the doctrine of the rule of law, the control over the sovereign's purse proved to be more effective in ensuring Parliamentary oversight.[39] It should, however, be noted that the composition of the Commons and Lords during this period was made up primarily of men of property; they were often related to or the dependents of peers or members of the merchant class or bankers.[40] It is argued the system that emerged would go on to create a set of financial instruments that would work for the benefit of that class and creating, again in a manner which has contemporary resonance, a separate financial stratum divorced from the reality experienced by ordinary citizens.

Nonetheless, the fiscal regime was economically and administratively poised to support the accumulation of debt required to achieve military objectives. It should be noted, however, that constitutional reform in England did not occur in the sense that we attribute to the American and French tradition, it was gradual and evolutionary in nature. However, the changes were profound:[41] what emerged during this period was a commitment by the Crown (government) to honour national debts. That commitment would be centred within the constitutional architecture of the country as a greater emphasis was placed on the operation of constitutionalism;[42] a focus on separation of powers, limited government and the rule of law.[43] As a result, the property rights of government creditors would be recognised and protected and parliament would gain control over public finances borrowing over the longer term whilst committing future tax revenues to the repayment of debts.

[39] Ibid, Roseveare, p. 31.
[40] D. Hayton, "Moral Reform and Country Politics in the Late Seventeenth-Century," House of Commons Past and Present No. 128 (1990), pp. 48-91, p. 50.
[41] P. O'Brien, "Fiscal Exceptionalism: Great Britain and its European Rivals. From Civil War to Triumph at Trafalgar and Waterloo." London School of Economics, Working Paper No. 65/01 (2001), p. 10. O'Brien notes that, over the period 1648-1815, the English state presided over the most rapidly growing economy in Europe. It is estimated that Britain's national product increased by a factor of three and the tax receipts increased by a multiple of fifteen. Britain's European competitors simply lacked the fiscal and financial capacity to match her dominance at sea, over colonies and international trade. By the time of Waterloo national debt amounted to 207 times the national income.
[42] M. Dincecco, *Political Transformations and Public Finances. Europe, 1650-1913* (Cambridge University Press, Cambridge, 2011), p. 28.
[43] Ibid.

B: The Rise of the Investor (Creditor) Class.

The accumulation of that debt was facilitated through the development of government bonds that would lead to the rise of the investor(creditor) class. They invested in those instruments based on the faith placed in the Crown to honour the agreement. However, when the monarch reneged on those commitments, it would lead to a further intervention that would have a significant legal impact within the realm of public finance.[44] This period of legal activism would recognise the increased influence of the (financial) markets founded on the values of the emergent liberal philosophy.

During the reign of Charles II, Parliament forced the king, in 1667, to accept the Commission of Public Accounts which was vested with the power to investigate the fate of the money voted by Parliament to support conflicts.[45] This body, together with Second Treasury Commission was responsible for major restructuring of the English state apparatus.[46] The Commission's goal was to establish the Treasury with power to oversee and regulate central government finance and supervising revenue collection and government credit.[47] Sir George Downing,[48] along with his treasury colleagues, conceived of the plan to borrow from the public under the Additional Aid Act 1665: the lender would get a receipt known as a Treasury Order which guaranteed payment by Statute in a strict numerical sequence drawn against specific taxes.[49] The Orders were assignable by endorsement so that they could be used as payment for goods and services or sold on the money market to raise finance.[50] Downing's structuring of the bonds, by allowing for transfer by written endorsement, enabled the government to engage in longer-term borrowing with borrowers only being committed on a shorter term which endowed the bonds with currency that enabled it to become "a vehicle of liquidity in its own right."[51] However, due to the tight financial conditions at the time, the Treasury allowed the Orders to be drawn on ordinary revenue

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[44] P. F. Figley, J. Tidmarsh, "The Appropriations Power and Sovereign Immunity," Michigan Law Review 107 (2009), pp. 1207-1268, p. 1207.
[45] T. Ertman, *Birth of the Leviathan: Building States and Regimes in Medieval and Early Modern Europe* (Cambridge University Press, Cambridge, 1997), p. 195.
[46] Ibid.
[47] Ibid.
[48] After whom Downing Street is named.
[49] Ibid, Ertman, p. 196.
[50] Ibid, p. 197.
[51] Desan, *Making Money*, p. 249.

too (as well as specific revenues).[52] As Ertman notes, the new Treasury Orders did not enjoy the same level of security as the earlier issues despite the commitment to repay and containing a "solemn promise" by the King that the debts would be honoured punctually.[53]

Nonetheless, the newly structured Treasury orders were very successful,[54] as would be noted later: "The good faith for some time observed by the Crown had established so much confidence on the part of the Bankers, that they lent their money without the least suspicion of seeing a misapplication of the revenue appropriated to repay them."[55] Confidence was also inspired by a declaration from the king, in 1667, by which he promised that he would not "… on any occasion whatever … suffer an interruption of payment on these orders of the Exchequer."[56]

However, the practice of issuing Orders against general revenue rather than against specific taxes meant that the orders were no longer linked to the revenue already voted for, and thus, there was no automatic limit to the number issued.[57] The king, needing further finance at the end of 1671, requested the same from the bankers who had already made significant loans to the Crown. As a result of the bankers' refusal, the king, on 2nd January 1672, through what was known as the Stop of the Exchequer, prohibited certain payments in respect of funds lodged there before 18 December 1671.[58] It should be noted that not all orders were affected by the Stop. However, the most seriously affected were those holders of assigned orders, that is the goldsmith-bankers who were the most aggrieved.[59]

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[52] H. Roseveare, *The Treasury, 1660 – 1870: The Foundations of Control, Historical Problems, Studies and Documents* (Allen and Unwind, London, 1973), p. 32 as cited by Desan, p. 281. See also P. G. M. Dickson, *The Financial Revolution in England* (Macmillan, London, 1967), p. 44. J. K. Horsefield, "The "Stop of the Exchequer" Revisited" The Economic History Review, Vol. 35, No. 4 (1982), pp. 511-528 and R.D. Richards, *The Early History of Banking in England* (Routledge, London, 1929), Ch. III.

[53] Ibid, Ertman, p. 197.

[54] Desan, *Making Money* p. 281.

[55] *The Case of the Bankers* in T.B. Howell, *A Complete Collection of State Trials and Proceedings for High Treason and other Crimes and Misdemeanours, Vol. XIV 1700 – 1708* (London, T.C. Hansard, 1812), p. 1. Hereinafter referred to as *the Case of the Bankers.*

[56] Ibid, *The Case of the Bankers*, p. 1.

[57] J. K. Horsefield, "The "Stop of the Exchequer" Revisited" The Economic History Review, Vol. 35, No. 4 (1982), pp. 511-528, p. 512.

[58] Ibid.

[59] Ibid.

The Stop was not intended to be permanent,[60] but in effect it was. The government negotiated with its creditors and agreed to allocate annual payments from revenue to them, through the grant of Letters Patent, which it did intermittently over the next fifteen years, until Parliament appropriated the revenue previously designated tor repayment of the loans.[61] Nonetheless, payments remained in arrears and, inevitably, creditors would seek redress in the courts. The action that followed raised questions of parliamentary sovereignty, sovereign immunity and fiscal policy.[62] Ultimately, it would reflect the rise of a representative parliament and the decline of the Crown's control over the courts[63] and, in so doing, restrict the ability of the state to manipulate economic rules.

C: Legal Recognition of Creditors' Property Rights.

In *The Case of the Bankers*, the plaintiffs brought an action in the Court of Exchequer seeking repayment in 1691.[64] The action was brought against the Crown because the obligation was viewed as the king's and Parliament's, as the latter at this point had not gained full control over state finances.[65] The plaintiffs did not seek consent from the Crown under a petition of right. They made a procedural leap in bringing the action under a writ of *monstrans de droit*. [66] At first instance, before the Barons of the Exchequer, the case

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[60] Ibid, Horsefield, "The Stop of the Exchequeer," p. 514. It was originally imposed for a year, until December 1672, then continued until May 1673 and then extended to January 1674, by which time it had effectively become permanent because "the funds on which the orders had been drawn were all expended."
[61] Desan, *Making Money*, p. 281.
[62] P. F. Figley, J. Tidmarsh, "The Appropriations Power and Sovereign Immunity," Michigan Law Review 107 (2009), pp. 1207-1268, p. 1227.
[63] Desan, Making Money, p. 288.
[64] *The Case of the Bankers (1690 – 1700)* in T. B. Howell (ed.), *Cobbett's Complete Collection of State Trials and Proceedings for High Treason and Other Crimes and Misdemeanours from the Earliest Period to the Year 1783, Vol. 14* (London, 1812. Reprinted Sagwan Press, London, 2015). Hereinafter referred to as the Case of the Bankers.
[65] See generally W. Reitan, "From Revenue to Civil List, 1689 – 1702: The Revolution Settlement and the 'Mixed and Balanced' Constitution," The Historical Journal, Vol. 13(4) (1970), pp. 571-588.
[66] Desan, *Making Money*, p. 283. See also L. L. Jaffe, "Suits Against Governments and Officers: Sovereign Immunity," Harvard Law Review, Vol. 77(1) (1963), pp. 1-39: In England, from the reign of Edward I onwards there emerged the development of two types of action in the form of suits against the King, petitions of right which required the monarch's consent and the other which consisted of claims against an officer or agency of the Crown which did not require consent. The reason that the king's consent was required was not because the monarch was above the law, but because "The King, as the fountain of justice and equity, could not refuse to redress wrongs when petitioned to do so by his subjects." The phrase "the king can do no wrong" did not, as has sometimes been represented, mean that the monarch was immune from legal process, but was not capable of "... being a party to injustice ... and would therefore consent to suits when his actions harmed the interests of a subject. Thus, the practice grew of screening petitions by Privy Council or by the Chancellor

revolved around two central issues: whether the grant out of excise was good and whether the form of the petition as a *montrans de droit* was the appropriate writ.[67] Judgment was given in favour of the complainants and a direction given to order payment by the Exchequer.[68] Following this, an appeal in the form of a Writ of Error was brought against the judgment before the Attorney General in the Exchequer Chamber.

On appeal, the majority of the judges upheld the original judgment. Lord Sommers, as Lord Keeper, sat by the authority of the Lord Chancellor and Lord Treasurer and effectively had the casting vote and reversed the original decision. An appeal was brought before the House of Lords. The judgment of the House of Lords is brief:

> "After hearing counsel for several days, to argue the errors assigned upon the said writ of error; and due consideration of what was offered on either side; it is this day ordered and adjudged, by the Lords spiritual and temporal in parliament assembled, that the said judgement of Reversal shall be, and is hereby, reversed."[69]

As a result, therefore, the substance of the principles established in the case is found in the appeal. Lord Chief Justice Holt, in his judgment in the Exchequer Chamber, recognised the need of the sovereign to raise monies by "alienating his revenue" without the need, of necessarily having to do so by Act of Parliament, due to the exigencies of war.[70] It would be "…repugnant to the constitution" of the government if he could not "... and it has been the constant usage of the kings of England to reward persons deserving of the government out of the crown revenues, by pensions, and giving estates to support the titles of earl and other

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which were consented to on the basis of law following factual inquiries as to whether there was a "right," which would be endorsed if that was the case and which were then tried as to the facts ultimately in the Exchequer, the Chancery or the King's Bench. Where the issue at hand concerned the Crown's title, or involved an attempt to reach the Treasury, the action was presumed to be one against the Crown, and was considered a petition of right. However, the process was protracted and the courts developed other, more efficient procedures not requiring consent despite their being issued in cases involving the Crown's interests. Thus, a considerable number of real property claims in which the Crown was interested could also be settled by *monstrans de droit*. See also W. Blackstone, *Commentaries on the Law of England*, (T.B. Wait & Co. 1807), p. 242, et seq, P. F. Figley, J. Tidmarsh, "The Appropriations Power and Sovereign Immunity." Michigan Law Review 107 (2009) and Holdsworth, *A History of English Law* (3rd ed. 1944).

[67] *The Case of the Bankers*, p. 3.

[68] Ibid, p. 3.

[69] Ibid, p. 111.

[70] Ibid, p. 30.

dignities." [71] Holt LCJ, whilst in his tone deferential to the monarch also recognises the power of government to "reward persons that deserve well,"[72] Holt LCJ concludes that the Letters Patent (granting annuities to the bankers) which charge the branch of the revenue, "are good and firm in law."[73] This in part is also reflected in his judgment regarding the remedy taken.

Holt LCJ draws a distinction between the Petition of Right procedure and the *monstrans de droit* claiming that the latter was the appropriate route for redress.[74] It is suggested his reasoning was based on two points: firstly, the rights contained within the letters patent are a matter of record not requiring an inquiry into the possibility of the existence of a right by a commission associated with the petition of right procedure. Secondly, the claimants were not challenging the legitimacy of the king's title (which petitions of right did) as they were not inconsistent with the king's title.[75] *Monstrans de droit* was sued at common law when the party's title appears as a matter of record. Following on from this reasoning Holt LCJ then examined the status of the sovereign moving into the substance of the application having determined that consent is not required: "But here the plea does concern the king; for here is the king's grant, and the suit is to the king: and this determination of the barons in this case is not thus any judgment of their own; but the king himself by reasons of such his letters patent." Holt LCJ continued: "It is not so much the judgment of the court as binds the property, as the obligor himself, who by his bond has subjected his property to be determined by the judgment."[76] Thus, in adopting a respectful tone, Holt LCJ is suggesting that the court is merely upholding the will of the Crown.

With regard to the remedy taken Holt LCJ stated: "We are all agreed that they have a right; and if so, then they must have some remedy to come at it too."[77] It should be noted that at this stage of the development of common law, that it is difficult to separate those elements of the case which could be considered substantive from those which are procedural. As

[71] Ibid, *The Case of the Bankers*, p. 30.
[72] Ibid.
[73] Ibid, p. 34.
[74] Ibid, p. 38. Holt notes that the Lord Keeper (Somers) was minded to reverse the judgment on the basis that the complainants had not taken the "proper remedy by Petition to the barons, who have no power or control over the king's treasury" and should have petitioned the king himself.
[75] Ibid, p. 34.
[76] Ibid, p. 36.
[77] Ibid.

Henry Sumner Maine stated ".... Substantive law has at first the look of being secreted in the interstices of procedure; and the early lawyer can only see the law through the envelope of its technical forms."[78] Through the identification of property rights on the one hand, and the determination of the procedure to be adopted, Holt has effectively removed the distinction between the Crown and the bankers effectively draining the former of the "power of the prerogative."[79] Therefore, the sovereign is an "obligor" like any other contracting party despite dressing the judgment in the language of loyalty to the Crown as the Court is seen to give effect to the royal will.[80] At first glance the language employed by Holt appears benign and respectful. However, as his judgment progresses, the implications of his reasoning imply a transitional, paradigmatic shift towards the separation of the judiciary and executive[81] which I argue is significant, as through the operation of that doctrine, the court is not only upholding, but prioritising the rights of those investors and protecting that property from expropriation by the state.

Lord Justice Sommers took a different view. In his extensive judgment, he traced the common law development of sovereign immunity, ultimately placing the security of the realm at the centre of his reasoning:

> "So that suppose there was only 4,000L. in the exchequer, and we were threatened with a foreign invasion, how shall this money be disposed? Says the treasurer, to raise men to pay the army and our fleets, that by their assistance we may prevent the enemy from coming amongst us. No, say the barons ... we must pay the bankers with this money, though at the same time we open the gates, and let in Hannibal to our utter ruin and destruction ..."[82]

According to Sommers LJ, the sovereign retained the ability to exercise the prerogative in order to spend as the public good required, with creditors only being able to demand payment with the consent of the Crown. In allowing himself to be constrained by interpretation of the common law, Sommers LJ is attempting to preserve the royal

[78] H. Sumner Maine, *Dissertations on Early Law and Custom* (John Murray, London, 1883), p. 389.
[79] Desan, *Making Money*, p. 285.
[80] Ibid, p. 286.
[81] Ibid.
[82] Also cited by Desan, p. 283, who notes that Sommers, as a committed whig and patron of John Locke, would not be ideologically committed the preservation of the royal prerogative.

prerogative by legal reasoning reminiscent of that in the *Case of Mixed Money (Brett v. Gilbert)*,[83] upholding the right of the Crown to use money as it saw fit.[84] Thus, Sommers LJ's judgment, in contrast to that of Lord Chief Justice Holt's, defends the prerogative pointing to the danger of the "King's treasure" being subject to the administration of an ordinary court of justice, in which a subject can make a demand in relation to an annuity or other debt.[85] Such an action may lead to a "weakening of the public safety to a very high degree."[86]

D: The Impact of the Case of the Bankers

The effect of the decision was not immediately felt. In fact, the bankers did not receive payment on foot of the judgment; Parliament would go on to appropriate those revenues for their payment and commit them to the war.[87] The significance of the decision is found in the repositioning of constitutional powers, set against the financial fabric of the state with the courts attempting to limit the Crown/government's ability to appropriate property and subjugate individual rights while Parliament asserts its hard won right to control the distribution of revenue. Ultimately, however, as the institutional arrangements settled, creditors would become confident in repayments being made.[88] As a result, the decision changed the design of public debt.[89] In fact, the potential failure of the new financial mechanisms could endanger public security that was at the heart of Lord Justice Sommers' concerns.[90]

North and Weingast examined the degree to which the sovereign was bound by the rules and institutions which govern economic exchange and the extent to which the sovereign could alter those rules for his or her own benefit which would result in lower returns of

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[83] See previous chapter.
[84] Desan, *Making Money*, p. 283.
[85] *The Case of the Bankers*, p. 103.
[86] Ibid.
[87] Ibid, Horsefield, "The Stop of the Exchequer," p. 578.
[88] D. North and B. Weingast, "Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth-Century England." The Journal of Economic History Vol. 49(4) (1989), pp. 803-832, p. 808.
[89] Desan, *Making Money*, p. 286.
[90] Ibid.

investment or reduce the incentive to invest.[91] They suggest that the arbitrary exercise of governmental power by the sovereign in terms of the expropriation of wealth through the redefinition of rights in the sovereign's favour to meet fiscal demands ultimately led to the establishment of fundamental institutions after the Glorious Revolution of 1688.[92] They also argue that it was not necessarily in the sovereign's interest to exercise power arbitrarily, through the use of state powers of coercion, in order to extract surplus resources, and that by reaching agreement with his or her constituents, achieve a greater sense of security thereby increasing revenue.[93] However, compliance on the part of the sovereign could not be guaranteed and, thus, the role of the constitution is to ensure that the bargain made between the state and its constituents provides the incentive for the parties to abide by the agreement.[94] The risk of reputational damage was not a sufficient disincentive to prevent the possibility of reneging on an obligation, and thus, this provided the "endogenous role for political institutions."[95] As a result, North and Weingast suggest that the emergence of free markets must be accompanied by some "credible restrictions" on the ability of the state to manipulate economic rules in order to allow private rights and markets to prevail.[96] Such a commitment, they argue, provided the conditions for economic growth when compared with the approach by absolutist states where private rights and exchange were not promoted to the same extent. However, it is suggested that such a view is, in fact, a state manipulation of economic rules: such legal interventions did in fact delineate the operation of markets through the prioritisation of creditor rights over those of the state. This was, in fact, an opportunity for those economic actors to ensure that their interests were prioritised during a time when the money and financial markets were in their ascendancy.

It is argued, therefore, that the view put forward by North and Weingast is merely a continuation of a classical liberal view that provides an *ex post* justification of the prioritisation of creditors rights. Indeed their study is not without its critics.[97] From a legal

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[91] North and Weingast, "Constitutions and Commitment," p. 803.
[92] Ibid, North and Weingast, p. 804.
[93] Ibid, p. 804.
[94] Ibid.
[95] Ibid, p. 807-808.
[96] Ibid.
[97] See, for example: A. Irigoin and R. Grafe "Bounded Leviathan: or why North & Weingast are only right on the right half," MPRA Paper No. 39722 (2012); S. R. Epstein, *Freedom and growth: the rise of states and markets in*

perspective, the vocabulary associated with the autonomy of the market can be criticised: the notion of rights of public creditors would not equate to a set of rights that are generally accessible to any individual, and nor does it represent a body of property rights.[98] When that state, through the operation of the judiciary, prioritized those claims it redirected the "revenues and legal attention from the 'private rights' of others."[99] In order to fulfil its obligations to creditors, government needed to rely on the expectation of future revenues (an expectation shared by investors). As a result, the collection of taxes was designed in such a way that the rights of taxpayers were subjugated in favour of creditors.[100] The rights established are not self-defining absolutes but rather labels for a series of state interventions.[101] The notion that a certain conception of property rights in relation to capital markets implies an "abstract and unbiased standard," operating outside of politics, neutralising them as being immune from regulation and thus disappears from view enforcing the notion that the state no longer has a role to play;[102] a view that is regularly expounded today. Furthermore, the developments in relation to the public and private financing could not have evolved without the operation of legal and constitutional institutions. The operation of law gives credence and lends authority to public and private financial instruments and, in so doing, it delegates power to other public or private actors. As a result, those financial products, having emerged from a private contract, are vindicated if they are consistent with the law.[103] Thus, those discretionary choices that are made complete a self-fulfilling virtuous circle. Consequently, and in a form that has resonance today, the creation of institutions, through the operation of law prioritises one set of rights above another ensuring the repayment of government creditors in order to guarantee long-

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Europe, 1300-1750 (London, Routledge, 2000); N. Sussman & Y. Yafeh, "Institutional Reform, Financial Development and Sovereign Debt: Britain 1690-1790," *The Journal of Economic History* Vol. 66(4) (2006), pp. 906-935.

[98] Desan, *Making Money*, p. 292.

[99] Ibid.

[100] For example, see Sir Watkin Lewes in a Commons Debate on Tobacco duties, in The Parliamentary History of England from the Earliest Period to the Year 1803. Vol. 28 (London, T.C. Hansard, 1816) p.231 – 232: "The trial by jury had always been considered as the palladium of that liberty for which this country had long been the envy of foreign nations. Mr Justice Blackstone, in treating on the laws of excise, says, that 'the rigour and arbitrary proceedings of excise laws, seem hardly compatible with temper of a free nation.' ... the proceedings, in case of transgressions are so summary and sudden that a man may be convicted in two days ... to the total exclusion of the trial by jury, and disregard of the common law.".

[101] Ibid, Desan, p. 293.

[102] Ibid, p. 293.

[103] K. Pistor, "Law in Finance" Journal of Comparative Economics Vol. 41(2) (2013), pp. 315-330, p. 315.

term government finance ultimately underwritten by the taxpayer. These values would be enhanced by further institutional developments.

3. The Institutionalisation of Creditors' Rights.

A: The Rise of Central Banking

The emergence of central banking, after the establishment and development of the Bank of England in 1694 was to amount to further constitutional shift in the establishment of the political economy. Not only would its foundation build on the financial innovations that had occurred during the preceding period (above), it would also introduce new forms of currency which would ultimately establish paper money as a medium of exchange and provide the mechanisms for money creation under the fractional reserve system of banking.[104] What resulted was a hierarchy of money within the state that established an implied dual relationship between the ability to raise taxes on the one and the creation of money on the other:[105] a dual system of payments from the taxpayer to the state and the state payment of interest in servicing its debts to creditors with the latter enjoying an enforceable set of property rights.

The Bank of England was established, following the financial innovations and the gradual gaining of control of finances by parliament in order to have a source of funding when faced with pressing needs.[106] Despite the financial innovations that allowed for the creation of debt over the longer term, the government had secured those loans on the basis of future revenues which were essential to service the loan. However, the Exchequer rule only allowed for payment of taxes in coin taken measured by weight.[107] The favoured means of payment was in silver coin.[108] However, the stock of silver coinage had deteriorated significantly.[109] In addition, a buoyant foreign market for silver bullion had led to silver

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[104] See Chapter One.

[105] S. Bell, "The Role of the State and the Hierarchy of Money" Cambridge Journal of Economics Vol 25(2) (2001), pp. 149-163, p. 150.

[106] C. Giannini, "Money, Trust, and Central Banking," Journal of Economics and Business Vol. 47(2) (1995), pp. 217-237, p. 219.

[107] An Act for the better Observation of the Course anciently used in the Receipt of Exchequer. 1696-7 (W.III, 8 & 9).

[108] J. K. Horsefield, *British Monetary Experiments 1650-1710* (Harvard University Press, Harvard, 1960), p. 117.

[109] J. Appleby, "Locke, Liberalism and the Natural Law of Money" Past and Present, No. 71 (1976), pp. 43-69, p. 52.

export.[110] The Recoinage Act was enacted in 1696 under which the older depreciated coins were taken in and gradually replaced with new (milled) coins. However, the process was gradual and the scarcity of coinage was exacerbated during this period.[111] A method of money creation and circulation was needed which did not rely so heavily on specie (coinage).

Many of the most important features of modern banking developed in the two centuries after 1640. The expansion of private debt created by new groups of financial intermediaries using novel financial instruments and the change in government debt from royal, personal debt to "the higher status of national debt"[112] and the growth of taxation all contributed to the main features of the financial landscape which we inhabit.[113] The growth in economic activity led to the position that by the end of the seventeenth century the supply of bank money exceeded the supply of metallic money and constituted a milestone in world monetary history.[114]

Many proposals for a novel system of public financing had been proposed. Sir William Killigrew proposed a method of funding which differed from the Treasury Orders developed by Downing in that, according to his proposal, the paper public debt could circulate and have the same qualities as paper money.[115] That paper, as a promise of value, could be spent by government and allowed to circulate and be taken back by it in settlement for taxes.[116] It was William Patterson's proposal that was eventually adopted.[117] That proposal partnered both the private and public sectors.[118] The government was able to borrow from a privately created fund of credit which took the form of bank notes and thus create a circulating medium thus joining the creation of public debt with the creation of money.[119]

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[110] Ibid, Appleby.
[111] W. R. Bisshcop, *The Rise of the London Money Market* 1640 – 1826 (Batoche Books, Ontario, 2001), p. 30.
[112] G. Davis, *A History of Money from Ancient Times to the Present Day* (University of Wales Press, Cardiff, 2002), p. 238.
[113] Ibid.
[114] Ibid, p. 239.
[115] Sir William Killigrew, *An Humble Proposal Shewing How This Nation May Be Vast Gainers by All Sums of Money, Given to the Crown, without Lessening the Prerogative* (1663). Available at: https://quod.lib.umich.edu/e/eebo/A47388.0001.001/1:3?rgn=div1;view=fulltext (last accessed 25/04/20).
[116] Desan, *Making Money*, p. 303.
[117] W. Patterson, *A Brief Account of the Intended Bank of England* (Randal Taylor, London, 1694). Available at: https://archive.org/details/ABriefAccountOfTheIntendedBankOfEngland (Last accessed 25/04/20).
[118] Desan, *Making Money*, p. 303.
[119] Ibid.

Under the Bank of England Act 1694,[120] Parliament accepted the proposal to raise £1.2 million at an interest rate of 8% per year.[121] Consequently, the Bank of England was formed. The establishment of the bank was confirmed by Royal Charter of Incorporation on 27th July 1694.[122] Under the Act, subscriptions were invited from persons who provided a loan of not more than £20,000, and the £1.2 million would be redeemable after 1705 upon one year's notice being given to the company. The Bank was allowed to issue assignable bills.[123] By December 1694, 60 % of capital had actually been paid up, yet the Bank had advanced the entire value of the loan to the government by the end of the same year – the transaction was carried out by issuing the greater part of the loan in sealed bills and cash notes.[124]

The arrangement was mutually beneficial to both the subscribers and the government.[125] With the periodic calling in of capital payments, subscribers continued to be in possession of their funds whilst the Bank was able to circulate the bills to an amount greater than the amount of the capital called in.[126] In addition, the government turned to the bank and persuaded it to accept the problem tallies (that were the source of the action brought by the bankers above) at a discounted rate.[127] With the tallies assimilated into the whole of the public debt, the government was able to deal with a "single, more manageable creditor" and had converted those shorter-term debts into part of the national debt on which only the interest was payable.[128] The 1694 Act[129] also provided for the servicing of the loan through the imposition of taxes on shipping and the import of goods.[130] The arrangement draws together several aspects of public financing: it establishes the fiscal relationship in

[120] 5 and 6 Wm. & M., c.20, ss. 18 -23.
[121] V. Kaul, *Easy Money: Evolution of Money from Robinson Crusoe to the First World War* (Sage Publications Ltd, London, 2013), p. 58.
[122] Text available at: http://www.bankofengland.co.uk/about/documents/legislation/1694charter.pdf (last accessed 25/0420).
[123] R. D. Richards, *The Early History of Banking in England* (Routledge, Oxford, 1929), p. 146: in addition, the bank could deal in bills of exchange, buy and sell bullion, and to sell commodities deposited as securities.
[124] Ibid, Richards, p. 149.
[125] Desan, *Making Money*, p. 307.
[126] Ibid.
[127] G. Davis, *A History of Money from Ancient Times to the Present Day* (University of Wales Press, Cardiff, 2002), p. 262
[128] Ibid.
[129] Also known as the Tonnage Act 1694.
[130] A. Browning, *English Historical Documents*, (Routledge, London, 1966),p. 322 : Preamble 'An Act for granting to their Majesties several Rates and Duties upon Tunnages of Ships and Vessels, and upon Beer, Ale, and other Liquors; for securing certain Recompenses and Advantages . . . to such persons as shall voluntarily advance the Sum of Fifteen hundred thousand Pounds towards carrying on the war against France.'

terms of the expectation of future revenues whilst securing current spending on the basis of future capital subscriptions over the longer term.

B: The Ascent of Paper Money

The instruments issued by the bank were benefitted by a further "constitutional contrivance." [131] They became institutionalised by holders and public officials as a mode of payment. The Bank gave the paper issues to the government which, in turn put them into circulation to pay for the goods and services it required.[132] Secondly, officials began to accept those notes back in payment of fees and taxes.[133] The arrangement was advantageous for the Bank because it could lend on its principal on a short-term basis while holding only a fractional reserve, based on the guarantee of the government and the operation of the fiscal system.[134] The system was also advantageous to the government because it reduced the demands for specie and because it could always cash the paper issues and reduce the money supply or continue and channel them back into circulation.[135] One of the main features of the arrangement was that it created a permanent debt, which in essence meant that subscribers would receive interest in perpetuity, without the requirement for repayment of the principal, which was possible but not a requirement under the contract.[136] This allowed the government to borrow larger amounts on the same revenue base, and because the government had the right to repay the capital it could extricate itself from the contract if an agreement in a change of terms could not be reached.[137]

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[131] Desan, *Making Money*, p. 311.
[132] Ibid.
[133] Ibid.
[134] Ibid, p. 119.
[135] Ibid, p. 318 – 319. Desan observes that the notes were vested with a degree of confidence by users. People tended to hold them rather than exchanging them for specie because they could use them to satisfy obligations to the government. However, specie still acted as a guarantee if the notes were cashed, but that would simply reduce the supply of paper issue, as the Bank was committed to a limit to the amount it could issue. However, that limitation was not based on specie backing but on the functioning of the fiscal system.
[136] J. L. Broz, R. S. Grossman, "Paying for privilege: the political economy of Bank of England charters, 1694 – 1844." Explorations in Economic History Vol.41(1), (2004), pp. 48-72, p, 51. In fact, the contract was weighted in favour of the government; the loan was non-callable and the government had the right to terminate the contract with one year's notice starting from 11 years from the date of the Charter.
[137] Ibid, Broz and Grossman.

The Bank was re-chartered under the Continuance Act 1697.[138] Additional loans were advanced to the government in exchange for the insertion of a clause which stated "no other Bank or Constitution in the nature of a bank be erected or established, permitted or allowed by Act of Parliament during the Continuance of the Bank of England."[139] Furthermore, under the Bank of England Act 1708,[140] the Bank was afforded the status of a joint-stock company. Other joint-stock companies with more than six persons were prohibited from lending or borrowing "on their notes, payable at demand, or at any less time six months from the borrowing thereof."[141] This was crucial in the creation of a partial monopoly for the Bank. There was not a ban on joint-stock deposit banking but "the intention was to give the Bank of England a monopoly of joint-stock banking, and had any other institution of more than six partners attempted to carry on a banking business ... it would have been suppressed."[142] This is an important development: other corporations could issue notes or bonds but they were restricted to longer-term investments that could not represent immediate value (payable on demand).[143] This confirmed the particular financial relationship between the Bank and government.[144]As noted above, this relationship allowed emergence of a circulating medium which was accepted as money and not "simply as a money-substitute."[145] When viewed in the light of the acceptance of the issue for the settlement of (tax) obligations to government a demand for the currency is created. However, in this context, the faith in the currency, as a form of credit, is not established on the amount of specie backing it up, but on the faith in the settlement of future obligations to government i.e. the collection of revenue.

Creditors invested in government securities because they were secured not only by the pledge of the king, lords and commons to honour the agreement but the ability of tax

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[138] 8 & 9 Will. 3, c. 20.

[139] J. Clapham, *The Bank of England: A History, 1694 – 1914*, (Cambridge University Press, Cambridge, 1944), p. 47. As Clapham notes, this was in response to the attempted establishment of the Land bank which threatened the Bank's partial monopoly. The Land Bank failed to raise enough capital for subscription.

[140] 7 Anne, c. 30 s.66.

[141] Ibid, Clapham.

[142] A. Feavearyear, *The Pound Sterling.* (Clarendon Press, Oxford, 1963), p.167 – 168, as cited in J.L. Broz, R.S. Grossman, "Paying for privilege: the political economy of Bank of England charters, 1694 – 1844." Explorations in Economic History Vol. 41(1) (2004).

[143] Desan, *Making Money*, p. 316.

[144] Ibid.

[145] Ibid, Davis, *A History of Money From Ancient Times to the Present Day*, p. 305.

collectors to service it.[146] Thus, the relationship between government borrowing and future revenue income becomes more firmly established. The tax returns grew rapidly during this period: "Between the reign of Charles II and the end of the American War aggregate net tax revenue had grown six-fold."[147] The success of the maintenance of the long-term debt was contingent on the efficacy of the revenue system. The ability of individuals to discharge liabilities to the state with paper currencies imbued those instruments with a value not related purely to the gold or silver it represented. In fact, it actually created a demand for the notes as they circulated. As Smith stated:

> "A prince who should enact that a certain proportion of his taxes should be paid in a paper money of a certain kind might thereby give a certain value to this paper money ... If the bank which issued this paper was careful to keep the quantity of it always somewhat below what could easily be employed in this manner, the demand for it might even be such as to make it even bear a premium, or sell for somewhat more in the market than the quantity of gold or silver currency for which it was issued."[148]

In addition to the delegation of money creation,[149] there was a further institutional development: the adoption by the Bank of England of the role of lender of last resort. Financial crises and panics had caused a run on commercial banks during the period of the Bank's existence.[150] The Bank had been acting as lender of last resort twenty years before Lord North described it as "...from long habit and usage of many years ... a part of the Constitution."[151] Thornton, in his report, *An Enquiry Into the Nature and Effects of the Paper*

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[146] J. Brewer, *The Sinews of Power: War, Money and the English State, 1688 – 1783,* (Harvard University Press, Harvard, 1990), p. 89.

[147] Ibid, Brewer, p. 90. The percentage of national income appropriated as taxes rose from 3.5% in the 1670s to 22% in 1760.

[148] A. Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776) (Metalibri, Amsterdam, 2007). Book II, Chapter II "Of Money, considered as a Particular Branch of the General Stock of Society, or of the Expense of Maintaining the National Capital," p. 134. Available at: https://www.ibiblio.org/ml/libri/s/SmithA_WealthNations_p.pdf (last accessed 25/04/20).

[149] See Chapter One.

[150] M. C. Lovell, "The Role of the Bank of England as Lender of Last Resort in the Crises of the Eighteenth Century," Explorations in Entrepreneurial History Vol. (10) (1957), pp. 8-21, p. 17.

[151] Ibid.

Credit of Great Britain (1802)[152] identified the Bank, acting as lender of last resort as the ultimate source of liquidity for the financial system (and the government) through the stock of high-powered money supported by gold reserves.[153] The Bank's monopoly to issue bank notes gave it control over an "inexhaustible source of domestic legal tender."[154]

4. Concerns about the Public Debt.

With the establishment of the Hanoverian monarchy, the increased level of public debt was seen as necessary to preserve the protestant succession by military means to resist what was seen as the papist ambition to create a universal monarchy in Europe.[155] As a result, the state of public finances in Britain was subject to extensive debate during the eighteenth century, particularly with the empowering of the monied interests that had arisen around the creation of the Bank of England on the one hand, and the level of debt on the other.[156]

The intellectual basis on which these objections are founded would go on to form an essential strand of neoliberal ideology that has come to dominate political and economic discourse. In addition to Locke, David Hume would prove most influential.[157] He had rejected the notion that monetary stimulus could lead to increased economic activity rather it would lead to inflation or dissipate without effect.[158] As a result, an emphasis is placed on the productive economy and the greatest threat to economic growth and the wealth created by that class would be the state's need for revenue in order to service its debt.[159]

[152] H. Thornton, *An Enquiry Into the Nature and Effects of the Paper Credit of Great Britain*, [1802], (Rinehart and Co., New York, 1939), p. 147. Available at: https://oll.libertyfund.org/titles/thornton-an-enquiry-into-the-nature-and-effects-of-the-paper-credit-of-great-britain (last accessed 24/05/20).
[153] T. M. Humphrey, R. E. Keleher, "The Lender of Last Resort: A Historical Perspective," Cato Journal Vol. 4 No.1 (1984), pp. 333-364, p. 342.
[154] Ibid.
[155] D. Winch, "The Political Economy of Public Finance in the 'Long' Eighteenth Century," Intellectual History Archive, St Andrews University, p.2. Available at: https://arts.st-andrews.ac.uk/intellectualhistory/islandora/object/intellectual-history%3A56/datastream/OBJ/view (last accessed 24/05/20).
[156] Ibid, Winch, p. 6. Concern was also raised over the monopolistic powers of the East India and South Sea Companies that existed by means of government privilege.
[157] See R. Ledger, *Neoliberal Thought and Thatcherism: a Transition from Here to There* (Routledge, Oxford, 2018).
[158] M. Blyth, *Austerity: The History of a Dangerous Idea* (Oxford University Press, Oxford, 2013), p. 106. (Hereinafter referenced as Blyth, *Austerity*).
[159] Ibid, p. 107.

Indeed, a more effective system of revenue collection had been put in place.[160] A considerable effort had been made to ensure that the policies implemented were politically sensitive to the potential for tax revolts.[161] This was balanced with an awareness of the need for an efficient system where the costs of collection did not exceed the amount of revenue.[162] Certainly Britain was able to raise more in taxation than France; approximately twice as much per capita during the Napoleonic wars.[163] The tax base was widened, focussing on the imposition of customs duties arising from increased foreign trade.[164] However, domestic economic growth did not counteract the increased burden.[165]

The fear was that the taxes the state would need to raise to pay the interest on public debt would have the effect of increasing wages,[166] a disbenefit to those productive economic actors that create wealth. In arguments that resonate today, there was concern that the nation would be overburdened with debt and taxes, which means of course, the merchant and landowning classes. It is too easy for the state to increase taxes without the consent of the taxpayer and this would lead to a reduction of individual liberty.[167] It is also too tempting for a government to increase public debt as a short term political expedient without raising taxes at the time but leading to rises in the future.[168] This, therefore, alludes to the inter-generational injustices that contemporary critics of public spending levy against the practice. Moreover, that rise in public spending/debt has the tendency to crowd out private investment driving up the costs of raw materials and labour.[169] The easiest taxes to raise are those based on consumption but there are fears that once these options have been exhausted, taxes will be levied on property.[170] This will lead, therefore, to government

[160] P. K. O' Brien, "The Political Economy of British Taxation, 1660-1815", Economic History Review, Vol. 41(1) (1988), pp. 1-32, p. 1-3.
[161] Ibid, O' Brien.
[162] Ibid.
[163] P. Mathias, P. K. O'Brien, "Taxation in Great Britain and France, 1715-1810'; A Comparison of the Social and Economic Incidence of Taxes Collected for the Central Governments", Journal of European Economic History, Vol. 5, (1976), pp. 601-50, p. 620.
[164] Ibid.
[165] Ibid.
[166] D. Hume, "Of Public Credit," (1752) in *Essays, Moral, Political, and Literary*, II.IX. Available at: http://www.econlib.org/library/LFBooks/Hume/hmMPL.html?chapter_num=37 (last accessed 24/05/20).
[167] Ibid.
[168] Ibid.
[169] Ibid.
[170] Ibid,: "…the excises upon malt and beer afford a large revenue; because the operations of malting and brewing are tedious, and are impossible to be concealed; and at the same time, these commodities are not so

having to constantly increase taxes to service ever increasing debts that will ultimately lead to a form of despotism resulting in the bankruptcy of the state.[171]

This concept would be revived by contemporary critics of public spending: debt-financed government spending could lead to a lower national income because it leads to a "reduction in the physical volume of assets created because of lowered private productive investment."[172] This doctrine is controversial[173] yet remains the predominant theory that supports the monetarist/neoliberal policy of reducing public spending to, theoretically at least, promote economic growth.

Whereas Hume predicts the ultimate bankruptcy of the state and the rise of a form of despotism, Adam Smith provides a more detailed analysis in terms which are more familiar to the modern reader and which advocate principles that underlie the modern (neoliberal) political economy regarding public spending. Smith introduces the notion of frugality (parsimony) and cautions against prodigality, that is, excessive or extravagant spending.[174] In the case of the exigencies of the state, notably at that time the funding of wars, the cost should be equal to revenues and rarely exceed it and, therefore, might require the imposition of more taxes, in what today might be termed a balanced budget or surplus.[175] However, when funds are needed urgently by the state, the taxation system is too slow and the state will have to borrow those funds. The issue with this, however, is that within a commercial state it creates the propensity and ability for certain economic actors to extend credit based on the belief that they will be repaid.[176] Moreover, when loans are made to government it is usually on terms that are advantageous to investors and, therefore, very profitable.[177] In addition, those securities can be traded at a profit on the market before

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absolutely necessary to life, as that the raising of their price would very much affect the poorer sort. These taxes being all mortgaged, what difficulty to find new ones! what vexation and ruin of the poor!
Duties upon consumptions are more equal and easy than those upon possessions. What a loss to the public, that the former are all exhausted, and that we must have recourse to the more grievous method of levying taxes!"

[171] Ibid.

[172] M. Friedman, "Comments on the Critics," Journal of Political Economy Vol. 80(5) (1972), pp. 906-950, p. 917.

[173] É. Tymoigne and L. Randall Wray "Modern Money Theory 101: A Reply to Critics" Levy Economics Institute, Working Paper No. 778 (2013), p. 2.

[174] A. Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, ed. S.M. Soares (Metalibri Digital Library, 2007) Book IV, p. 708.

[175] Ibid, p. 709.

[176] Ibid, p. 710.

[177] Ibid.

they are repaid.[178] This allows for the accumulation of capital for those financial investors.[179] The government, in foreseeing its ability to borrow, dispenses itself from the duty of saving. This is particularly true due to the creation of the perpetual fund, associated with the establishment of the Bank of England, whereby interest is paid in the form of annuities whilst the principle exists.[180] Whereas it is politically convenient to pay annuities funded by modest tax rises from year to year, it denies the country a proportion of capital that could be put to a more productive use and, ultimately, it has the effect of destroying capital as the government borrows from the future.[181] However, despite the presentation of the worst-case scenario put forward by such theorists,[182] their apocalyptic vision did not materialise. The public spending measures allowed Britain to steal a significant march on her competitors and become a leading actor in international markets facilitated by a 'fiscal military state' that financed colonial and mercantile expansion[183] based on the accompanying *casus belli*.[184]

Nonetheless, the concern over, and fear of, public debt would be maintained well into the twentieth century: a government paper, summarising the "Treasury View of 1929"[185] maintained that, contrary to the proposals being made by proponents of an economic stimulus at that time, that the funding of public works to alleviate unemployment would not only increase unemployment but those funds would only subtract from other forms of productive investments.[186] This view was a continuation of those economic theories that placed a continued faith in a liberal, non-interventionist state focussing on free capital movements and an unregulated labour market.[187] The borrowing of money to finance such a stimulus meant that the government would have to offer better terms to those creditors

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[178] Ibid, Smith, *Wealth of Nations*.
[179] Ibid.
[180] Ibid, p. 714.
[181] Ibid, p. 721.
[182] M. Pia Pagnelli, "David Hume on Public Credit," Digital Commons @ Trinity, Trinity University, (2012), p. 5. Available at: https://digitalcommons.trinity.edu/cgi/viewcontent.cgi?article=1005&context=econ_faculty (last accessed 24/04/20).
[183] E. A. Wrigley, "Society and the Economy in the Eighteenth Century," in L. Stone (ed.), *An Imperial State at War. Britain from 1869-1815* (Routledge, Abingdon, 1994), pp. 72-95.
[184] See generally J. Black*, British Foreign Policy in an Age of Revolutions*, *1783-1793*, (Cambridge University Press, Cambridge, 1994).
[185] Officially titled a "Memoranda on Certain Proposals Relating to Unemployment."
[186] L. L. Pasinetti, *Growth and Income Distribution. Essays in Economic Theo*ry, (Cambridge University Press, Cambridge, 1974), p. 35.
[187] Blyth, *Austerity*, p. 121.

which would have the effect of crowding out private capital that would only alleviate conditions in the short term rather than provide a permanent solution.[188]

Theorists, such as Smith and Hume, writing during this period were primarily concerned with restraining the state, protecting the rights of the property-owning classes and limiting government expenditure which might lead to those assets being taxed. What they did not foresee was the evolution of British liberalism, inspired by John Stuart Mill, that saw the state's role as one of both protector of capitalism and as a tool for social reform which allowed the raising of living standards for ordinary people.[189] Nonetheless, attitudes towards the notion of deficit spending during an economic depression did not change.

Conclusions

The reconfiguration of the structure and administration of public finances was driven primarily by practical concerns, namely, the need to develop longer term funding of state activities, specifically war. This was set against a background of legal reform (that had a significant constitutional impact), informed by liberal philosophy, that reduced monarchical power. Analysis of this period reveals a governmental approach to public finance which envisioned significantly increased interactions with financial markets. In fact, it created a new market in government bonds. It is argued that, contrary to the liberal belief that markets are a natural phenomenon, they are created socially, politically and legally. This period of legal activism allowed the inculcation of the values associated with liberal capitalism. It is argued that it was at this point that the law entered a period of inertia: the law stepped aside in deference to the operation of political constitutionalism putting the challenge of those values beyond reach.

Moreover, it is argued that the legal recognition and prioritisation of investors' property rights allowed them to take up and occupy a position higher in the economic and political order. It guaranteed a return on those investments, facilitated by a more efficient and effective revenue collection system, that subjugated the rights of those lower down in that

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[188] Ibid, Blyth, p. 121-122. In the United States, the Hoover administration had adopted a similar approach under the 'liquidationist' policy. See also J. Bradford De Long, "Liquidation Cycles: Old Fashioned Real Business Cycle Theory and the Great Depression," NBER Working Paper No. 3546 (1990), p. 1. The Federal Reserve did nothing to maintain the money supply or price levels as the Great Depression approached. It was considered that it could not be avoided and had to be endured. The 'liquidationist' theory was common before the adoption of Keynesian ideas and supported by economists such as Hayek and Schumpeter.

[189] Ibid, Blyth, p. 117.

order. Furthermore, given the qualifications that allowed participation in democratic processes and the composition of Parliament, those legal interventions allowed for the division of the political economy from its political and economic aspects.[190] When considered in conjunction with the development of commercial banking,[191] analysis of this period reveals the origins of today's power relations in terms of the nexus of mutual interests of governments and financial markets. Indeed, they would provide the basis for the operation of a *laissez-faire* form of capitalism that would dominate the economic policies of many western economies and would subsist until 1929. After a brief hiatus, it would of course re-emerge in the 1970s, arguably in a more extreme form. Furthermore, and as will be shown in the next chapter, the prioritisation of creditors' rights and, in particular, the opposition to public debt, that is providing a fiscal stimulus in the event of an economic shock, would be replicated at the European level resulting from the development ordoliberal theory and its blending with monetarist policies.

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[190] C. Desan, "The market as a Matter of Money: Denaturalizing Economic Currency in American Constitutional History." Law and Social Inquiry, Vol.30, No.1, (2005), pp. 1-60, p. 10.
[191] See Chapter One.

Part II

A Flawed Monetary Paradigm in Europe

The model developed in Britain would go on to represent the organisational structure for the global economy.[1] Under the aegis of the Gold Standard, governments were required to implement internal, deflationary policies in order to address international trade imbalances. This resulted in the rise of two opposing forces - the desire of *laissez-faire* proponents to expand the scope of the market, and the countermovement that attempts to protect society from the adverse effects of that economic model.[2] This state of affairs would ultimately prove unsustainable and led to the Great Depression, a deterioration in international relations, the rise of fascism and, ultimately, global conflict.[3]

These insights were not lost on the architects of the post-war order. Europe's economic success in the post-war era was not only due to the security of property rights and the operation of markets, it also depended on a set of norms and conventions (some informal, others legally enacted) to coordinate the actions of all social partners to address the problems that decentralised markets could not solve.[4] However, this model was gradually deconstructed with the ascendancy of neoliberalism in the 1970s and 80s. This development coincided with the move towards closer economic integration culminating in the introduction of the single currency.

The development of European Economic and Monetary Union (EMU) occurred during a period characterised by a sense of complacency on the part of political elites: with the rise of globalisation and the collapse of the Soviet Union there was an unshakeable belief in the neoliberal economic paradigm. Chapter Three argues that such confidence was unjustified as the new economic model was essentially "plucked from the entrails of the old"[5] and there was an inevitability that the mistakes of the past would be repeated with the law

[1] F. Block in K. Polyani, *The Great Transformation* (Beacon Press, Boston, 1957, 2001), p. xxii.
[2] Ibid, Block, p. xxviii.
[3] Ibid.
[4] B. Eichengreen, *The European Economy Since 1945* (Princeton University Press, Princeton and Oxford, 2007), p. 4.
[5] D. Harvey, *A Brief History of Neoliberalism* (Oxford University Press, Oxford, 2005), p. 2.

playing its part in this recurrent pattern. Indeed, that pattern would be repeated with the rise of financial capital which exacerbated the instability of the system.[6] Chapter Four examines the role of finance in the inflation of asset prices and the sovereign bond markets that led up to the Eurozone crisis. More importantly, it considers the institutional (legal) responses to the crisis. It argues that the political deference to a set of contestable economic principles entrenched the interests of financial elites whilst undermining the interests of the more vulnerable, again, replicating the events of the past. Ultimately, given the nature of the allocation of losses following the crisis, those legal measures (both under EU law and by means of international law) would be challenged. Chapter Five critically analyses the role of the CJEU in defending the political and economic hegemony. It examines the unprecedented levels of interpretative creativity deployed by the Court that validated the political and legal responses to the crisis. As a consequence, not only was the rule of law undermined at the European level, the ability of Member States to insulate the most economically vulnerable from the externalities created by international (financial) markets was further eroded.

[6] See A. Fasianos, D. Guevata, C. Peirros, "Have we been here before? Phases of financialization within the 20th century in the United States," Levy Economics Institute Working Paper No. 869 (2016).

Chapter Three

Creating the Euro

Complacency and the Illusion of Economic Stability

Introduction

The road to Economic and Monetary Union (EMU) was paved with good intentions. Its realisation represented the zenith of the integration process during a period characterised by Euro-optimism.[7] It was designed to promote and enhance cross-border trade within the single market with the benefit of reduced transactional costs facilitated by the single currency. Set against the background of increasing globalisation, the project was also a seen as a means of increasing European competitiveness on the world market. However, the project was incomplete and the legal architecture of single currency was characterised by an asymmetry between its economic and monetary components: on the one hand monetary sovereignty was transferred to the European level, whereas on the other, Member States retained a greater degree of economic sovereignty. It was envisaged that the commitment to closer economic coordination, contained in the Treaties, would reduce the disparity between Member States' economies thereby eliminating that asymmetry and achieve full economic and monetary union.

This chapter examines the evolution of EMU and offers a critical analysis of the monetary and economic norms that were inculcated in it. A single currency had been long envisaged and by the time of its realisation its architects were informed largely by the inflationary pressures experienced in the 1970s. This was despite the anomalous nature of that period.[8] It is argued, therefore, that the construction of EMU was undertaken according to a relatively narrow conception of economic and monetary matters. As a result, by the time of the introduction of the single currency, there had been a gradual shift away from the values that underpinned the post-war consensus to a model that sought to limit the role of the state. Financial stability was the order of the day and the markets would act as a

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[7] F. Scharpf, "The European Social Model: Coping with the Challenges of Diversity," MPIfG Working Paper 02/8 (2002), p. 2. It was a response to the perceived threat of "Eurosclerosis" and followed the Internal Market programme and the Single European Act.

[8] W. C. Peterson, "Macroeconomic Theory and Policy in an Institutionalist Perspective," in *Evolutionary Economics Volume II Institutional Theory and Policy* (ed. M. R. Tool) (M. E. Sharpe Inc., London. 1988), p. 174.

disciplinarian force on Member States. In monetary terms, it is argued that the theoretical foundation of the single currency is flawed. The architects of the Euro based its establishment on Optimal Currency Area (OCA) Theory, a model normally associated with the use of currency within a federal structure and that allowed for fiscal transfers in the event of an economic shock. Not only did the structure of EMU not share these features, it severed the link, traditionally found at the national level, between the power to raise revenue through fiscal authority and the issuance of currency by monetary authorities.[9] In economic terms, Member States committed themselves to the maintenance of 'sound' public finances with limits set on the levels of public debt and deficits in order to maintain the confidence of markets. In the event of an economic shock Member States were expected to undergo a period of fiscal consolidation as a monetary policy response was no longer possible.

This chapter argues that there was an unjustified sense of complacency concerning the pursuit of EMU. The rise of monetarism, as an arm of neoliberal ideology, combined with German ordoliberal values had become the dominant economic paradigm with regard to the project: governments should run a balanced budget or a surplus, Keynesian-style monetary stimulus was rejected (in order not to crowd out private finance) and government economic intervention was discouraged. However, the chapter argues that such commitments were unrealistic: Germany and France would go on to breach their obligations regarding the levels of public debts and deficits resulting in the amendment of the rules allowing for greater flexibility in difficult economic circumstances. Nonetheless, governments' debt as a proportion of GDP would go on to decline[10] in the Eurozone giving the impression that all was well. The reality was that with the limits placed on public spending, an environment was created that allowed for the accumulation of private debt.[11] This chapter argues that EMU represents a reversion to a form of *laissez-faire* capitalism, reflective of the values and features discussed in Part I, with the state constrained by the

[9] C. Goodhart, "One Government, One Money," Prospect, March 1997, p. 1.
[10] S. Storm, C.W.M. Naastepad, "Myths, Mix-ups and Mishandlings: What Caused the Eurozone Crisis?" Paper written for the panel on "The Eurozone Crisis: Fiscal Profligacy or Capital Flows as Final Causes", Institute for New Economic Thinking, Annual Conference, April11, 2015, P. 6.
[11] L. Randall Wray, "Teaching the Fallacy of Composition: The Federal Budget Deficit," New Economic Perspectives August 10, 2009. Available at: http://neweconomicperspectives.org/2009/08/teaching-fallacy-of-composition-federal.html (last accessed 12/05/20).

disciplinarian nature of liberalised financial markets that would ultimately recreate the mistakes of the past.[12]

1. The Quest for Stability: The Origins of Economic and Monetary Union (EMU) in Europe

The development of EMU in Europe has been informed by the experiences of the past, particularly those associated with the interwar period following the collapse of international trade and the return to protectionist policies. Policies within the region of Europe, after the War, before and since the formation of what is now the European Union, have been driven by the desire to avoid the economic conditions that led to political instability in the 1920s and 30s, in particular, the inflationary conditions experienced in Germany.[13] As a result, price stability has been the primary focus of monetary policy within the realm of economic cooperation in Europe.[14] The goals of EMU have remained consistent: to create a "regime of stable and ultimately irrevocably fixed exchange rates compatible with economic policies ... to create a framework of monetary policy so as to promote monetary and financial stability."[15] Ultimately, the establishment of EMU represented an ideological shift away

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[12] A. Pettifor, "Why the Euro is the Gold Standard Writ Large – and like the Gold Standard, will fail," New Economic Perspectives (2015). Available at: https://static1.squarespace.com/static/541ff5f5e4b02b7c37f31ed6/t/55ba08e6e4b0c6602ddd7f9d/1438255334668/Why+the+euro+is+the+gold+standard+writ+large.pdf (last accessed 11/05/20). See also A. Parguez, M. Seccareccia, C. Gnos, "The theory and practice of European monetary integration: Lessons for North America," in L.-P. Rochon & M. Seccareccia (Eds.) *Dollarization: Lessons from Europe and the Americas* (Routledge, London, 2003), pp. 48–69, p. 69:

> "In many ways …, the European states are virtually repeating the old mistakes of the gold zone during the 1930s. Since their restrictive monetary and fiscal policies have had the effect of compressing aggregate demand and employment on the European continent, the consequence has been …. to trigger deflationary pressures in the world economy."[12]

[13] It should be noted that the historical view of the inflationary conditions and their effect in Germany in the 1920s is controversial. See Mark Schieritz, "Die Inflationslüge," (The Inflation Myth), Die Zeit, 5 May 2013. Schieritz questions the myth that inflation led to Hitler's rise to power. In fact, the Nazis came to power during a period of deflation, high unemployment and economic crisis due to the austerity policies of Heinrich Brüning's government from 1929 to 1932.

[14] Price stability exists in two forms: firstly, at the domestic level in terms of maintaining control over inflation, and; at the international level, in terms of maintaining an exchange rate that contributes to a healthy balance of payments. Both forms of price stability, if maintained, are considered to contribute to economic growth and stability.

[15] H. Ungerer. *A Concise History of European Monetary Integration: From EPU to EMU* (Quorum Books, Westport, CT, 1997), p. 97. However, the emphasis on price stability, at the expense of financial stability, also laid the grounds for the potential collapse of the Euro currency with the threat of contagion and the inadequate suite of tools available to provide an appropriate monetary response to the crisis.

from the post-war policies that encouraged international trade whilst ensuring domestic social protection for the citizenry from (international) economic shocks.

A: First Steps: Rebuilding Europe

Following the end of war in Europe, the Marshall Plan was implemented, in 1947, to aid reconstruction and recovery. Funds were administered by the Committee for European Economic Cooperation, which was succeeded by the Organisation for European Economic Coordination (OEEC), in a bid to allocate aid and attempt to rebuild the economic structure of the region.[16] Indeed, it is suggested that the origins of European monetary union can be dated back to the establishment of the OEEC in 1948.[17] The OEEC established the European Payments Union (EPU) in 1950. The purpose was to reduce the demand for dollars as the Marshall Plan was coming to an end. The members of the EPU pooled their reserves and coordinated their policies in order to re-establish current account convertibility,[18] and therefore the balance of payments.[19] The EPU was working in order to address the coordination problems that had previously prevented trade liberalization and created export-led growth that would not have been as successful in its absence.[20]

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[16] L. Neal, *The Economics of the Europe and the European Union* (Cambridge University Press, Cambridge, 2007), pp. 26-28.

[17] B. Eichengreen, "European Monetary Unification," Journal of Economic Literature Vol. 31(3) (1993), pp. 1321-1357, p. 1324. However, the Plan resulted in a shortage of dollars. As a result, Britain devalued sterling relative to the US dollar by 30.5%, in September 1949 in an attempt to solve the shortage. Most European governments also devalued their currencies and the price of the dollar was raised (in European currencies) thus reducing the dollar shortage.

[18] Note that the balance of payment calculation consists of current account convertibility and capital account convertibility, that is trade in goods and services and trade in financial assets, with other nations. For a detailed account see the "Balance of Payments Manual" issued by the IMF, available at: https://www.imf.org/external/pubs/ft/bopman/bopman.pdf (last accessed 2/06/20).

[19] Ibid.

[20] See S. Hall, G. Hondroyiannis, P. A. Swamy, G. Tavlas, "Bretton-Woods Systems, Old and New, and the Rotation of Exchange-Rate Regimes," Economic Research Department – Special Studies Division, Bank of Greece Working Paper No. 1121 (2010): The operation of such regional measures took place against the background of the broader international regime agreed at Bretton Woods. The Bretton Woods Agreement was concluded in New Hampshire, July 1944 and was intended to avoid the exchange-rate instability experienced during the 1920's. It aimed to prevent the "beggar thy neighbour" policies associated with the failure of the Gold Standard in its revised form during the inter-war period, namely the competitive currency devaluations and trade restrictions designed to increase trade surpluses. It also sought to address the asymmetries associated with balance of payments surpluses and deficits between different countries and, therefore, to achieve symmetric positions with regard to national currencies within the newly created financial regime. See also: A. Giovannini, "Bretton Woods and Its Precursors: Rules versus Discretion in the History of International Monetary Regimes," in *A Retrospective on the Bretton Woods System: Lessons for International Monetary Reform* (eds. M. Bordo, B. Eichengreen) (University of Chicago Press, Chicago, 1993), pp.109-154.

The events in Europe should also be set against the broader international developments. The Bretton Woods Agreement (1944) took the principles established under the Glass-Steagall Act 1933 and transposed them to the international order. Consequently, it placed restrictions on the domestic financial sectors of participating states *viz* the separation of investment and retail banking, managing the level of domestic demand with capital controls.[21] The Bretton Woods Agreement also led to the establishment of the International Monetary Fund[22] which was designed to facilitate the expansion of balanced growth of international trade and to promote and maintain high levels of employment.[23] In addition, participating states agreed to promote exchange rate stability and to avoid competitive exchange depreciation.[24] Moreover, there was a commitment to assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which would hamper the growth of world trade.[25]

In Europe, under the Treaty of Rome,[26] Member States were committed to pursue economic policies that ensured the equilibrium of its overall balance of payments, to maintain confidence in its currency and ensure a stable level of prices.[27] In addition to the commitment by Member States to coordinate their economic policies,[28] a Monetary Committee was established to promote the coordination "... of policies in the monetary field."[29] Thus, whereas Member States retained sovereignty over monetary policy, the shared objectives of Member States' monetary policies in relation to the balance of payments, price stability and maintenance in the currency form the link, both in the Treaty and in reality, between economic and monetary policy. [30] Whereas monetary and economic

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[21] See P. Sikloss, "From Bretton Woods to the Euro: How Policy-Maker Overreach Fosters Economic Crises," The Centre for International Governance Innovation (2012), pp. 11-12.
[22] Articles of Agreement of the International Monetary Fund. Available at: http://www.imf.org/External/Pubs/FT/AA/pdf/aa.pdf (last accessed 2/06/20).
[23] Article 1(2), Articles of Agreement of the International Monetary Fund.
[24] Ibid, Article 1(3).
[25] Article 1(4), Articles of Agreement of the International Monetary Fund.
[26] Treaty of Rome 1957. Title II Economic Policy Chapter 2 – Balance of Payments.
[27] Article 4, Treaty of Rome, 1957.
[28] Ibid, Article 105(1).
[29] Ibid, Article 105(2).
[30] Article 108(1), Treaty of Rome. Where a Member State was threatened with difficulties with regard to its balance of payments (either as a result of an overall disequilibrium in that balance or due to the type of currency at its disposal) and where those conditions threatened the functioning of the common market, the

policy formation was coordinated by Member States, sovereignty ultimately resided with them. However, the inclusion of such provisions appeared to be motivated by the desire to avoid the potential problems created by the protectionist measures associated with the interwar years.[31]

B: Steps Towards Further Integration

In 1962, the Marjorlin Memorandum[32] demonstrated the need for a move towards a single centre for economic policy. Despite this, the Memorandum recognised that such a coordination of national policies, leading to their eventually being merged into one, would be ineffective, if no "comparable action were undertaken in the field of monetary policy..."[33] The Memorandum stated that monetary policy no longer played the same exclusive part as in the past, possibly due to the relative stability of the operation of the Bretton Woods system.[34] The EEC (as it was) still had an important role to play in maintaining the general equilibrium to act as a brake on an economy threatened by inflation.[35] The Commission also recognised the role that monetary policy had to play in the role of economic union and the need to fix exchange rates between Member States within narrow limits allowed for variation.[36] Whereas the Memorandum first launched the idea of a common currency, no further action was taken, except for the establishment of the Committee of Governors of central banks of the Member States in 1964, which complemented the Monetary Committee established under Article 105(2) of the EEC Treaty.[37]

Commission could investigate and make recommendations as to what measures that State should take. Under Article 108(2), if action taken by the Member State and the measures suggested by the Commission proved not to be successful, the Commission, in consultation with the Monetary Committee, could recommend the granting of mutual assistance.

[31] In addition, the relatively smooth operation of the Bretton Woods system did not place the issue of monetary integration at the top of the agenda. Thus, the Treaty of Rome confined itself to treat their monetary policies as a matter of common interest.

[32] European Commission Memorandum, 24th October 1962. Available at: https://www.cvce.eu/en/obj/memorandum_from_the_commission_24_october_1962-en-4bf24e3a-80ca-4886-b8dd-1a4d0a92d411.html (last accessed 2/06/20).

[33] Ibid, Chapter VIII at Para. 127.

[34] H. K. Scheller. *The European Central Bank – History, Role and Functions* (2004, 2nd revised edition 2006), p. 15. Available at: https://www.ecb.europa.eu/pub/pdf/.../ecbhistoryrolefunctions2004en.pdf (last accessed 25/05/20).

[35] The Marjorlin Memorandum, European Commission Memorandum, 24th October 1962, para. 128. Available at: https://www.cvce.eu/content/publication/2010/10/27/93d25b61-6148-453d-9fa7-9e220e874dc5/publishable_en.pdf (last accessed 25/05/20).

[36] Ibid.

[37] Ibid, H. K. Scheller. *The European Central Bank – History, Role and Functions*.

As the Bretton Woods system began to fail, pressure intensified for a re-evaluation of EEC policy.[38] Thus, at the Hague Summit in 1969, Pierre Werner was appointed to head a committee to develop a new plan.[39] The Werner Report[40] recognised that the "increasing interpenetration of the economies" had led to a progressive weakening of autonomy for the formation of national economic policies.[41] In identifying the final objective, Werner stated that Economic and Monetary Union would allow for the creation of an area in which goods, services, people and capital would be able to circulate without competitive distortions and, therefore, avoid structural or regional disequilibrium.[42] As a result, Werner recommended a monetary union that would be irreversible and eliminate the fluctuation in exchange rates, the irrevocable fixing of parity rates and the complete liberation of the movement of capital and, to ensure this newly established cohesion, the transfer of responsibility from the national to the Community level.[43] Additionally, the report noted the indispensable nature of the decision making in terms of monetary policy should be centralized in terms of liquidity, interest rates, foreign exchange markets and the management of reserves for the fixing of exchange parities.[44]

The Werner Report was endorsed by the ECOFIN Council in its Resolution of March 1971. It became evident that the transfer of powers and the emergence of supranational structures were problematic for the French who, therefore, failed to take part in the endorsement of the clear definition of the final stage which envisaged the creation of a central bank which would govern European monetary policy.[45] Furthermore, for Germany, curtailment of

[38] B. Eichengreen, "European Monetary Unification," Journal of Economic Literature Vol. 31 (3) (Sept. 1993), pp. 1321-1357, p. 1328.
[39] Ibid.
[40] P. Werner, "Report to the Council and the Commission on the realization by stages of economic and monetary union in the Community." Luxembourg, 8th October 1970, p. 8. Available at: https://ec.europa.eu/economy_finance/publications/pages/publication6142_en.pdf (last accessed 25/05/20).
[41] Ibid, p. 8.
[42] Ibid, p. 9.
[43] Ibid, Werner Report, p. 10.
[44] Ibid.
[45] H. Tietmeyer "From the Werner Report to the Euro," Pierre Werner Lecture, delivered in Luxembourg 21 October 2003, p. 5. Available at: https://www.cvce.eu/content/publication/2010/12/7/8728be43-8433-4ccf-b3d7-eeab79b4c4bb/publishable_en.pdf (last accessed 20/05/20).

national and monetary sovereignty without a definition of the supranational structures was not acceptable.[46]

In 1978, a "scheme for the creation of closer monetary cooperation leading to a zone of monetary stability in Europe" was proposed by the European Council.[47] The scheme allowed for the creation of the European Currency Unit (ECU) with the aim of stabilising exchange rates but, more importantly, without the removal of policy divergences through either the application of fiscal and monetary rules or by creating competence at the European level in terms of the coordination of national policies.[48] The scheme which established the European Monetary System (EMS) facilitated closer monetary cooperation with the formulation of policies conducive to greater stability at home and abroad for both deficit and surplus countries.[49] [50]

It has been argued that the EMS contributed to progress towards the double objectives of greater monetary stability and exchange rate stability with economic convergence and low levels of inflation, and, in turn, providing further progress towards financial and monetary integration.[51] As a result of the relaxation of controls over international capital flows which

[46] However, some elements of Werner did survive. The Werner Report had detailed the desirability and methods for narrowing the fluctuations between the various EC currencies. See: European Commission, "One Currency for One Europe. The Road to the Euro." (2007), pp. 4-10. In 1972, exchange rate fluctuations were narrowed by limiting those variations between rates to a 2.25 % band. The mechanism, known as the "snake in the tunnel" thus limited currency fluctuations inside narrow limits against the dollar (the tunnel). The participating currencies were allowed to move up and down, or undulate within the wider 4.5% band set for the dollar established under the Smithsonian Agreement of 1971. The subsequent oil crisis and following policy divergence and dollar weakness meant that the snake had it lost its efficacy. However, the death of the snake did not diminish interest in trying to create an area of currency stability. Available at: https://ec.europa.eu/economy_finance/publications/pages/publication6730_en.pdf (last accessed 20/05/20).

[47] Resolution of the European Council of 5 December 1978 on the establishment of the European Monetary System and related matters.

[48] B. Eichengreen, "European Monetary Unification," Journal of Economic Literature Vol. 31(3) (1993), pp. 1321-1357, p. 1330.

[49] Ibid.

[50] In addition, to the Resolution the EMS was founded on two Council Regulations: Council Regulations No. 380 and 381/1978, OJEC, No L379. Through these measures the European Currency Unit (ECU) was introduced essentially as an internal unit of account as the denominator for the exchange rate mechanism and as the basis for the divergence indicator of currencies. Accordingly, each currency had an ECU related central rate which was used to determine exchange rates which allowed for a fluctuation of +/- 2.25%. As a result, it was intended that the intervention mechanism would detect divergences in excess of 75% of the threshold allowed. Thus, it was presumed that in that event the authorities concerned would take corrective action by, inter alia, addressing measures of domestic monetary policy, changing the central rates or other measures of economic policy.

[51] This occurred despite the crises in September 1992 and August 1993. Indeed, the Delors Report noted that the EMS had created a zone of increasing monetary stability creating an element of exchange rate constraint

resulted in increased mobility of funds, European monetary arrangements were increasingly prone to currency upsets.[52] The Single European Act (SEA), signed in Luxembourg in February 1986, was designed to promote further integration and complete the single market and with the inclusion of the article on monetary capacity, recognised the EMS and envisaged continued progress towards Economic and Monetary Union through institutional changes.[53]

The thirty-year period, following the end of World War II is often referred to by economists as the Golden Age of Capitalism.[54] Many western economies had generated significant growth and achieved low unemployment based on the prevalence of Keynesian policies. Indeed, many nations, particularly in Europe, based their economic and monetary policies on the notion of "Keynes at home, Smith abroad."[55] Opposition to unfettered economic liberalism (outside the United States) was united in its rejection unimpeded *laissez-faire* policies and, thus, the task of the architects of the post-war institutional structure was to devise a system which would aid domestic stability without triggering mutually destructive polices that prevailed during the interwar period.[56] It was necessary, therefore, to create rules and institutions that would act as a constraint on free markets in order to prevent the descent into a Hobbesian war.[57] It was considered necessary to create the potential for political and regulatory responses to the growth and spread of markets, to the

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which helped those states with higher rates of inflation in gearing their monetary policies to the objective of price stability "thereby laying the foundations for a downward convergence of inflation rates and the high degree of exchange rate stability." The Delors Report - Committee for the Study of Economic and Monetary Union "Report on Economic and Monetary Union in the European Community." Presented April 17, 1989.

[52] D. Marsh, *The Euro. The Politics of the New Global Currency* (Yale University Press, Yale, 2009), p. 102

[53] J. Pipkorn "Legal Arrangements in the Treaty of Maastricht for the Effectiveness of the Economic and Monetary Union," Common Market Law Review 31(2) (1994), pp. 263-291, p. 270.

[54] See generally *The Golden Age of Capitalism* (eds. S.A. Marlin and J.B. Schor) (Oxford University Press, Oxford, 1991).

[55] S. Bilal, U. Dadush, F. Erixon, S. O' Connor, "Keynes at Home, Smith Abroad – The Right Approach," Carnegie Endowment for International Peace, November 23, 2009. Available at: https://carnegieendowment.org/2009/11/23/keynes-at-home-smith-abroad-right-approach-event-1487 (last accessed 2/06/20).

[56]J. G. Ruggie, "International Regimes, Transaction, and Change: Embedded Liberalism in the Postwar Economic Order," Vol. 36 No. 2 International Regimes (1982), pp. 379-415, p. 393.

[57] F. Block, "Karl Polanyi and the Writing of the Great Transformation," Vol. 32 Theory and Society (2003), pp. 275-306, p. 297.

commodification of labour and land, thus offsetting the forces of economic liberalism by the principles of social protection.[58]

The extension of New Deal values to international post-war monetary and financial regulation created an era of stability: the restrictions on the movement of capital preserved a system of fixed exchange rates which limited the currency trades that had previously caused instability and speculative attacks. The collapse of that regime, followed by the oil crisis, led to a period of great economic instability and, ultimately, the abandonment of Keynesian policies. It would lead to the rise of Monetarism spearheaded by Milton Friedman. As will be shown below, there was an increasing belief in the causal link between the money supply, price stability and national income accompanied by the rejection of the use of fiscal measures by the public sector to counter economic shocks.[59] From the mid-eighties there had been a decline in volatility and inflation in a period known as the Great Moderation.[60] This, it is argued, led to a degree of complacency: the establishment of EMU would be characterised by asymmetries, of which the architects of the Euro were aware but did not fully address, due to the faith in the ability of the Central Bank to maintain financial and price stability through monetary policy transmission and a commitment by Member States to achieve increased economic convergence.

2. The Birth of Economic and Monetary Union

After the Werner Report, there had been little, if any, discussion of EMU. However, after the launch of the SEA, the subject of further integration[61] was brought to the fore again. To that end, and in connection to it, Helmut Kohl, the German Chancellor, put EMU on the agenda

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[58] D. Ashiagbor, "Unravelling the Embedded Liberal Bargain: Labour and Social Welfare Law in the Context of EU Market Integration," Vol. 19 (3) European Law Journal (2013), pp .303-324, p. 305.

[59] "The ECB and the Financial Crisis: Rigid Theory vs a Pragmatic Approach," European Parliament Briefing, July 2015, p. 1. Available at: http://www.europarl.europa.eu/RegData/etudes/BRIE/2015/565876/EPRS_BRI%282015%29565876_EN.pdf (last accessed 2/06/20).

[60] D. Giannone, M. Lenza, L. Reichlin, "Explaining the Great Moderation: It is not the Shocks," ECB Working Paper Series No. 865 (2008), p. 5.

[61] It should be noted that integration and economic performance stalled in the 1970s and 1980s following the collapse of the Bretton Woods system and the 1973 OPEC oil boycott. This led to a period of intervention and protectionism that undermined aspects of the liberalisation measures contained in the Treaty of Rome. See M. Kahler, "European Protectionism in Theory and Practice," Vol. 37 No. 4 World Politics (1985), pp. 475-502.

of the European Council in Hannover in June of 1998. Jacques Delors was appointed to chair a committee composed of the twelve governors of the national central banks (NCBs) to prepare a report on the realisation by stages of EMU. The Committee for the Study of Economic and Monetary Union (the Delors Committee) submitted its report in April 1989.[62]

A: The Three Stage Plan

The Committee envisaged economic and monetary union in three stages. Stage one, in order to initiate the process, would aim at a greater convergence of economic performance through the strengthening of economic and monetary policy coordination through the establishment of a process of multilateral surveillance of economic policies and a procedure for budgetary policy coordination, with precise quantitative guidelines.[63] In monetary terms, the focus was on the removal of all obstacles to financial integration and the coordination of monetary policies.[64] Stage two would begin when the new Treaty came into force, establishing the institutional framework of EMU that would “gradually take over operational functions, serve as the centre for monitoring and analysing macroeconomic developments and promote a process of common decision-making…”[65] Stage three would consist of a move towards irrevocably locked exchange rates and the eventual replacement of national currencies by a single Community currency.[66] However, the Committee also recognised that current legal provisions under the SEA were insufficient for the realisation of EMU without a new Treaty.[67] It was agreed therefore that the first stage could be undertaken in compliance with the Treaty of Rome.

Following the Delors Report, a series of economic and political factors would prove influential in the negotiations leading to the Treaty of the European Union and provide the impetus for Member States to move towards EMU. At the meeting of the European Council

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[62] Committee for the Study of Economic and Monetary Union “Report on Economic and Monetary Union in the European Community.” Presented April 17, 1989, p. 30.
[63] Ibid, p. 30.
[64] Ibid, p. 31.
[65] Ibid, p. 33.
[66] Ibid, p. 35.
[67] Ibid, p. 36-37: The rules governing the EMS were based on agreements between the central banks concerned and are not an integral part of Community legislation. Without a new Treaty it would not be possible to take major additional steps towards economic and monetary union. Work on economic and monetary union continued at the Maastricht summit in December 1991. The negotiations and subsequent Treaty closely followed the work of the Delors Report and the work being undertaken on the European Central Bank Statute by the European central bank governors.

in Strasbourg, in December 1989, an intergovernmental conference (IGC) was agreed to be held at the end of 1990. The IGC would agree the amendment of the Treaty of Rome to implement stages two and three of EMU. By June 1991, a completed draft of the Treaty was produced, followed by negotiations which took place over the following six months. The Treaty was signed in February 1992 by the foreign and finance ministers of twelve Member States.

Whereas the negotiations around the Maastricht Treaty were clearly of great significance, the surrounding political and economic circumstances were also salient. The D-Mark had been the anchor currency under the ESM (and therefore the Exchange Rate Mechanism)[68] and, as such, it had retained credibility on the international markets which, in turn, led to the hegemony of German monetary policy within Europe. However, under that system, and in order to maintain parity with the D-Mark, other countries had suffered a disproportionate burden of adjustment.[69] Nonetheless, other EC Central Banks would imitate the Bundesbank model; with the growth in size of financial markets and the implications for the exercise of state power given the increased mobility of capital, the financial markets were acting as a disciplinarian force to avoid inflationary pressures (which would undermine the value of those assets).[70] This created a degree of tension. The Bundesbank was mandated to maintain price stability within its own jurisdiction but was under no obligation to take account of the economic conditions within other Member States. This was particularly true in France whose Socialist government was forced to abandon a programme of economic stimulus.[71] These concerns were amplified with the collapse of the Soviet Union, and in particular, the reunification of Germany and the potential for her dominance within Europe.[72] Whereas the costs of reunification would allow the Bundesbank to conduct a relatively relaxed monetary policy,[73] there were concerns, particularly on the part of France, that if further integration was not undertaken, her status would be undermined if the EC

[68] The primary objective of the EMS was to stabilise inflation and prevent large exchange rate fluctuations between Member States. The ERM pegged national exchange rates allowing limited deviations from the ECU.
[69] K. Dyson, K. Featherstone, *The Road to Maastricht: Negotiating Economic and Monetary Union* (Oxford University Press, Oxford, 1999), p. 26.
[70] Ibid, p. 27.
[71] M. J. Baun, "The Maastricht Treaty as High Politics: Germany, France and European Integration," Political Science Quarterly Vol 110(4) (1995), pp. 605-624, p. 608.
[72] N. Thygesen, "Why Did Europe Decide to Move to a Single Currency 25 Years Ago?" Intereconomics, Leibniz Information Centre for Economics Vol. 51 (2016), pp. 11-16, p. 12.
[73] Ibid.

were to remain a trading bloc.[74] As a result, France viewed EMU and a stronger political alliance as an opportunity to be more of an equal partner to Germany; the domination of European monetary policy by the Bundesbank would be diluted as with the establishment of the ESCB and ECB as both countries would, theoretically sit as equals.[75] In Germany, the Euro was presented as the successor of the D-Mark that would inculcate the stability policies that were reflected in the Excessive Deficit Procedure and the requirement for low and stable inflation.[76] In a further economic development, on September 16, 1992 the EMS neared collapse with the advent of Black Monday.[77] Since 1987 there had been a stability due to the convergence of inflation through the close cooperation among central banks, led by the Bundesbank. However, the crisis revealed that the system of fixed-but-adjustable exchange rates could be very unstable in an environment of free movement of capital.[78]

Within Member States, political leaders, often with the leaders of the opposition, exhorted their citizens to support the project. However, the majority of the public were unconvinced by the project, to say the least.[79] Only three countries were required by their constitutions to hold a referendum: France, Denmark and Ireland. The French approved the Treaty by the narrowest of margins (50.8% in favour) whereas the Danish initially rejected Maastricht by a margin of 50.7% to 49.3% leading to a second referendum in May 1993, following the Edinburgh Agreement, after which it was ratified. In addition, polls taken in Germany at the time show that nearly two thirds of voters were opposed to the country's participation in EMU.[80]

It is not unreasonable, therefore, to question why European leaders, especially the German and French, were so keen to pursue the project? With the collapse of the Soviet Union there was a degree of triumphalism associated with the model of increasingly globalised capitalism and that, therefore, it was essential for EMU to take place in order to ensure EU

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[74] O. Waever, "Three Competing Europes: German, French, Russian," International Affairs Vol. 66{3) (July 1990), pp. 477-499, p. 483.
[75] M. Feldstein, "The Political Economy of the European Economic and Monetary Union: Political Sources of an Economic Liability," Journal of Economic Perspectives Vol. 1(4) (1997), pp. 23-42, p. 28.
[76] N. Thygesen, "Why Did Europe Decide to Move to a Single Currency 25 Years Ago?" Intereconomics, Leibniz Information Centre for Economics Vol. 51 (2016), pp. 11-16, p. 13.
[77] F. Snyder, "EMU Revisited. Are we Making a Constitution? What Constitution are we Making?" EUI Working Paper Law, No. 98/6 (1998), p.30: Sterling withdrew from the ERM due to market pressures; the Lira was suspended and the Peseta was devalued.
[78] Ibid.
[79] Ibid, Feldstein, p. 31.
[80] Ibid.

competitiveness within that economic order.[81] Indeed, this was reflective of the intellectual climate that favoured minimum government and economic deregulation (in terms of the operation of the market) that provided the basis for further integration.[82] Moreover, notwithstanding the ERM crisis in 1992-1993, there had been a prolonged period of economic expansion since the 1980s which created a climate that tends to favour international cooperation.[83] This was accompanied by the unwavering support of the political elites in Europe, particularly the German and French governments: Kohl's government had supported the Mitterrand administration during the ratification debate and supported the Franc during the exchange-rate crisis of 1992 and 1993.[84] In short, they were committed to the realisation EMU.

B: A Questionable Theoretical Foundation

Clearly, the intentions behind the single currency were noble. The reduction of currency risk, reduced transaction costs and greater transparency for price comparison were compelling reasons to believe it would lead to greater economic activity. However, a one-size-fits all monetary policy would reduce Member States' flexibility: changes in relative wages and prices are more easily adjusted for by currency depreciation, a mechanism those states would now loose, which is especially problematic in the event of asymmetric shocks.[85] The single currency finds its underpinnings in Optimum Currency Area theory (OCA).[86] It suggests that transactional costs can be minimised by the increase in the spatial domain for a currency. Adjustments, if necessary, can be made by the existence of increased flexibility in the form of mobility of labour. Moreover, as OCA theory developed further contributions were made: Kenen had noted the advantages when countries had a common

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[81] R. 0. Keohane, S. Hoffmann, "Institutional Change in Europe in the 1980s" in Keohane and Hofmann, eds., *The New European Community* Westview Press, Boulder, CO, 1991), pp. 22-23.
[82] L. Bini-Smaghi, T. Padoa-Schiopa, F, Papadia, "The Transition to EMU in the Maastricht Treaty," Essays in International Finance, Princeton University, No. 94 (1994), p. 6.
[83] Ibid.
[84] M. J. Baun, "The Maastricht Treaty as High Politics: Germany, France and European Integration," Political Science Quarterly Vol 110(4) (1995), pp. 605-624, p. 623.
[85] P. Krugman, "Revenge of the Optimum Currency Area" NBER Macroeconomics Annual Vol. 27(1) (2012), pp. 439-448, p. 439. Traditionally, if wages were rising domestically, for example, currency devaluation would aid competitiveness for exporters. A boom or a bust everywhere in a currency is not as problematic as one in one participating state. For example, a housing boom could lead to full employment and rising wages but then collapses. Those increases lead to an uncompetitive domestic environment and relative wages will need to be reduced.
[86] OCA theory was originally developed by Robert Mundell in "A Theory of Optimum Currency Areas," The American Economic Review 51(4) (1963), pp. 657–665.

supra-national mechanism for fiscal transfer as it would reduce the effects of asymmetric shocks by means of redistribution of funds.[87] However, the notion of a federal structure and fiscal integration was not politically feasible at the time. By means of comparison with the US, the level of labour mobility and with virtually no fiscal integration is much lower in the EU.[88] However, the architects of the Euro continued to have faith in the monetary and economic arrangements. They believed that the maintenance of price stability and the obligation to maintain sound public finances (below) would lead to a convergence of economic conditions that would lessen the impact of potential asymmetric shocks. However, it should be noted that the authors of OCA theory were attempting to develop a theory to explain the operation of monetary union within existing federations such the USA and Canada; the theory said nothing of the political preconditions for the single currency in the EU.[89] It said nothing about the need for a central bank to act as lender as last resort.[90] The ECB was essentially a currency board. Moreover, the theory, as it developed in the late 1960s said nothing about the effect of banking as, at that time, banking was much more highly regulated. It is for these reasons that it is argued that there was a high degree of complacency and optimism in the institutional arrangements for the Euro.

There is also an important philosophical and constitutional dimension that explains the complacency of the authors of the Euro. OCA theory represents part of the monetarist paradigm: it has its origins in the debate concerning the nature and origin of money (see chapter 1). Monetarists believe money emerged from the private sector as economic actors seek to minimise the cost of exchange within the market. According to this paradigm, the role of government is minimised. This is in contrast to the chartellist school of thought that argues currency gains its legitimacy from the sovereign nature of the issuer, thus decoupling it from its intrinsic value.[91] However, the monetarist view prevails despite being

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[87] P. B. Kenen, "The Optimum Currency Area: An Eclectic View," In R. Mundell and A. Swoboda, (eds.), *Monetary Problems of the International Economy*, (University of Chicago Press, Chicago, 1969), p. 185.
[88] P. Krugman, "Revenge of the Optimum Currency Area," NBER Macroeconomics Annual Vol. 27(1) (2012), pp. 439-448, p. 443.
[89] B. Eichengreen, "The Eurozone Crisis. The Theory of Optimum Currency Areas Bites Back," Notenstein Academy White Paper Series, O4 (2014), p. 3.
[90] Ibid, p. 4.
[91] C. A. E. Goodhart, "The two concepts of money: implications for the analysis of optimal currency areas," European Journal of Political Economy 14 (1998), pp. 407-432, p. 408. See also S. Gleeson, *The Legal Concept of Money* (Oxford University Press, Oxford, 2018), p. 28. Gleeson notes that proponents of the market-based monetary origins can be divided into two categories: those who associate the origin and value of money on its intrinsic value and those who see money arising from a private-sector, market response to overcome

constitutionally weak in terms of "institutional detail and historical empiricism."[92] The monetarist view ignores the link, identified by the chartellists, between political sovereignty, fiscal authority and money creation; a link weakened by the creation of the Euro.[93] The complacency founded on that normative assumption did not seem to be of much concern to the authors of the single currency. In fact, in line with classical liberal theory, they were quite content with the weakening of those institutional relationships as it prevents political actors from pursuing short term political goals though the manipulation of monetary policy.[94]

3. From Maastricht to Lisbon – Legislating for a Fiscal and Economic Straightjacket

The Treaty on European Union (TEU) came into effect in November 1993 and represented a step towards stage three of Economic and Monetary Union. The Treaty laid the foundations for the coordination of economic policies within the Council.[95] Therefore, to ensure closer coordination and sustained convergence of the economic performances of the Member States, the Council, based on reports from the Commission, undertook the responsibility to monitor economic developments within Member States.[96]

Title VI of the TEU concerns economic and monetary policy and consists of four chapters, the first three of which deal with the rules associated with the third stage of EMU. Accordingly, under Article 3(2)(a), further to the proceeding Article, Member States agreed to the irrevocable fixing of exchange rates leading to the introduction of the single currency

transactional costs. The latter group are often referred to as Mengerians in reference to Karl Menger's article "On the Origin of Money," The Economic Journal Vol. 2 (1892), pp. 238-236.

[92] Ibid, Goodhart, p. 409.

[93] Ibid.

[94] Ibid.

[95] Art. 103(1) TEU.

[96] Art. 103(3) TEU. Under Art. 103(4) TEU where it appeared that the economic policies of the Member states were not consistent with those guidelines or that they risked jeopardizing the proper functioning of the EMU, the Council could make recommendations to the Member State concerned. Consequently, the TEU introduced the Excessive Deficit Procedure, under Art. 104(1). It was designed to bring Member State public finances back to a sustainable footing in line with Treaty objectives. The primary provision for the coordination of economic policy is now contained within the Treaty on the Functioning of the European Union (TFEU). The Protocol on the Excessive Deficit procedure (Article 1) defines reference values referred to in Art. 104(2) TEU. – 3% ratio of planned or actual government deficit to gross domestic product; 60% for ration of government debt to gross domestic product at market prices.

and the conduct of a single monetary policy and exchange rate policy to maintain price stability and to support the general economic policies in the Community.

Following the introduction of the single currency, governance of EMU is now found within the Treaty on the Functioning of the European Union (TFEU). Article 3[97] states that the Union has exclusive competence with regard to monetary policy for Member States who have adopted the euro. Thus, under Article 119,[98] for the purposes stated in Article 3, Member States are committed to adopting activities which includes the adoption of economic policies which are closely coordinated and conducted in accordance with the principle of an open market economy with free competition.[99] Further to the pursuit of those commitments, such activities also include the single currency, and the definition and conduct of a single monetary policy and exchange rate policy.[100] The primary objective of both is to maintain price stability.[101] Both the EU and Member States agree to conduct such activities in compliance with the guiding principles of stable prices, sound public finances and monetary conditions and a sustainable balance of payments.[102]

A: Monetary Arrangements under EMU

Having established that monetary policy falls within the exclusive competence of the EU, the tasks outlined above are delegated to the European System of Central Banks (ESCB). The ESCB consists of the NCBs and the European Central Bank (ECB). Thus, under Article 282,[103] the ECB, together with the national central banks, "shall constitute the European System of Central Banks. The ECB, together with the NCBs of the Member States whose currency is the Euro, which constitute the Eurosystem, shall conduct the monetary policy of the Union."[104] The ECB is directed to adopt measures that are necessary to "... carry out its tasks in accordance with Articles 127 to 133, with Article 138, and with the conditions laid down in the Statute of the ESCB and of the ECB."[105] It should be noted that, whereas the ECB and NCBs have legal personality, the ESCB does not. The term ESCB represents an institutional

[97] Article 3(1)(c), TFEU.
[98] Under Title VIII concerning Economic and Monetary Policy, TFEU.
[99] Article 119(1), TFEU.
[100] Article 119(2), TFEU.
[101] Ibid.
[102] Article 119(3), TFEU.
[103] Article 282(1), TFEU.
[104] It is of note that under this Article, those Member States, and therefore their national banks, which are not part of the euro shall retain their powers in monetary matters.
[105] Article 282(4), TFEU.

framework that establishes a link between the ECB and the NCBs.[106] This ensures that decision-making is centralised and that the tasks of the Treaty are performed jointly and in line with the allocation of powers within the system.[107]

The primary role of the ESCB and ECB, according to Article 127, is to maintain price stability."[108] Furthermore, the ESCB "shall support the general economic policies in the Union with a view to contributing the achievement of the objectives of the Union as laid down in Article 3 and also in compliance with the principles set out in Article 119."[109] Central to the performance of this role is the independence of the ECB. Accordingly, Article 130 states that when carrying out the tasks defined under the Treaties and the Statute of the ESCB and the ECB, "neither the European Central Bank, nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions from Union institutions, bodies, offices or agencies, from any government of a Member State or any other body." Additionally, "Union institutions, bodies, offices or agencies and the governments of the Member States" are to respect this principle and not seek to influence the decision-making bodies of the ECB.[110] There is, however, a problem with an independent central bank setting a one-size-fits-all interest rate in pursuit of price stability. It was noted at the time of the establishment of the ECB that a single nominal interest rate within an integrated currency union creates an asymmetry:[111] areas experiencing growing inflation, often with stronger growth, experience lower 'real' interest rates as compared with those with lower inflation. At the time of the Euro's introduction there were indications that those countries on the periphery, such as Ireland, were experiencing lower real interest rates than those countries, such as Germany, at the centre.[112] The belief was, that following the introduction of the Euro, as a spill-over effect, economic integration would follow as a matter of course. It is argued that there was a degree of complacency associated with this

[106] H.K. Scheller. *The European Central Bank. History Role and Functions*. European Central Bank (2006), p. 42. Available at: https://www.ecb.europa.eu/pub/pdf/other/ecbhistoryrolefunctions2006en.pdf (last accessed 23/05/20).
[107] Ibid. With the attribution of legal personality to it, the ECB is recognised under public international law, and can conclude international agreements (in areas relating to its competence) and participate in the work of international organisations such as the IMF and the Bank for International Settlements (BIS).
[108] Article 127(1), TFEU.
[109] Ibid.
[110] Article 130, TFEU.
[111] C.A.E. Goodhart, "The ECB and the Conduct of Monetary Policy: Goodhart's Law and Lessons from the Euro Area," Journal of Common Market Studies Vol. 44(4), pp. 757-778, p. 774.
[112] Ibid.

view; as will be shown below, without a form of fiscal union (that had originally been proposed in the Werner Report and rejected) to cushion Member States from asymmetric shocks. Member States are limited to domestic fiscal policy responses which may not be politically feasible.

The institutional structure, in relation to monetary policy, under Article 130, also has an asymmetric effect: namely the interaction of the ECB and NCBs and the impact of that architecture on conduct of monetary policy and its subsequent implications for monetary and economic sovereignty. NCBs are performing their role as part of the ESCB at the European level. However, they are also operating as national bodies when performing those tasks not related to the function of ESCB.[113] This notion of duality should be read in the light of Article 131[114] which states that Member States are to ensure that national legislation (including the statutes of its national central bank) is compatible with the Treaties and the Statute of the ESCB and the ECB.[115] As a result, the formulation and conduct of monetary policy has been transferred to the EU level. The decision-making process in relation to monetary policy is centralized at the ECB whereas implementation is decentralized.[116] Furthermore, Article 14.3 of ESCB statute[117] identifies the NCBs as an integral part of the ESCB and their commitment to act in accordance with the guidelines and instructions of the ECB such that the NCBs are acting in that capacity as part of the ESCB and therefore not as national agencies.[118] As a result, the link between the fiscal, revenue raising function of government and its ability to control the money supply through the setting of interest rates is severed.

The ECB's purported political independence is designed to allow it to determine monetary policy as an exclusive competence. Founded on monetarist theory, it considers the money supply to be the key factor as a determinant of economic activity that creates value.[119] The control of the money supply by the determination of interest rates, is designed to promote

[113] R. M. Lastra, J-V. Louis, "European Economic and Monetary Union: History, Trends, and Prospects." Yearbook of European Law Vol. 32(1) (2013), pp. 57-206, p. 123.
[114] Article 131, TFEU.
[115] Ibid.
[116] R. M. Lastra "Evolution of the European Central Bank." Queen Mary University of London, Legal Studies Research Paper No. 99, (2012), p. 8.
[117] Protocol on the Statute of the European System of Central Banks and of the European Central Bank.
[118] Ibid.
[119] J. Komorowski, "Monetarism and the Battle with the Global Economic Crisis," International Journal of Business Administration Vol. 6, No. 6 (2015), pp. 36-44, p. 38.

economic growth (or prevent an economy from overheating) in conjunction with a liberal economic policy. The policies of the Central Bank are then implemented by financial institutions that act as intermediaries facilitating the supply and demand of money as it, theoretically, flows into the non-financial sector i.e. the real economy. Due to the postulated theory that there is a causal link between the money supply, price stability and national income, there should be a steady increase in the supply of money to maintain growth yet within an acceptable level of price stability.[120]

B: Economic Arrangements under EMU

The justification for EMU was based on the desire to promote economic growth because the adoption of a single currency would reduce the transactional costs associated with cross-border trade within the EU.[121] Under the Maastricht Treaty,[122] new economic objectives were included in anticipation of the introduction of the single currency. Those provisions (optimistically) envisaged a high degree of convergence:

> "The Community shall have as its task, by establishing a common market and an economic and monetary union and by implementing the common policies or activities referred to in Articles 3 and 3a, 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."[123]

This provision differs from its equivalent under the Treaty of Rome by including objectives in relation to non-inflationary growth and respect for the environment. In addition, Article 2 of Maastricht differs from the Treaty of Rome changing the "harmonious development of

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[120] "The ECB and the Financial Crisis: Rigid Theory vs a Pragmatic Approach," European Parliament Briefing, July 2015, p. 1. Available at: http://www.europarl.europa.eu/RegData/etudes/BRIE/2015/565876/EPRS_BRI%282015%29565876_EN.pdf (Last accessed 22/04/2020).
[121] "One Market, One Money: An Evaluation of the Potential Benefits and Costs of forming an Economic and Monetary Union," Directorate-General for Economic and Financial Affairs No. 40 (1990), p. 63. Available at: https://ec.europa.eu/economy_finance/publications/pages/publication7454_en.pdf (Last accessed 22/04/2020).
[122] Article 2, TEU.
[123] Ibid, Art. 2 TEU.

economic activities"[124] to a "high degree of convergence" in a manner that established the intergovernmental coordination of economic policy being upgraded to the supranational level and implemented domestically in the light of those commitments.[125] Again, the primary objective of the architecture of the single currency, in economic and monetary terms, was to promote price stability, a sustainable balance of payments and, most importantly, sound public finances.[126]

The EU economic constitution, therefore, is founded on the premise that the coordination of economic policies would prevent fiscal profligacy based on the reference values in the Treaties and secondary legislation. The EU is not a state but a group of states acting collectively, coordinating their policies (out of mutual self-interest), based on the Treaties for the purpose of "exercising a number of delimitated functions."[127] As a result, limits of EU competences are governed by the principal of conferral and the use of Union competences is governed by the principles of subsidiarity and proportionality.[128] Thus, under the principle of conferral, the EU acts only within the limits of the competences conferred upon it by Member States to attain the objectives set out in the Treaties. Competences not conferred upon the EU remain with Member States.[129] Moreover, the Treaty provisions distinguish those competences which are shared and those which are exclusive. The EU exercises exclusive competence with regard to monetary policy[130] for Member States whose currency is the euro whereas Member States agree to coordinate economic policies with EU,[131] which implies a shared competence and created the legal conditions that allowed the development of the asymmetry. The existence of such an asymmetry within the legal architecture of EMU resulted from those political aspects of economic coordination: the implementation of economic policy will have redistributive effects at the national level and therefore need to have input legitimacy from a democratic

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[124] Art. 2, Treaty of Rome.
[125] W. Sauter, "the Economic Constitution of the European Union," Columbia Journal of European Law Vol. 4(1) (1998), pp. 27-68, p. 32.
[126] Now contained in Article 119(3), TFEU.
[127] J. Ziller, "The Reform of the Political and Economic Architecture of the Eurozone's Governance. A Legal Perspective," in *Governance in the Eurozone – Integration or Disintegration* (eds. Allen, Carletti, Simonelli) EUI and Wharton Financial Institutions Center (2012), p. 116.
[128] Art. 5(1) TEU.
[129] Art. 5(2) TEU.
[130] Art. 3(c) TFEU.
[131] Art. 5(1) TFEU.

perspective.[132] Thus, according to the principle of subsidiarity, Member States would continue to exercise a greater degree of economic sovereignty at the national level.[133] To be sure, the asymmetry was deliberate: even after economic and monetary union, the Community would continue to "consist of individual nations with differing economic, social, cultural and political characteristics…" and the "... preservation of this plurality would require a degree of autonomy in economic decision-making to remain with individual member countries and a balance to be struck between national and Community competences."[134] The result was a combination of transnational, European monetary policy combined with national fiscal and economic policy.[135] It was fuelled by a sense of Euro-optimism founded on the belief that apparently divergent economies would converge and gradually cancel out those economic asymmetries over time as EMU became more established. Resultingly, the Lisbon Process provided the overarching framework for the economic pillar of EMU[136] and demonstrated another asymmetrical facet of economic integration: the TFEU obliges Member States to coordinate economic policies to achieve the aims of economic stability whilst simultaneously respecting fiscal sovereignty.[137] This is achieved by the establishment of broad guidelines of economic policy[138] formulated by the Council founded on recommendations from the Commission.[139]

On the one hand, there is a commitment to coordinate economic policies whilst on the other domestic policy makers need to allocate resources according to need and in line with the legitimate expectations of the electorate. However, these commitments to pursue economic policy as a matter of common concern, are reinforced by the obligation to avoid fiscal profligacy.[140] Derived from the monetarist/ordoliberal policies found in the German

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[132] F. Scharpf, "Monetary Union, Fiscal Crisis and the Pre-emption of Democracy," MPIfG Discussion Paper No. 11, 2011, p. 3.
[133] Art. 3(b) TEU.
[134] "Report on economic and monetary union in the European Community" (Delors Report) April, 1989, p.m17.
[135] K. Tuori, "The European Financial Crisis – Constitutional Aspects and Implications," EUI Working Papers Law 2012/28, p. 2.
[136] K. Dyson, L. Quaglia, H. Fewster, "Economic and Monetary Union and the Lisbon Strategy," in *The EU's Lisbon Strategy: Evaluating Success, Understanding Failure* (eds. D. Papadimitriou and P. Copeland) (Palgrave MacMillan, London, 2012), p. 190.
[137] Art. 2(3) TFEU.
[138] Art. 121 (2), TFEU.
[139] Art. 121(2), TFEU.
[140] R. M. Lastra, J-V Louis, "European Economic and Monetary Union: History, Trends, and Prospects," Yearbook of European Law Vol. 32(1) (2013), pp. 56-206, p. 98. The authors argue that these provisions have acted as a "straightjacket" in trying to solve the sovereign debt crisis in some Member States. This principle is

economic constitution (discussed above), there was an ongoing belief that participant states would be able to align their economies despite the divergent political and social conditions amongst them.

Nonetheless, the guidelines for economic policies are formed by the Council, on the recommendations from the Commission. The Council will then adopt a recommendation (by qualified majority) setting out broad guidelines (the European Parliament will be informed). The Council then monitor the economic performance of Member States based on reports by the Commission and carry out regular overall assessment.[141] Coordination is carried out on the basis of multilateral surveillance which, in order to be effective, endeavours to place an obligation on Member States to provide information to the Commission as it deems necessary.[142]

The purpose of the decentralised application of economic policy of these provisions is to encourage coordination (as a matter of common concern) through the reinforcement of market mechanisms which were considered an effective incentive to avoid fiscal profligacy.[143] It is of note, however, that prior to the introduction of the Euro, the TEU[144] had set out the convergence criteria that Member States had to observe in order to take part in the single currency:[145] in preparation for the introduction of the single currency some

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extended by the TFEU, that is, in order to preserve the operation of market principles and maintain price stability, by the prohibition of undertaking overdraft facilities or any other type of credit facility with the ECB or with other national central banks in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities of Member States.

[141] Art 121(3), TFEU.

[142] Art. 121(3), TFEU. Under Art 121(4), where it is established that the economic policies of the Member State are not consistent with the guidelines or risk jeopardising the proper functioning of economic and monetary union, the Council, on the recommendation and acting by a qualified majority from the Commission may address the recommendations to the State concerned. The Council may also, acting on a qualified majority, on the basis of a recommendation of the Commission, make public its recommendations. In addition, as an innovation on the TEU, the Commission may also issue a warning to the Member State concerned under Art. 121(4).

[143] Ibid, Lastra and Louis. “European Economic and Monetary Union: History, Trends, and Prospects,” p. 42.

[144] Art. 104c, TEU.

[145] The convergence criteria as defined under Art. 109 TEU required Member States to demonstrate a high degree of price stability based on the rate of inflation and comparison with the best three performing Member States in terms of price stability; sustainability of government financial position (apparent from a government budgetary position without an excessive deficit in accordance with Art. 104c(6); observance of normal fluctuation margins provided for by the Exchange Rate Mechanism for at least two years, without devaluing the currency of another Member State; the durability of convergence achieved by the Member State and of its participation in the Exchange Rate Mechanism being reflected in the long-term interest rate levels. Further

member states were becoming concerned with the possibility of irresponsible budgetary behaviour by some governments once admitted into EMU.[146] However, it was believed that the market, as disciplinarian, would temper these purported excesses.

This principle is extended under the TFEU to preserve the operation of market principles and maintain price stability. Specifically, Member States are under an obligation to avoid excessive government deficits under Art. 126(1) TFEU. Accordingly, the Commission is responsible for the monitoring of the budgetary situation and the stock of government debt in Member States in order to identify gross errors.[147] In particular, it examines compliance with budgetary discipline on the basis of two criteria: (a) where the ratio of planned or actual government deficit to gross domestic product exceeds a reference value (unless it has already declined substantially and continuously to a level close to the reference value or the excess over the reference value is exceptional and temporary; (b) where the ratio of planned or actual government debt to gross domestic product exceeds a reference value (unless it has already declined substantially and continuously to a level close to the reference value or the excess over the reference value is exceptional and temporary).[148] Indeed, there would appear to be considerable room for negotiation where an excessive deficit or debt would appear to have been identified if the Member State concerned can show that it is temporary or exceptional, or, that it has already substantially declined to a level close to the reference value.[149] This would appear to be something of a paradox. Both monetary policy and the commitment to avoid excessive deficits/debts are founded on the conception that, left to their own devices, political actors are prone to abuse those policy areas in return for short term political advantage, and would, in so doing, undermine the

details, with regard to the convergence criteria, are found in the Protocol on the Convergence Criteria annexed to the Treaty.

146 J. Mortensen, "Economic Policy Coordination in the Economic and Monetary Union. From Maastricht via the SGP to the Fiscal Pact," CEPS Working Document, No 381/August 2013, p. 4.

147 Art.126(2) TFEU.

148 Art. 126(2) TFEU. The reference values referred to in Art. 126 are specified in the Protocol on excessive deficit procedure annexed to the Treaties[148] Thus, under Art. 1, the values are identified as (a) 3% for the ratio of the planned or actual government deficit to gross domestic product at market prices, and; (b) 60% for the ratio of government debt to gross domestic product at market prices.

149 Under Art. 126, if a Member State does not fulfil the requirements under one or both criteria, the Commission will prepare a report taking into account whether the deficit exceeds investment and other relevant factors, including medium-term economic and budgetary position of the Member State. The Economic and Financial Committee shall formulate an opinion on the report of the Commission and inform the Council which, if a deficit exists or may come into existence, will address the recommendation to the Member State to bring the situation to an end.

stability of the Euro. Hence, the reliance on the disciplinary nature of the markets. And yet there remains within Art. 126 the potential for political manoeuvre between a state, not in compliance with those reference values, and other Member States. Clearly this respects the domestic democratic relationship between government and the citizenry especially within the realm of fiscal policy and this might account for its inclusion. However, in fiscal terms and in the event of a breach under Art. 126, governments would have no choice but to correct debts and deficits by increasing receipts in the absence of the ability to avail of monetary tools. The commitment to pro-cyclical fiscal policies in the event of an unforeseen economic shock would therefore have significant redistributive effects which would leave the government, facing public opposition to those policies, attributing responsibility to the European Union. There was, therefore, an institutional gap at the centre of EMU in the absence of further political integration: the creation of monetary union and its administration by a supranational institution was not accompanied by a mechanism that allowed for decision-making that took account of political priorities, choices and competing social values.[150] On the contrary, in order to maintain the stability of the currency, Member States were committed to maintaining compliance with the technocratic values contained in the Excessive Deficit Procedure (and secondary legislation, discussed below) and, in so doing, broke the (constitutional) link between the fiscal and monetary competencies traditionally defined at the national (sovereign) level. Those normative economic assumptions, contained in the Excessive Deficit Procedure and derived from monetarist theory, would ultimately encourage an environment in which Member States would create new mechanisms for public procurement that would create the illusion of compliance with the obligations under Art. 126[151] that would reinforce the sense of complacency amongst the proponents of the single currency.

C: Fiscal Discipline – Violation and Reform

In addition to the eligibility criteria for membership of the Euro area and the fiscal commitment to the avoidance of excessive deficits, Member States agreed to the establishment of the Stability and Growth Pact (SGP) in order to aid the implementation of

[150] F. Snyder, "EMU Revisited. Are we Making a Constitution? What Constitution are we Making?" EUI Working Paper LAW No. 98/6, p. 55.
[151] See Chapter 4.

those obligations in the Treaties.[152] In anticipation of the single currency, there was concern that participating states should maintain their commitment to low budgetary deficits once it was introduced. Again, it was Germany that had put forward measures to maintain fiscal discipline at the December 1995 Madrid summit.[153] Consequently, the Council announced proposals to adopt regulations on the strengthening of surveillance and budgetary discipline and on speeding up and clarifying the excessive deficit procedure.[154] It is of note that during negotiations, leading to the introduction of the SGP, that Germany wanted to limit the scope for political discretion within the EMU system by the creation of a 'fiscal Schengen.'[155] France, representing herself and other states who expressed reservations, whilst wanting to keep EMU on track wanted to retain as much flexibility as possible.[156] As will be seen below, the pursuit of national interests (through an intergovernmentalist approach) during the negotiations, would ultimately result in the disjuncture of domestic political concerns and commitments at the European level in the pursuit of ever closer economic union.

The SGP consists of the resolution and two Council Regulations: Regulation 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (as amended by Regulation 1055/2005) and Regulation 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure (as amended by Regulation 1056/2005).

The first of the Regulations represents the "preventive arm" of the SGP. It was intended to strengthen the provisions for the implementation of EU objectives under Art. 121 TFEU, that is, with regard to multi-lateral surveillance of Member States' budgetary positions. As a result, each Member State is required to have a differentiated medium-term objective for

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[152] L. Schuknecht, P. Moutot, P. Rother, J. Starkl "The Stability and Growth Pact, Crisis and Reform," European Central Bank Occasional Paper Series No. 129 / September 2011, p. 9. Prior to the introduction of the SGP, on September 26 1994, the Council endorsed decisions on the existence of excessive deficits in ten states. See also M. Peil, "The Sovereign Debt Crisis, the European Fiscal Stability Treaty, and the Balance of Power Between the EU and the Member States," Legal Studies Research Paper Series, Paper No. 12-07-05 (2012).
[153] Agence Europe, 9 November 1995, No 6601, p. 5.
[154] Conclusions of the Dublin European Council: report on the preparations for the third stage of EMU (13-14 December 1996) available at: http://www.cvce.eu/education/unit-content/-/unit/en/02bb76df-d066-4c08-a58a-d4686a3e68ff/f03e162e-d9a9-44e5-b820-c075089a1d1a/Resources#9bf2a5fd-f943-447 (last accessed 27/04/20).
[155] M. Heipertz, A. Verdun, "The Stability and Growth Pact – Theorising a Case in European Integration," Paper prepared for delivery at the Ninth Biennial International European Union Studies Association Conference Austin Texas, 31 March – 2 April 2005, p. 7.
[156] Ibid.

its budgetary position.[157] These objectives are country specific and a close to balance or surplus budgetary position is required within a safety margin of 3% of GDP government deficit ratio in order to ensure sustainability of public finances.[158] A Member State's medium-term objective can be revised when a major structural reform is implemented. During the European Semester, the Council will, based on recommendations from the Commission, address guidance to Member States making full use of the instruments provided under Articles 121 and 148 TFEU.[159] Member States are then obliged to take account of that guidance before taking key decisions on national budgets and progress is monitored by the Commission. Failure to act on that guidance may result in further recommendations, a warning by the Commission under Art. 121(4) TFEU, or measures under Regulation No. 1467/97.

Council Regulation 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure represents the "corrective arm" of the SGP.[160] The Economic and Financial Committee will formulate an opinion within two weeks of the adoption by the Commission of a report as to the existence of an excessive deficit and address an opinion and recommendation to the Council.[161] The Council will decide whether an excessive deficit exists and make recommendations to the Member State concerned,[162] which will then have to take corrective action which should be completed in the year following its identification.[163] Failure to act in compliance with the decisions of the Council can lead to the imposition of sanctions.[164] When the excessive deficit continues as a result of non-compliance the Council may impose a sanction in the form of a deposit equal to 0.2% of GDP, and variable component equal to one tenth the difference between the deficit as a percentage of GDP in the preceding year and the reference value of 3% of GDP.[165] The

[157] Art. 2a, 1466/97.

[158] In addition, under Art. 3, Member States are obliged to submit to the Council and Commission information necessary for the purpose of multilateral surveillance (in accordance with Art. 121 TFEU).

[159] Art. 3, Council Regulation 1466/97.

[160] As amended by Council Regulation 1056/2005.

[161] Ibid, Art. 3(1) and (2) Council Regulation 1467/97.

[162] Ibid, Art. 3(3).

[163] Ibid, Art. 3(4).

[164] Ibid, Art. 7.

[165] Ibid, Art. 12.

Council may also make public its recommendations where it considers that no effective action has been taken to reduce the deficit.[166]

However, the process of effective enforcement of those obligations, under the SGP, rested on the political interactions between the members of the Council. There was a lack of political will to enforce the procedure against another Member State when the other participants might also find themselves subject to the same procedure.[167] Participants in the Council, whilst attending to issues of a European nature, are always mindful of domestic political pressures. This is especially pertinent to national economic policies when balancing them with the obligations deriving from the Treaties. The SGP was further weakened following the action taken by the Commission regarding the fiscal position of Germany. Ironically, given its stance on fiscal discipline during negotiations, Germany's budget deficit and projected government debt exceeded the reference values and, in accordance with Art. 126 TFEU the Commission adopted a report stating that the excessive deficit did not result from an unusual event outside the control of the county or from a severe economic downturn.[168] The Commission also found that government finances in France had deteriorated and the Council adopted a recommendation giving an early warning to France to prevent an excessive deficit.[169] The Commission proposed that the Council should adopt two recommendations on the basis that no effective action had been taken by either country in relation to the excessive deficit. However, the Council did not adopt the decisions. The Council drew a set of conclusions holding the Excessive Deficit Procedure in abeyance and addressing recommendations to both countries for correcting their excessive deficits.[170] The Commission brought an action[171] based on the Council's failure to adopt the decisions recommended by the Commission.[172] The CJEU held that the failure to adopt recommendations by the Commission was not challengeable by an action for annulment. The Judgment focussed essentially on procedural issues relating to the SGP. Fiscal rules and budget policy had been left to politicians to renegotiate. The Court limited its judgment "to

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[166] Ibid, Art. 4.

[167] K. Seng, J. Biesenbender, "Reforming the Stability and Growth Pact in Times of Crisis." Journal of Contemporary European Research Volume 8(4) (2012), pp. 451-469, p. 459.

[168] Council Opinion 21 January 2003, OJ C026.

[169] Ibid.

[170] Ibid, Lastra and Louis. "European Economic and Monetary Union: History, Trends, and Prospects" p. 59.

[171] Case C-27/04 *Commission of the European Communities v. Council of the European Union* [2004] OJ C228/12.

[172] Under Arts. 104(8) and 104(9) TEU.

the clarification of the powers of the Council and the Commission relating to the excessive deficit procedure but did not rule on the wisdom of fiscal rules...”[173] As a result, far from strengthening the enforcement of the Excessive Deficit Procedure, the judgment strengthened the political resistance to the narrow focus on the quantitative limits and an overly mechanical application of the treaty rules on fiscal discipline.[174] The reluctance to engage in judicial activism in relation to economic policy coordination therefore leaves it to the Member States who, with the nature of the wording, have significant room for manoeuvre.[175] Rather than acting to reduce the divergence of economic policy, the decision served, at a minimum, to maintain it, and in so doing preserve the asymmetry of EMU. There was a degree of complacency in the creation of the SGP; a centralised monetary policy for members of the Eurozone will inevitably affect economic policy within those states and therefore have fiscal implications. Prior to the introduction of the Euro, increased deficits would have had the effect of depreciating the currency leading to higher inflation. With the abandonment of exchange rates and the introduction of the single currency, that effect is spread across the Eurozone thereby reducing the effect on the state in breach of those commitments.[176] The belief, therefore, that a centralised monetary policy would lead to increased economic convergence was unfounded. Despite warnings to the contrary, deficit spending would lead to an increased issue of bonds by that state, to fund that spending, increasing the money supply and therefore leading to inflationary pressures.[177] Without greater fiscal or political integration, the ECB would be forced to increase interest rates which would cause the appreciation of the Euro and negatively impact the region’s trade balance.[178] Nonetheless, despite the breaches by Portugal (2001), France and Germany (2002) and with Italy predicted to run a deficit in 2005, ECOFIN maintained a lenient approach towards these infringements when it voted to suspend the Excess Deficit Procedure in November 2003.

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[173] “The Stability and Growth Pact. Crisis and Reform.” ECB Occasional Paper Series No 129/2011, p. 60

[174] C. D. Zinmmerman, *A Contemporary Concept of Monetary Sovereignty* (Oxford University Press, Oxford, 2013), p. 160.

[175] Ibid.

[176] See generally R. M. W. J Beetsma, "The Stability and Growth Pact in a model with politically induced deficit biases," (eds. A. Hughes Hallett, M. M. Hutchison, S. E. H. Jensen) in *Fiscal Aspects of European Monetary Integration*, (Cambridge University Press, New York, 2011), pp. 189-215.

[177] M. Heipertz, A. Verdun, “The Stability and Growth Pact – Theorising a Case in European Integration,” Paper prepared for delivery at the Ninth Biennial International European Union Studies Association Conference Austin Texas, 31 March – 2 April 2005, p. 17.

[178] Ibid.

Moreover, subsequent amendments further weakened the SGP. Council Regulation 1055/2005 introduced a greater degree of flexibility to the definition of the medium-term objective under the SGP.[179] The Commission and the Economic and Financial Committee and Council examine the budgetary objectives presented to them by Member States, and assess whether those economic assumptions, on which the stability programme is based, are plausible. Sufficient progress towards the medium-term objective is then evaluated based on an overall assessment with the structural balance as the reference, including an analysis of expenditure net of discretionary revenue measures. However, this analysis is softened by the allowance of divergence from the "requirement of close to balance or in surplus position" to leave room for budgetary manoeuvre.[180] Similarly, the revised corrective arm of the SGP was weakened by the introduction of a greater degree of flexibility:

> "...the Commission shall give due consideration to any other factors which, in the opinion of the Member State concerned, are relevant in order to comprehensively assess in qualitative terms the excess over the reference value... In that context, special consideration shall be given to budgetary efforts to ... achieve European policy goals ... if it has a detrimental effect on growth and fiscal burden of a Member State."[181]

The experience of the SGP demonstrates the conflict between the normative, narrow technocratic observance of the Pact's values on the one hand and the reality of Member States' domestic political and economic conditions on the other. The aspirational nature of increased economic integration and coordination is characterised by a soft law mode of governance in its interpretation and the hard law nature of its drafting on the other.[182] To be fair, flexibility is important when Member States are confronted with uncertainty as a result of unforeseen economic conditions. From that perspective, to impose a sanction due to an expected cause could potentially undermine the rules further.

The staggered development of economic coordination, therefore, was to a degree inhibited by influence of domestic political and economic considerations. In the absence of a federal

[179] Art. 5 Council Regulation 1466/97 as amended by Council Regulation 1055/2005.
[180] Ibid, Art. 2a.
[181] Art. 2(3), Council Regulation 1467/97, as amended by Council Regulation 1056/2005.
[182] D. Hodson, I. Maher, "Soft law and sanctions: economic policy co-ordination and reform to the Stability and Growth Pact," Journal of European Public Policy Vol. 11(5) (2004), pp. 798-813, p. 803.

structure, a greater degree of economic and fiscal sovereignty continued to allow Member States, by means of democratic input processes, to allocate resources, in theory at least, with the social and economic priorities of the state. Indeed, the tension between domestic and European objectives accounts for the notion that such measures are founded on the principle of 'positive integration' and therefore display the characteristics of soft law. Its success, therefore, relied on self-commitment, peer review and benchmarking. Governance by these rules was characterised by two things: [183] first, its rejection of overly strict discipline and, second, its refusal to allow supranational bodies to play a controlling role similar to that accorded to them in other areas.[184]

As a shared competence, economic policy was determined at the national level. The commitment was therefore political in nature and consists essentially of a loose commitment. However, by definition, economic and monetary union implies constraints on a state's margin for manoeuvre in terms of fiscal policy formation and it is the differing views on that degree of manoeuvre that has led to a lesser degree of macroeconomic convergence that was originally envisaged.

The question, therefore, is that, given the economic and political realities that governments face, why did Member States agree to such constraints? The answer is found in the dominance of German fiscal and monetary policies. The economic constitution of the EU, and in particular the demand for fiscal responsibility, is rooted in ordoliberal thought.[185] According to theory, the government should construct a rule-based, constitutionally founded, framework in which markets operate whilst the government would not intervene in everyday economic decisions.[186] In broader macroeconomic terms, ordoliberal thought assumes that for the market to work effectively it depends on the nature of the legal-institutional framework in which it operates; the ultimate goal was to ensure conditions in which economic actors pursue their own interests but also, as a result, promote the

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[183] R. Dehouse, "The 'Fiscal Compact': Legal Uncertainty and Political Ambiguity," Notre Europe Policy Brief, No. 33 (2012), p. 4.

[184] Ibid. Under art. 126(1) of the TFEU proceedings before the European Court of Justice (ECJ) were excluded under the excessive deficit procedure framework, while under art. 126(9) TFEU, the power of the Commission was limited to merely making recommendations.

[185] It was founded in the "Freiburg School" in the 1930s led by Walter Eucken, an economist, and Franz Böhm, a lawyer. Other contributors to the theory include Wilhelm Röpke and Alexander Rüstow.

[186] L. P. Feld, E. A. Köhler, D. Nientiedt, "Ordoliberalism, Pragmatism and the Eurozone Crisis: How the German Tradition Shaped Economic Policy in Europe," CESIFO Working Paper No. 5368 (2015), p. 1.

common interest.[187] Resultingly, the *Ordnungspolitik* ensures that the state is restrained in its ability to intervene in the economy as is the private sector that operates within it.[188] It is designed to prevent the abuse of power by private economic actors, distorting the market, whilst simultaneously promoting competition between those actors. As a consequence, the freedom and rights of citizens are protected from abuses within a state with a delineated set of functions that prevents the arbitrary use of public power.[189] In fiscal terms, it is viewed as inappropriate for the state to set the conditions for investment or target prices by means of monetary stimulus.[190] Resultingly, Keynesian policies are rejected. Ordoliberalism, therefore, promotes an economic model in which businesses compete for custom within an established regulatory structure, preventing distortion of the market and funded by savings and investment. Economic growth is achieved through the legal enhancement of competition. This coincided with the Bundesbank's adoption of monetarist policies in the 1970s[191] openly following the ideas of Friedman.[192]

There is, however, a clear distinction between the neoliberalism, associated with Hayek, Mises, Friedman *et al*, and German ordoliberalism. The former has become a proponent of *laissez-faire* capitalism focussing on the deregulation and liberalisation of markets, whereas the latter envisions the economy operating within a strong legal and institutional framework. However, they also share certain features: the rejection of Keynesian style stimulus in the event of an economic shock and a belief in strict fiscal discipline. These are the features that were transposed to the European level as EMU became a reality. These values are based on predominant normative assumptions about how the economy functions. There was a level of complacency when the legal architecture of EMU was constructed. Why not incorporate features of the German economic constitution into the treaties? After all, Germany had developed an extremely successful export-led economy. What is good for the individual should be good for the whole. In economics, this is known as

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[187] V. J. Vanberg, "The Freiburg School: Walter Eucken and Ordoliberalism," Freiburg discussion papers on constitutional economics, No. 04/11 (2004), p. 7.
[188] Blyth, *Austerity*, p. 136.
[189] M. Vatiero, "The Ordoliberal Notion of Market Power: An Institutionalist Reassessment," European Competition Journal Vol 6. No. 3 (2010), pp. 689-707, p. 690.
[190] Ibid, Blyth.
[191] Ibid Feld, Köhler, Nientiedt, "Ordoliberalism, Pragmatism and the Eurozone Crisis: How the German Tradition Shaped Economic Policy in Europe," CESIFO Working Paper No. 5368, p. 9. The Bundesbank announced a money supply target for the first time in 1974
[192] Ibid.

the fallacy of composition:[193] the micro cannot necessarily be conflated with the macro. With the promotion of an economic model based on savings and investment, public debts and deficits within strict limits working towards a trading surplus economic growth would be fostered in the EU. However, for a Member State to operating a surplus, another must be running a deficit. It is not possible for all Member States to operate a surplus and save.[194] As a result, the chances of economic integration as envisaged, at this stage of EMU, were slim. As will be shown in the following chapter, these asymmetries would have a profound effect.

Conclusions

EMU was designed and intended to promote economic growth within the region and enhance the prosperity of its citizenry. To take advantage of the EU's potential, a single currency had been envisaged long before its realisation. However, the institutional and legal arrangements that were ultimately put in place were informed largely by the experiences of the 1970s. Indeed, it is argued that policymakers overemphasised the impact of that relatively short period which was, too a large extent, anomalous when viewed against broader economic historical trends. Nonetheless, the inflationary pressures and volatility of that period ushered in the neoliberal era during which an economic orthodoxy was established that was considered irrebuttable. Monetarist values (as an arm of neoliberalism) were incorporated into the legal framework of the ECB whilst the principles that the ordoliberals and monetarists shared were incorporated into the economic constitution of the EU. There was little concern about how EMU did not share the characteristics identified by the authors of Optimum Currency Area theory. There was, in fact, a misplaced confidence and complacency that the separate Member States' (heterogeneous) economies would continue to converge and any shocks would be overcome. The sovereign disjuncture in monetary and fiscal competences did not seem to be of much concern to the architects of the single currency. There was an ongoing faith that the constitutional lacuna could be bridged by the restrictions of government debts and deficits in pursuit of 'sound' public finances. When France and Germany's sluggish economic growth during the early 2000s caused their failure to abide by the fiscal rule book in the SGP, it should have served as a warning. It demonstrated flaws in those normative assumptions that provided the

[193] See R. J. Caballero, "A Fallacy of Composition," The American Economic Review Vol. 82(5) (1992), pp. 1279-1292. Available at: https://economics.mit.edu/files/12642 (last accessed 28/05/20).
[194] Blyth, *Austerity*, p. 140.

justification for the ideological commitment to pro-cyclical fiscal policies. It led to a profound shift in public spending that saw the exponential growth in private sector investment in, off-balance sheet, public projects. Such practices, as will be shown in the next chapter, contributed to a reduction government debts and deficits with many countries falling within the tolerances demanded by the Treaties and secondary legislation. What was not heeded were the growing imbalances in terms of capital flows from the core to the periphery and the unsustainable levels of private debt that would ultimately lead to the Eurozone crisis. What had been constructed was, essentially, an economic and monetary ticking-time-bomb.

Chapter Four

Political Deference to Economics

Crisis, Control and the Curbing of Sovereignty

Introduction

The asymmetry associated with EMU would be thrown into stark relief with the onset of the Eurozone crisis. The development of EMU coincided with a move, in many developed economies, towards a financialised economic model in which the size and influence of financial institutions increased[1] and grew much more quickly than the non-financial sector.[2] These developments took place against the background of what was viewed as the triumph of western liberal capitalism accompanied by a sense of hubris and confidence in that economic orthodoxy. The policies supporting that model were founded on a belief in the efficiency of markets[3] and a light-touch regulatory system that facilitated the flow of capital both globally and between the Member States of the EU. As a consequence, there was a significant growth in the accumulation of private debt secured against assets that were overvalued.[4] The combination of that overvaluation, over-leveraged financial institutions and the threat of debtor default led to the 'credit crunch' as the financial markets seized up depriving banks of their ability to avail of access to the short-term refinancing facilities that had driven the inflation of those asset classes in the first place. There was a short-lived degree of complacency within the EU based on the belief that the regulatory structures

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[1] A. Baker, G. Epstein, J. Montecino, "The UK's Finance Curse? Costs and Processes," Sheffield Political Economy Research Institute (2020), p. 1. Recent research in the UK suggests that a finance sector growing beyond a useful size causes significant damage to the real economy. It leads to the misallocation of resources away from more productive non-financial activities into finance. Available at: http://speri.dept.shef.ac.uk/wp-content/uploads/2019/01/SPERI-The-UKs-Finance-Curse-Costs-and-Processes.pdf (last accessed 24/04/20).
[2] A. J. Menéndez, "The Crisis of Law and the European Crises: From the Social and Democratic Rechtsstaat to the Consolidating State of (Pseudo-) technocratic Governance," Journal of Law and Society Vol. 44(1) (2017) 56-78, p. 57. (Hereinafter Menéndez, "Crisis of Law").
[3] P. De Grauwe, "The Banking Crisis: Causes, Consequences and Remedies," CEPS Policy Brief No. 178 (2008), pp. 1-2. Available at: http://aei.pitt.edu/11706/1/1758.pdf (last accessed 13/05/20).
De Grauwe notes that the efficient market hypothesis provided the 'intellectual backbone' justifying the deregulation of the banking sector since the 1980s.The efficient market paradigm was developed by academics in the 1970s who considered, firstly, that financial markets were able to allocate savings efficiently to the most promising projects. Secondly, as asset prices reflect certain underlying fundamentals, bubbles and crashes cannot occur. Thirdly, markets are self-regulating and, therefore, government or central bank regulation is not needed.
[4] Ibid, Menéndez, "Crisis of Law."

within European banking would insulate the Eurozone from the effects of what was viewed as a transatlantic financial crisis. However, as the extent of the European banking exposures emerged, it became apparent that the risk of financial contagion represented a systemic risk to the Eurozone.

This chapter examines the legal responses to the crisis. It offers a critical analysis, in substantive terms, of those measures and the values that underpin them. Founded on a set of economic norms, derived politically from ordo and neoliberal ideology, those responses focussed on a narrow interpretation of the economic constitution found in the Treaties: the legislation emphasised and reinforced the doctrine of fiscal conservatism. That, in turn, would lead to a pro-cyclical bias in economic terms that limited the policy choices of Member States.[5] The failure of the initial political responses to settle the markets was then accompanied by a significant and profound change in the narrative: what had started as a private debt crisis was transformed into a morality tale blaming the sovereign debt crisis on the fiscal profligacy of those peripheral Member States who had failed to adhere to their obligations as Eurozone members. The result was a "stealth bailout" of the assets of the top thirty percent of the income distribution curve[6] that had a profound distributive effect on the socio-economic interests of the citizenry of Member States. This is, it is argued, reflective of a commitment that prioritises the interests of the creditor and investor class, the origins of which are found in classical liberal thought.

This chapter is concerned with the role played by law in the facilitation of those responses. Political and, consequently, institutional actors demonstrated a degree of deference, if not submission, to the economic orthodoxy. As an extension of that orthodoxy, deference took the form of an ongoing depoliticisation of economic policy that relied on the markets as the ultimate disciplinarians of national public finances. It is argued that that faith was, and remains, misplaced: many of the underpinning theories justifying this approach are normative in nature, that is, a description of the economy as to how it ought to operate rather than how it actually does. Fiscal consolidation (austerity) was represented as the only

[5] See Commission Staff Working Document Report on the application of Regulations (EU) No 1173/2011, 1174/2011, 1175/2011, 1176/2011, 1177/2011, 472/2013 and 473/2013 and Council Directive 2011/85/EU. Available at: https://ec.europa.eu/info/sites/info/files/economy-finance/swd_2020_210_en.pdf (last accessed 14/07/20).

[6] M. Blythe, "The Sovereign Debt Crisis That Isn't: Or, How To Turn A Lending Crisis Into A Spending Crisis And Pocket The Spread," American Consortium on European Studies (ACES), No. 1 (2014), p. 3.

course of action justified and misrepresented, as being scientifically and objectively based and, therefore, value-free in its application and not ideologically driven.[7] It is argued that the narrative that accompanied the legal enactments, in response to the crisis, served to uphold a set of contestable[8] political and economic interests representing, in turn, an abandonment of a normative, disciplinary function that the law had had in balancing the interests of the market and the citizenry. It is argued that the measures adopted, in the form of intergovernmental treaties, secondary EU legislation and the policy decisions of the ECB, created a form of economic governance characterised by top-down technocratic processes that denies the citizenry agency and economic self-determination as the political actors involved deferred to the economic dogma promoted by the markets and the institutions of the EU.

1. Crisis and the Management of Perception by Misdirection

The triumph of neoliberalism[9] led to a shift to the right in terms of economic policy. Even those on the left of the political spectrum had capitulated to its principles.[10] There was, after all, no alternative.[11] During the period leading up to the financial crisis there was an unjustified sense of complacency as politicians deferred to the wisdom of the markets and the economic theories that underpinned it. It was an era in which the hubris of finance

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[7] For example, see C. Reinhart, K. Rogoff, “Growth in a Time of Debt,” American Economic Review, No. 2 (2010), pp. 573-578. T. Herndon, M. Ash, R. Pollin, “Does High Public Debt Consistently Stifle Economic Growth? A Critique of Reinhart and Rogoff,” Political Economy Research Institute, University of Massachusetts Working Paper No. 322 (2013), p. 1. The authors debunked Reinhart and Rogoff’s findings asserting that “…coding errors, selective exclusion of available data, and unconventional weighting of summary statistics lead to serious errors that inaccurately represent the relationship between public debt and GDP growth among 20 advanced economies in the post-war period.”

[8] J. Stiglitz, “Moving beyond Market Fundamentalism to a more balanced economy,” Annals of Public and Cooperative Economics Vol. 80(3) (2009), pp. 345-360, p. 345.

[9] D. E. Thorsen, “The Neoliberal Challenge. What is Neoliberalism?” Contemporary Readings in Law and Social Justice Vol. 11(2) (2010), pp. 188-214, p. 203:

> “Neoliberalism is … a loosely demarcated set of political beliefs which most prominently and prototypically include the conviction that the only legitimate purpose of the state is to safeguard individual liberty, understood as a sort of mercantile liberty for individuals and corporations. This conviction usually issues, in turn, in a belief that the state ought to be minimal or at least drastically reduced in strength and size, and that any transgression by the state beyond its sole legitimate *raison d’être* is unacceptable.”

[10] See S. L. Mudge, *Leftism Reinvented: Western Parties from Socialism to Neoliberalism*, (Harvard University Press, Harvard, 2018).

[11] Margaret Thatcher frequently invoked the phrase “there is no alternative” creating what became known as the T.I.N.A. doctrine.

ministers would lead them to declare an end to the economics of boom and bust.[12] When the crisis hit, proponents of neoliberal economics would declare, almost to a person, that nobody could have seen it coming. Their perceptions had been dulled by the opacity of the financial sector that they had helped create and which created the illusion of economic prosperity.[13] Therefore, to ensure the survival of the system that preserved the interests of those higher in the economic order, political elites would turn on the traditional neoliberal nemesis: the state. A narrative would be constructed that would hold the governments of struggling states responsible for the malfeasance of private actors.

A: The Complacency of the ECB

Initially, in the EU, the onset of the financial crisis was viewed primarily as a problem with the Anglo-Saxon financial and banking model.[14] Indeed, German policy makers blamed the crisis as having been caused by irrational lending practices through the excessive provision of cheap money.[15] The responses by the ECB were somewhat restrained during the initial stages of the crisis. Following the effects of the liquidity shortage among financial institutions,[16] the focus of the ECB was to address the financial shocks, adopting conventional monetary policies, by lowering short-term interest rates, to provide liquidity and enter into currency swap arrangements to facilitate access by European banks.[17] In this sense the approach of the ECB reflected the continued emphasis on the maintenance of

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[12] "No return to boom and bust: what Brown said when he was chancellor," The Guardian, September 11, 2008. Available at: https://www.theguardian.com/politics/2008/sep/11/gordonbrown.economy (last accessed 14/04/2020).

[13] It is of note that many prominent economists had predicted the financial crisis. For example, Ann Pettifor, director of Policy Research in Macroeconomics, Steve Keen, head of the School of Economics, History and Politics, Kingston University and Raghuram Rajan, governor of the Reserve Bank of India, Dean Baker, co-director of the Centre for Economic and Policy Research.

[14] I. Hardie, S. Maxfield, "What does the global financial crisis tell us about Anglo-Saxon financial capitalism?" Paper prepared for Workshop on The Financial Crisis, EMU and the Stability of Currencies and the Financial System, University of Victoria, October 1, 2010, p. 1.

[15] S. Theil, "Angela Merkel's Approach to the Financial Crisis," Newsweek, 12/5/08. Available at: http://www.newsweek.com/angela-merkels-approach-financial-crisis-83399 (last accessed 12/06/20)

[16] See "Economic Crisis in Europe: Causes, Consequences and Responses." European Commission, Directorate-General for Economic and Financial Affairs, European Economy, 7/2009. Available at: https://ec.europa.eu/economy_finance/publications/pages/publication15887_en.pdf (last accessed 12/06/20).

[17] P. Lane, "The European Sovereign Debt Crisis." Journal of Economic Perspectives Vol. 26 No. 3 (2012), pp. 49-68, p. 52.

price stability, in the narrow interpretation of its functions, and an ongoing faith in the efficiency of optimally self-regulating markets founded on monetarist principles.

However, the policies adopted in the EU differed starkly from those undertaken in the UK and the US where stimulus packages in the form of quantitative easing were applied; that is a stimulus package for the financial sector and not for those in the real economy. European leaders were vehemently opposed to such polices. Germany was particularly opposed to the stimulus deployed in other developed economies with Finance Minister Peer Steinbrück denouncing the policy as "crass Keynesianism" despite the commitment by the German government to a domestic stimulus.[18] Nonetheless, Germany remained critical of the stimulus policies being undertaken by others.[19]

Certainly, at the start of the crisis, the European view seemed to be well founded as the collapse seemed to have had little effect on European banks confirming the faith in their more robust lending practices.[20] Therefore, the unsustainable accumulation of private debt in other jurisdictions, fed by lax lending practices were, at this point, correctly viewed as the source of the crisis. Therefore, the ongoing faith in the monetarist emphasis on the control of inflation formed the basis for EU policy during the initial stages of the crisis.[21]

In the eight years before the crisis (2000-2007) government debt as a proportion of GDP fell by 6% on average. In Italy debt fell by 7% during that period, whilst in Ireland it fell by 8% and in Spain by as much as 24%. It is true, that during this period, the Portuguese government debt increased by 13% from 62.2% of GDP in 2000 to 75.5% in 2007. However, the question as to whether such levels of public debt could be considered profligate is difficult to answer when compared with the debts of Germany (65.7%), France (73%) or

[18] A. L. Newman, "Flight from Risk: Unified Germany and the Role of Beliefs in the European Response to the Financial Crisis," German Politics and Society, June 2010, pp. 151-164, p. 157. Newman notes that this stance is puzzling. Nearly 65% of its products were exported to other EU countries. In 2009, German exports fell by 20% from their 2008 level. Many workers had their hours reduced placing a further financial burden on the Government. Commerzbank had predicted a fall in German GDP of 6%. One would have thought that a European stimulus package would have been in the German economic interest.

[19] Ibid.

[20] M. Blythe, "The Sovereign Debt Crisis That Isn't: Or, How To Turn A Lending Crisis Into A Spending Crisis And Pocket The Spread," American Consortium on European Studies (ACES), No. 2014.1, p. 8. This belief was maintained despite the rescue of IKB in 2007, a Dusseldorf bank, exposed to losses on US subprime investments and the Hypo Real Estate bank in 2008.

[21] Ibid, p .9.

Belgium (88%).[22] Moreover, during this period the growth in household debt was linked to the rise in GDP which fed into higher household spending resulting from weaker constraints on liquidity through the provision of credit that led to an increase in asset (house) prices, leading in turn to higher aggregate demand and growth.[23] The rise in value of those assets increased household wealth (on paper) facilitating further borrowing leading, ultimately, to an unsustainable private borrowing boom.[24] Furthermore, bank and corporation indebtedness spiralled: corporate debt in 2012 stood on average at 212% of GDP whereas bank indebtedness stood at 522% as a percentage of GDP.[25] The belief that lending practices in Europe were more robust was not well founded. Moreover, the ECB's policy decisions, driven by monetarist principles, did not take account of the role of the financial sector and its link or effect it can have on the real economy. The environment that had been created that allowed the imbalances of capital flows to proliferate had its origins in the Single Market Programme in financial and banking services. In addition, following the introduction of the single currency, there was a convergence of bond yields. Banks filled their balance sheets with sovereign debt as a safe option.[26] Notwithstanding that convergence, there was still a small but significant difference between the lower yields of Northern core sovereigns and those higher yields of the periphery making the latter more profitable for banks.[27] Banks bought enough GIIPS sovereign debt to make them systemically important.[28] However, the ECB continued to believe "…in the efficiency of supposed self-equilibrating

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[22] Figures taken from Eurostat Data OECD data as cited in S. Storm, C.W.M. Naastepad, "Myths, Mix-ups and Mishandlings: What Caused the Eurozone Crisis?" Paper written for the panel on "The Eurozone Crisis: Fiscal Profligacy or Capital Flows as Final Causes", Institute for New Economic Thinking, Annual Conference, Aprill 11, 2015, P. 6.

[23] A. Barba, M. Pivetti, "Rising household debt: its causes and macroeconomic implications-a long-period analysis," Cambridge Journal of Economics Vol. 33 (1) (2009), pp. 113-137, p. 120.

[24] S. Storm, C.W.M. Naastepad, "Myths, Mix-ups and Mishandlings: What Caused the Eurozone Crisis?" Paper written for the panel on "The Eurozone Crisis: Fiscal Profligacy or Capital Flows as Final Causes," Institute for New Economic Thinking, Annual Conference, April 11, 2015, p. 13.

[25] Ibid, p. 14. Irish bank indebtedness stood at 1856% and Dutch bank liabilities were at 1018% as a percentage of GDP.

[26] Blyth, *Austerity*, p. 81. In Europe, sovereign bonds were the preferred form of collateral used on the Repo markets for short-term refinancing of longer-term loans.

[27] Ibid.

[28] Ibid. Blyth refers to this as "the mother of all moral hazard trades." He argues that banks knew that Greece was still Greece and yet bond purchases were reducing yields which were not reflective of the risk. By purchasing so much peripheral sovereign debt they made themselves too big to fail knowing they would have to be bailed out by the sovereign.

financial markets…"[29] So the ongoing belief in the economic model, acquiesced to by the body politic, went on.

Nevertheless, the narrative began to change following revelations by Greece. The government announced a deficit forecast of 12.7% of GDP, which was more than double the previous estimate of 6.0%. This was, in turn, reflected in the rising yields of sovereign bonds. Thus, despite the perceived risk of default by euro area countries being quite low, the financial markets began to discriminate among government issuers by requiring higher risk premiums.[30] The yield on 10-year government bonds spiked in early 2009 for various euro members, accompanied by downgrades in sovereign debt ratings for Greece, Spain and Portugal, and a warning for Ireland.[31] The markets had been aware that Eurozone members lacked the traditional mechanisms used to resolve banking problems and were, therefore, concerned about the risks threatening European assets. In the year prior to the sovereign debt crisis, the ECB had stated emphatically that there would be no quantitative easing in the Eurozone.[32] Therefore, Trichet's comments were essentially saying that the ECB would not back national bonds; it did not stand behind those banking book asset values by acting as lender of last resort.[33]

The financial crisis, therefore, had asymmetric effects across the euro area as financial flows across borders stopped as investors repatriated funds and reassessed their exposure to risk at the international level.[34] As a consequence, these actions had the greatest effect on those countries whose financial institutions had a greater reliance on external funding, such as

[29] "The European Crisis and the role of the financial system," Speech by Vítor Constâncio, Vice-President of the ECB, at the Bank of Greece conference on "The crisis in the euro area" Athens, 23 May 2013. Available at: https://www.ecb.europa.eu/press/key/date/2013/html/sp130523_1.en.html (last accessed 3/04/20). See also chapter 1 on the origins of monetarist theory.
[30] S. Sgherri, E. Zoli, "Euro Area Sovereign Risk During the Crisis," IMF Working Paper 222 (2009), p. 9. Available at: https://www.imf.org/external/pubs/ft/wp/2009/wp09222.pdf (last accessed 11/05/20).
[31] Ibid.
[32] Jean Claude Trichet, "Introductory Comments with Q and A," European Central Bank, Press Conference, May 7th 2009. Available at: http://www.ecb.europa.eu/press/pressconf/2009/html/is090507.en.html (last accessed 20/06/20).
[33] M. Blythe, "The Sovereign Debt Crisis That Isn't: Or, How to Turn A Lending Crisis Into A Spending Crisis And Pocket The Spread," American Consortium on European Studies (ACES), No. 2014.1, p. 11.
[34] Ibid Sgherri and Zoli, p. 9.

Ireland. The focus was on the liquidity of the banking system as national authorities injected capital into the banks in order to prevent their collapse.[35]

B: Governments Act, Markets get Nervous

The collapse in economic activity reduced tax revenues, led to rising unemployment and, as a result, higher levels of benefit payments.[36] The use of public balance sheets to shore up national financial systems therefore established the link between the distress in the financial sector and bailouts by the public.[37] As a result, the perceived, increased risk of default by financial institutions created market concerns about the fiscal implications of government intervention, leading to higher default risk premiums on sovereign bonds.[38] Therefore, as concerns about government debt sustainability started to develop in the markets, some economic actors began to reduce their exposure to those countries leading to a reduced demand for those bonds resulting in a price fall.[39] This had the effect of markets becoming illiquid leading to further downward pressure on prices which translates into higher yields.[40] The socialisation of those losses by financial institutions reinforced that narrative strand linking market concerns with the risk of default and weak public finances. This would provide the rationale and justification for the imposition of policies of fiscal contraction based on the interpretation of Treaty provisions which, in turn, are founded on certain pre-conceived political and socio-economic norms.

The resulting rise in public debt that occurred during the period 2008-2012 (by 33% across the Eurozone)[41] was due to the transfer of private debts onto the public balance sheet, as a result of bank bailouts creating a sovereign debt crisis *ex post facto.* The approach of the EU was prioritised by the attempt to reassure the markets and prevent the risk of contagion, as

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[35] European Financial Stability and Integration Report 2010, Commission Staff Working Paper, SEC (2011) 489, p. 5-6. Available at: https://ec.europa.eu/info/sites/info/files/efsir-2010-12042011_en.pdf (last accessed 11/05/20).
[36] P. Lane, "The European Sovereign Debt Crisis," Journal of Economic Perspectives Vol. 26 No. 3 (2012), pp. 49-68, p. 56.
[37] Ibid, p. 57.
[38] Ibid.
[39] G. Calvo, "Servicing the Public Debt: The Role of Expectations," American Economic Review Vol. 78(4) (1988), pp. 647-661, p. 648.
[40] Ibid.
[41] Ibid, S. Storm, C.W.M. Naastepad, "Myths, Mix-ups and Mishandlings: What Caused the Eurozone Crisis?" p. 7. During this period Irish public debt increased by 78%, 44% in Greece, 48% in Portugal and 45% in Spain.

the markets would only maintain faith in the single currency if Member States coordinated economic policy to ensure fiscal stability and eliminate productivity divergences that caused the perceived unsustainable imbalances between savings and investment and, therefore, reduce the risk of default and lower risk premia.[42] It was considered that financial stability would provide the foundation for the pursuit of closer economic integration. The declared political intention to enforce more effectively those earlier commitments to 'sound' budgetary policies, directed by the logic of the markets, would go on to be enshrined both in the legal enactments and European jurisprudence that would follow: the ad hoc responses to the crises were based on a faith in a form of market fundamentalism that prioritised the interests of the financial sector justified by an elective, and therefore contestable, interpretation of the economic constitution.

Indeed, Wolfgang Schäuble stated:

> "Whatever role the markets may have played in catalysing the sovereign debt crisis in the eurozone, *it is an undisputable fact that excessive state spending has led to unsustainable levels of debt and deficits that now threaten our economic welfare. Piling on more debt now will stunt rather than stimulate growth in the long run.* Governments in and beyond the eurozone need not just to commit to fiscal consolidation and improved competitiveness – they need to start delivering on these now."[43] (emphasis added).

In other words, having played down the role of the markets in the crisis, political reaction and ultimately the concomitant legal responses would remain subservient to the demands of a predetermined economic doctrine that was viewed as an inviolable truth.

2. Building a Firewall: Systemic self-preservation and the bailout of creditors

Schäuble's statement was indicative of the approach to be taken in dealing with those debtor states who were no longer able to access the financial markets: one of fiscal

[42] S. Micossi, "On the Tasks of the European Stability Mechanism," CEPS Policy Brief, No. 235, March 2011, p.6. Available at: https://pdfs.semanticscholar.org/27da/86d042388d4dc8243122995e9603f477a652.pdf (last accessed 13/05/20).

[43] Wolfgang Schäuble "Why austerity is the only cure for the Eurozone," Financial Times, 5 September, 2011. Available at: http://www.ft.com/intl/cms/s/0/97b826e2-d7ab-11e0-a06b-00144feabdc0.html#axzz2nHuKIbsB (last accessed 13/05/20).

conservatism and market fundamentalism. The implicit moral condemnation of those states' fiscal profligacy, overlooking previous German transgressions, would provide the justification for the imposition of conditions that would have a profound social, political and economic impact. The prioritisation of the interests of creditors was rationalised by the need to maintain financial stability and prevent contagion. Many core banks, particularly in France and Germany, were exposed to massive potential losses in peripheral countries.[44] As a result, mechanisms were put into place that would ensure government creditors, banks on the verge of bankruptcy, would have their balance sheets bolstered.[45] This would take place through the establishment of financial assistance funds and non-conventional monetary measures undertaken by the ECB. These developments represent the operation of intergovernmentalism by which political actors defer to the technocrats, based within EU institutions and guided by a form of policy, that allows for the continued depoliticization of monetary and economic policy. The result, at the domestic level, is a further weakening of the link between the electorate and their governments, undermining the former's ability to express economic preferences to the latter. At the European level, these measures, and the provisions discussed later in the chapter, contribute further to the growing imbalance between the economic and social constitutions of the EU.

A: The European Stability Mechanism

Following the decision to establish both the European Financial Stabilisation Mechanism (EFSM) [46] and the European Financial Stabilisation Fund (EFSF),[47] at the meeting of the

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[44] J. Stiglitz, "How I would vote in the Greek referendum," The Guardian, 29 July, 2015. Available at: https://www.theguardian.com/business/2015/jun/29/joseph-stiglitz-how-i-would-vote-in-the-greek-referendum (last accessed 13/05/20).

[45] J. Rocholl, A. Stahmer, "Where did the Greek bailout money go?" ESMT White Paper No. WP–16–02 (2016), p.19. Available at: https://faculty-research.esmt.berlin/publication/where-did-greek-bailout-money-go (last accessed 13/05/20).

[46] Council Regulation No 407/2010, Recital (1). The Commission is empowered to borrow on the capital markets or with financial institutions (Article 2) having discussed its financial needs and having submitted a draft economic and financial adjustment programme (Article 3). Thus, the decision to grant assistance is based on economic policy conditions determined by the Commission in consultation with the ECB, to be achieved by the state in question with a view to returning to the financial markets (Article 3(3)(b) and operating on similar terms to those of the IMF (see: Council of the European Union, Press Release 9596/10).

[47] EFSF Framework Agreement (Consolidated Version), Preamble: The EFSF was incorporated on 7 June 2010 for the purpose above. The primary aim was to prevent the threat of contagion. Accordingly, financial assistance can be granted through loan disbursements, precautionary facilities, the financing of the recapitalisation of financial institutions, facilities for the purchase of bonds on the secondary market on the basis of analysis by the ECB. Thus, the EFSF finances the assistance to states by "issuing or entering into bonds, notes, commercial paper, debt securities or other financing arrangements which are backed by guarantees of

Council of 28 and 29 October 2010, the Heads of State agreed on the need to establish a permanent crisis mechanism to safeguard the financial stability of the Euro area. The Belgian Government suggested the revision of Article 136 TFEU, with the addition of a paragraph, under which euro members would establish a permanent stability mechanism in order to safeguard the stability of the euro area. Following the European Council Decision 25 March 2011,[48] and under Article 48(6) TEU, Article 136 TFEU was redrafted to allow Eurozone Members to establish a stability mechanism "to be activated if indispensable to safeguard the stability of the euro area as a whole."[49]

One of the key objectives of the European Stability Mechanism (ESM) is to prevent the risk of financial contagion[50] whilst complying with the theoretical underpinning which is based on the faith in, and the imperative to observe, market discipline. Members are therefore required to maintain strict observance of integrated macro-economic surveillance, adherence to the Stability and Growth Pact and the macroeconomic imbalances framework. Thus, the economic governance rules of the EU are highlighted as the first line of defence in the event of a crisis of confidence that could affect the stability of the euro area.[51] According to Article 3, the purpose of the ESM was "... to mobilise funding and provide stability support under strict conditionality .... to the benefit of the ESM Members which are experiencing, or are threatened by, severe financing problems, if indispensable to safeguard the financial stability of the euro area as a whole ..."[52] In practical terms, therefore, the ESM is able to raise funds by issuing financial instruments or by entering into financial agreements with ESM Members, financial institutions or other third parties.[53]

the other Euro Member States which act as guarantors in respect of those funding instruments. The issues were guaranteed by participating states through the €440 billion based on the paid-up capital. That amount was increased to €780 billion in October 2011.

[48] European Council Decision 25 March 2011 amending Article 136 of the Treaty on the Functioning of the European Union with regard to a stability mechanism for the Member States whose currency is the Euro.

[49] The ESM Treaty entered into force on 27 October 2012.

[50] ESM, Recital 3.

[51] Ibid, Recital 4.

[52] Article 3, ESM Treaty.

[53] The ESM operates in line with the same policies and principles associated with the European Financial Stability Facility. While EFSF bonds are backed by guarantees from the euro area Member States, the ESM has capital of €700 billion, of which €80 billion amounts to paid-in capital. See the European Stability Mechanism, Annual Report, 2012. Available at: http://www.esm.europa.eu/pdf/ESM_Annual_Report_2012.pdf (last accessed 24/11/19)

The decision to provide financial assistance is taken by the Board of Governors (BoG) and the Managing Director, under Article 4.[54] Each ESM Member appoints a Governor who is a member of that Member's government who has responsibility for finance.[55] Provision is also made for the participation in the meetings of the BoG, as observers, for the European Commission, the President of the ECB and the President of the Euro Group[56] as well as other institutions such as the IMF.[57] Among the decisions that the BoG may take, is the ability to provide stability support, including the economic conditionality determined in the Memorandum of Understanding, and the choice of instruments and financial terms and conditions.[58]

Should a decision to provide assistance be agreed, Articles 14 – 18 determine the forms of assistance that the Mechanism may provide in order to ensure stability support. Precautionary financial assistance may be granted in the form of a conditioned credit line[59] to the Member with restricted access to the financial markets. It is also possible for financial assistance to be granted for the purpose of re-capitalising an ESM Member's financial institutions.[60] However, any re-capitalisation of those institutions is subject to the conditionality detailed in the Memorandum of Understanding.[61] A loan may also be granted to an ESM Member in accordance with Article 12[62] subject to a macro-economic adjustment programme.[63] In addition to those methods of direct financial assistance, the ESM also makes provision for primary and secondary market support.[64] Under Article 17 the BoG may arrange for the purchase of bonds of a Member on the primary market in order to maximise the cost efficiency of that financial assistance[65] or arrange for operations on the secondary market to address contagion (on the basis of ECB analysis).[66]

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[54] ESM, Art. 4 (2). In respect of all decisions, a quorum of 2/3 of the members with voting rights representing at least 2/3 of the voting rights must be present.
[55] Ibid, Art. 5(1).
[56] Ibid, Art. 5(3).
[57] Ibid, Art. 5(5).
[58] Ibid, Art. 5(6)(f).
[59] Ibid, Art. 14.
[60] Ibid, Art. 15(1).
[61] Ibid, Art. 15(2).
[62] Ibid, Art. 16(1).
[63] Ibid, Art. 16(2).
[64] Ibid, Art. 17 & 18.
[65] Ibid, Art. 17(1).
[66] Ibid, Art. 18(2).

Any assistance granted is, as previously noted, subject to strict conditionality. Under Article 13(3) ESM, the BoG entrusts the Commission, together with the ECB, and when possible with the IMF (the Troika), the task of negotiating with the ESM Member that is in distress, a Memorandum of Understanding (MoU) which details the conditionality attached to the assistance. The MoU is required to be fully consistent with the economic measures provided for in the TFEU.[67] There was, however, a concern that the Commission might not be sufficiently resolute in dealing with programme countries during negotiations and surveillance missions. This led Germany to insist on the extensive involvement of the IMF.[68] This, with the involvement of the ECB, profoundly influenced by ordoliberal/monetarist theory and the economic measures found in and derived from the TFEU together with IMF, an organisation that has championed austerity, would ensure the imposition of a set of economic conditions that would profoundly inhibit the sovereignty of the ESM Member concerned and have a deleterious effect on the economic interests of its citizens.

B: (Over) Reliance on Market Mechanisms

Whilst the operation of the ESM has been judged to be in compliance with the provisions of the TFEU (see chapter 5), its operation weakens the link between the function of the market and its pricing of debt: the knowledge of the existence of a financial assistance mechanism would imply that default risk would not be priced properly. In other words, in order for the logic of the market to work, according to received economic wisdom, it is essential that creditors fear losing their money.[69] It is necessary to have the threat of default or instability in order for the logic of the market to work and therefore promote stability. The restricted access of Member States to the financial markets had been due to the increase of yields on bonds that accompanied the recapitalisation of their financial institutions due to a supervisory failure;[70] differing regulatory approaches between Member States allowed their financial institutions to gain competitive advantages over one another to develop business models that allowed for the removal of risky assets from their balance sheets without the

[67] Art. 13(3) ESM.

[68] Transparency International EU, "From Crisis to Stability. How to make the European Stability Mechanism Transparent and Accountable" (2017), p. 19. Available at: https://transparency.eu/wp-content/uploads/2017/03/ESM_Report_DIGITAL-version.pdf (last accessed 14/5/20).

[69] H. Schepel, "The Bank, the Bond, and the Bail-out: On the Legal Construction of Market Discipline in the Eurozone," Journal of Law and Society 44(1) (2017), pp. 79-98, p. 85.

[70] W.W. Eubanks, "The European Union's Responses to the 2007-2009 Financial Crisis," Congressional Research Service 7-5700 (2010), p. 4. Available at: https://fas.org/sgp/crs/row/R41367.pdf (last accessed 20/06/20).

security of an appropriate amount of capital to protect them from exposure in the first place.[71] It was, in fact, a failure of both the market and the regulatory structure within which it functioned which was the result of the political acquiescence to a flawed economic model. The operation of the ESM allows for the transfer of those losses to the public, accompanied by the narrative of fiscal profligacy, ensuring returns to creditors. The provision of assistance, through the replication and recognition of market conditions, therefore, secures the interests of creditors, with the reduction of risk, but with the imposition of an internal devaluation associated with the strict conditionality associated with the Mechanism.

To be fair, the conclusion of the ESM Treaty was driven by the practical need to establish an effective response to the threat of financial contagion whilst continuing to convey a sense of credibility that would maintain the confidence of the markets. There is, therefore, a tension between the principles which underpin those economic norms, informing the interpretation of the economic constitution, and the need to formulate a mechanism which allows an effective response to limit the spread of economic shocks in the Eurozone whilst operating within the bounds of market discipline as demanded by the TFEU and related secondary legislation. To that extent the ESM represents a compromise. Prior to the crisis, the emphasis was on the prevention of fiscal profligacy whilst respecting the notion of fiscal and economic sovereignty.[72] The political faith in those economic norms that underpinned the legislative approach taken in the Treaty was based on certain key assumptions:[73] that the markets would exert strong pressure on euro area fiscal policies, secondly, if that was not the case, that multilateral monitoring, peer pressure and sanctions would do the job.[74] Thirdly, the previous assumptions were reinforced by the notion that if a Member State were unable to implement sound fiscal policies, it would be left to its own devices.[75]

[71] Ibid, Eubanks.
[72] Article 125 contains "no bailout" clause. Furthermore Article 123 TFEU prohibits overdraft facilities or any other type of credit facility with the ECB or with the central banks of the Member States in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, as is the purchase of them by the ECB or national central banks. Moreover, Article 124 TFEU prohibits the state from gaining privileged access to financial institutions. These provisions when viewed together with Art. 126 (to avoid excessive deficits) were designed to form an integral element of fiscal stability within the EU.
[73] "Challenges for the Euro Area, and the World Economy," Speech by Lorenzo Bini Smaghi, Member of the Executive Board of the ECB, 63rd Plenary Session, Session I: The Crisis of the Eurosystem, 28 May 2010, available at: file:///G:/TSCG%20and%20Integration/ECB%20%20Challenges%20for%20the%20Euro%20Area,%20and%20the%20World%20Economy.htm (last accessed 14/05/20).
[74] Ibid.
[75] Ibid.

However, reliance on those assumptions was misplaced.[76] As a result, EU institutions, rather than question the wisdom of the markets or the failure of the institutional design of EMU, placed responsibility on the ESM Member concerned. The prioritisation of the interests of creditors would inevitably necessitate the imposition of conditions that would ultimately diminish constitutional norms and undermine the values of the post-war social and democratic state.[77]

The ESM programme created an institution that would become one of the major players in the bond market.[78] The legal basis of the mechanism, and in particular the interpretation of the treaties on which they are based, would reinforce the dominant German policy of fiscal conservatism. There was a lack of accountability for the fundamentally flawed economic assumptions, supported by creditor institutions, that fiscal consolidation produces the multiplier effects for the real economy.[79] There was a lack of consideration of the effect that structural adjustment programmes would have on those economies' citizens. In Greece, for example, of the €215.9 billion, distributed in the first two programmes of assistance, less than 5% was not used for debt-related payments and bank recapitalisations.[80] The conditionality that accompanied the assistance consisted of deregulations, reforms and privatisation measures administered through the Hellenic Republic Asset Development Fund which would promote the sale of government assets including airports, ports and public oil, gas and water companies.[81] During negotiations, the ESM refused to consider debt write downs as part of the memorandum of understanding. Greece would be committed to running a primary surplus (before interest payments) of 3.5% of output. As the Financial Times noted, no country has ever maintained such a commitment over such an indefinite period: "Greek debt sustainability was thus premised on an obviously unfulfillable assumption."[82] The impact of the adjustment programme in societal terms appears

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[76] Ibid, Smaghi.
[77] Menéndez, "Crisis of Law," p. 57.
[78] Transparency International EU, "From Crisis to Stability. How to make the European Stability Mechanism Transparent and Accountable" (2017), p. 6.
[79] Ibid.
[80] J. Rocholl, A. Stahmer, "Where did the Greek bailout money go?" ESMT White Paper No. WP–16–02 (2016), p. 5. 64% went to repay existing debt and interest. 17% to recapitalise banks and 14% for the privatisation programme.
[81] Ibid, p. 10.
[82] W. Münchau, "A failure to tell the truth imperils Greece and Europe," Financial Times, 12 February, 2017: https://www.ft.com/content/87501830-ef85-11e6-930f-061b01e23655 (last accessed 14/05/20).

disproportionate and difficult to justify when the accumulation of Greek debt represented only 2% of Eurozone GDP.[83]

The interventions in the form of the ESM (and the actions of the ECB) reflect the rise and support of a financialised economic model underpinned by the political trust and assumptions in the operation of market discipline. This, in turn, ensures the continuation of an economic model that ensures the protection of the interests of financial elites at the expense of the taxpayer. Those Member States who displayed 'poor' budgetary discipline would be at greater risk of default and therefore would pay more for their debt. However, convergence of yields had occurred before the introduction of the Euro despite the differing state of public finances as between Member States which would cast doubt on the importance of budgetary discipline to actors in the financial markets.[84] Nonetheless, the narrative, following the crises, attributed the cause to fiscal profligacy. The purpose of such interventions was to preserve the "structural renewal"[85] and secured fiscal consolidation as a higher principle reflected in those measures governing closer economic integration.[86] Political deference to this economic model and its underlying doctrine has led to the "secession of law to discretionary political power"[87] undermining the normative values associated with a model which should seek to achieve the common good incorporating universal values that recognise human dignity, social justice, transparency and democratic participation.[88] The protection of the value of certain financial assets consolidated a hierarchy of economic and financial interests.[89] The manner in which the Euro was planned was hubristic. The lack of a mechanism, such as a fiscal transfer facility, was deliberate.

[83] P. De Grauwe, "Fighting the Wrong Enemy," Vox, 19 May 2010. Available at: https://voxeu.org/article/europe-s-private-versus-public-debt-problem-fighting-wrong-enemy (last accessed 13/05/20).

[84] H. Schepel, "The Bank, the Bond, and the Bail-out: On the Legal Construction of Market Discipline in the Eurozone," Journal of Law and Society 44(1) (2017), pp.79-98, p. 83. By 2002, the spread of yields between member states with different debt burdens steadied. Those countries with high debt ratios and the cost of their debt was nearly identical to that of Germany. Irish and Spanish debt went down and they were paying nearly the same as Germany.

[85] M. Everson, "A Technocracy of Governing: Power without the State; Power without the Market," in *The European Crisis and the Transformation of Transnational Governance* eds. C. Joerges and C. Glinski (Hart Publishing, Oxford, 2014), p. 229.

[86] Menéndez, "Crisis of Law," p. 66.

[8787] M. Everson, C. Joerges, "Who is the Guardian for Constitutionalism in Europe after the Financial Crisis?" LEQS Paper No. 63 (2013), p. 20.

[88] "The Economy for the Common Good: a sustainable economic model geared towards social cohesion," The Economic and Social Affairs Committee, ECO/378, September 2015, para. 1.1.

[89] Menéndez, "Crisis of Law," p. 66.

European elites, influenced by German fiscal conservatism, believed that the SGP would suffice.[90] As Paul De Grauwe put it: "This is like saying that if people follow the fire code regulations scrupulously there is no need for a fire brigade."[91] However, not only was faith in those principles maintained, they would be strengthened as European elites engaged in the enactment of a legislative programme that demonstrated continuing political deference to contestable economic principles.

3. Consolidating the Economic Hegemony through Law.

The commitment to multi-lateral surveillance contained in both primary and secondary EU legislation was reflective of Member States' (loose) political commitment to the values of the economic constitution. However, despite the institutional faith in those measures, it had failed to warn of the impending crisis. The fall in public debt and fiscal deficits in many Member States, in compliance with those provisions, had created the illusion of economic wellbeing whilst those supervisory bodies, such as the ECB, thought all was well as they continued to focus their attention on price stability (in both forms) despite the shortcomings of their economic models.

Nonetheless, with the immediate collapse of the single currency having been averted, in a period of intense legal activism, preventative mechanisms were introduced to ensure a greater and renewed commitment to 'sound' public finances. The rationale for this was the ongoing political faith in the operation of the markets and the need to maintain investor confidence in conveying policy credibility to them and, in so doing, disciplining Member States in their management of their finances. Some of those measures were enacted within the existing EU legal configuration whereas others were marked by their departure from European law, with the substitution of international law developing a form of managerialism

[90] P. De Grauwe, "Fighting the Wrong Enemy," Vox, 19 May 2010. Available at: https://voxeu.org/article/europe-s-private-versus-public-debt-problem-fighting-wrong-enemy (last accessed 16/05/20).
[91] Ibid, De Grauwe, "Fighting the Wrong Enemy."

to supervise and control budgetary imbalances weakening the democratic legitimacy of national institutions.[92]

Consequently, Member States' policy choices are limited to internal devaluation through the reduction of wages, prices and public spending to supposedly restore competitiveness.[93] Moreover, the drafting of those provisions is sufficiently imprecise to render them essentially non-justiciable, undermining the rule of law, creating a regime of pseudo-technocratic governance[94] mediated through legal rules suspending the normative values ordinarily determined at the national level by means of democratic input. As the crisis evolved, the Economic Constitution of the EU continued to transform from a model of coordination towards one of governance. As a consequence, political decisions made at the European level, in deference to the economic orthodoxy, represent an attempt to depoliticise policy decisions made at the national level resulting in the decoupling of the relationship between economic policy decisions applied at the national level from those directly affected by them.

A: Fiscal Discipline – From Coordination to Governance

As the crisis progressed, certain institutional responses attempted to secure closer economic integration in order to address the asymmetries associated with the Maastricht model. In May 2010, following the announcement of the 'Europe 2020 strategy,'[95] the Commission developed the 'European Semester.'[96] The Semester was intended to establish "a new architecture for the new economic governance."[97] Based on Articles 121 and 148 TFEU, it established a yearly six month cycle through the *ex ante* monitoring of Member States' economic, structural and budgetary policies by the Commission, the Council and the European Parliament. The purpose was to synchronise and increase the coordination of

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[92] Ibid, Everson, Joerges, "Who is the Guardian for Constitutionalism in Europe after the Financial Crisis?" p. 11-12.
[93] M. Blyth, *Austerity*, p. 2.
[94]Menéndez, "Crisis of Law," p. 57.
[95] "A Strategy for Smart, Sustainable and Inclusive Growth," Communication from the Commission of 3 March 2010, COM (2010) 2020 final. Available at: https://eur-lex.europa.eu/legal-content/en/ALL/?uri=CELEX%3A52010DC2020 (last accessed 16/05/20).
[96] "Reinforcing Economic Policy Coordination," Communication from the Commission of 12 May 2010, COM (2010) 250 final. Available at: https://ec.europa.eu/economy_finance/articles/euro/documents/2010-05-12-com(2010)250_final.pdf (last accessed 16/05/20).
[97] "European Semester: A New Architecture for the New EU Economic Governance," European Commission Memo 11.14 (2011). Available at: http://europa.eu/rapid/press-release_MEMO-11-14_en.htm. 13 (last accessed 16/05/20).

national budgetary polices to ensure compliance with the Stability and Growth Pact criteria. Having been originally launched as a code of conduct for the implementation of the SGP, it has now been codified under the collection of measures known as six-pack.

The rationale for these measures was framed within the narrative previously discussed: that governments had failed "yet again" to take advantage of the economic windfalls accumulated during the good times and had not used them to create room for manoeuvre during the bad times.[98] As a result, the reduction of debt levels was viewed as having negative effects on economic incentives and growth.[99] Following Commission proposals, cooperating with the European Council's Task Force on Economic Governance, five Regulations and one Directive, known as six pack, were enacted and came into force in December 2011.

Council Directive 2011/85/EU sets out the requirements for the budgetary frameworks of Member States going forward. As Article one states, the purpose was to ensure and reinforce compliance with the TFEU requirements regarding excessive deficits.[100] One of the factors that contributed to the weakening of the original SGP regime was a lack of accurate information informing fiscal policy formation at the national level and, in turn, undermining the assessment of coordination at the European level. Member States are now obliged to ensure that fiscal planning is based on realistic information.[101] Consequently, under Article 3, governments are to make public all fiscal data for all sub-sectors of government including central government, state government and social security sectors providing a reconciliation table demonstrating the methodology employed.[102] Based on that data, Member States are obliged to prepare and make public macroeconomic and budgetary forecasts and, at least annually, engage with the Commission in a "technical dialogue" concerning the assumptions underpinning those forecasts.[103] A further limitation is placed on governments' economic autonomy under Article 6 of the Directive: effective and timely monitoring of compliance

[98] "Proposal for a Council Directive on Requirements for Budgetary Frameworks of the Member States," Communication, 29 September 2010, COM (2010) 523, p. 1. Available at: https://ec.europa.eu/economy_finance/articles/eu_economic_situation/pdf/com2010__523en.pdf (last accessed 16/05/20).
[99] Ibid.
[100] Council Directive 2011/85/EU, Art. 1.
[101] Ibid, Art. 4.
[102] Ibid, Art. 3.
[103] Ibid, Art. 4(5).

with the rules is to be carried out by independent bodies that are functionally autonomous with regard to the fiscal authorities of the state. Furthermore, in narrowing a state's policy choices, any escape clauses contained in a state's fiscal legislation should be limited allowing only for temporary deviation from the deficit rules.[104]

However, the provisions contained in the Directive are not limited to the fiscal arrangements for the current year. Under Article 9, Member States are required to establish a medium term budgetary framework spanning a fiscal horizon of at least three years.[105] As part of that commitment, governments are required to set budgetary objectives in terms of deficit, debt and other fiscal indicators ensuring they remain in compliance with EU numerical fiscal rules.[106] Consequently, governments are obliged to describe how their policies will impact on public finances with a breakdown of major revenue and expenditure items and how they will achieve medium and long term budgetary objectives.[107] The rationale for this provision is to allow governments to extend the horizon for fiscal policy beyond the annual budgetary calendar as fiscal decisions have implications that extend beyond that year.[108]

The primary purpose of the six-pack measures was to strengthen the (weakened) SGP. Council Regulation 1175/2011 (amending Regulation 1466/97)[109] states that the preventive arm of the SGP would benefit from more stringent forms of surveillance in order to ensure compliance with the EU's budgetary coordination framework and ensure closer coordination of economic policies.[110] The idea underpinning the regulation is that closer coordination would be enhanced by "stronger national ownership of commonly agreed rules and policies"[111] purportedly to promote a strategy for growth and jobs.[112] Resultingly, under Article 2, greater emphasis is placed on the coordination of policy surveillance within the European Semester whereby the coordination cycle starts early in the year in which the

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[104] Ibid, Art. 6(2).
[105] Ibid, Art. 9(1).
[106] Ibid, Art. 9(1)(a).
[107] Ibid, Art. 9(1)(c) and (d).
[108] See "What are Medium-Term Budgetary Frameworks?" European Commission. Available at: https://ec.europa.eu/info/business-economy-euro/indicators-statistics/economic-databases/fiscal-governance-eu-member-states/medium-term-budgetary-framework_en (last accessed 16/05/20).
[109] Regulation 1175/2011 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies.
[110] Ibid, Recital 4.
[111] Ibid, Recital 8.
[112] Ibid, Recital 10.

Council can give strategic guidance on policies based on the challenges facing the EU (discussion is also envisaged in the European Parliament at this stage).[113] Under Article 3, governments are required to submit their assessment of stability and convergence programmes before key decisions on the national budgets for the following years are taken.[114] Under Article 5, the Council, based on the assessments by the Commission and the Economic Financial Committee, will examine the medium-term objectives submitted by governments and assess whether their assumptions are plausible.[115] In addition, the medium-term objective (MTO) is assessed by reference to an analysis of expenditure net of discretionary revenue.[116] For those Member States that have achieved their MTO, they are to ensure that expenditure growth does not exceed the reference rate of potential GDP growth unless it is offset by revenue measures.[117] Those States that have not reached their MTO are to ensure that annual expenditure growth is not is excess of a rate below the potential GDP growth unless it is matched by discretionary revenue measures in order to ensure an adjustment towards the MTO.

Under Article 6, the Council and Commission monitor the implementation of states' stability programmes on the basis of the information provided and the assessment of the Commission and the Economic and Financial Committee.[118] In the event of a significant deviation from the adjustment path to the MTO, and to prevent an excessive deficit, the Commission will address a warning to the Member State concerned[119] and the Council will examine the situation and make a recommendation for the appropriate policy measures to be undertaken by the Member State concerned.[120] The Regulation imposes a deadline of 5 months for the deviation to be addressed.[121]

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[113] Ibid, Art. 2a.
[114] Ibid, Art. 3.
[115] Ibid, Art. 5(1).
[116] Ibid.
[117] Ibid, Art. 5(1)(a)
[118] Ibid, Art. 6(1).
[119] Ibid, Art. 6(2).
[120] Ibid.
[121] Ibid. The deadline is reduced to 3 months if the Commission decides that the situation is particularly serious.

Whereas the previous provision focussed on the preventive arm of the SGP, Regulation 1177/2011,[122] founded on Art. 126 TFEU, aims to strengthen and speed up the corrective arm of the same. The regulation is more stringent than its predecessor. The prior assumption implied under Art 126 TFEU focused on the existence of excessive deficits, on the basis that the reduction of deficits naturally leads to a reduction of public debt.[123] Following these amendments, both excessive deficits and debts can now trigger the excessive deficit procedure under Art. 126 TFEU. Moreover, leeway for justifications for exceeding reference values has been tightened. The time limits for reduction have been shortened and the sanctions made more substantial.[124] In addition, the use of reversed majority voting increases the chance of sanctions being imposed as it will be more difficult to form blocking majorities.[125] However, the effectiveness of such provisions might be reduced as a result of the taking into account of all relevant factors, reminiscent of the flexibility of the 2005 reforms of the SGP.[126]

Furthermore, Regulation 1173/2011[127] is intended to strengthen the enforcement of sanctions under the reformed SGP (under Art. 126 TFEU). Under Article 4, concerning the preventative arm of the SGP, failure to respond to a Council recommendation, subsequent to a further decision by Council, will require the Member state concerned to lodge an interest-bearing deposit amounting to 0.2 % of GDP of previous year.[128] Furthermore, sanctions for failing to comply with the corrective arm of the SGP result in a non-interest-bearing deposit of 0.2%.[129] Continued failure to comply will result in a fine.[130] Moreover, the intentional or negligent misrepresentation of deficit and debt data may also result in a fine.[131] The purpose of this regulation is to overcome the deficiencies associated with the old system, namely, that the ability to apply sanctions for the failure to correct an excessive

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[122] Amending Regulation 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure.
[123] K. Tuori, “The European Financial Crisis – Constitutional Aspects and Implications,” EUI Working Papers Law 2012/28, pp. 5-6.
[124] Ibid
[125] Ibid, Tuori.
[126] C. Zimmerman, *A Contemporary Concept of Monetary Sovereignty* (Oxford University Press, Oxford, 2013), p. 168.
[127] Regulation 1173/2011 On the Effective Enforcement of Budgetary Surveillance in the Euro Area.
[128] Ibid, Art. 4.
[129] Ibid, Art. 5.
[130] Ibid, Art. 6.
[131] Ibid, Art. 8.

deficit had never been relied on. Under the new Regulation, sanctions will apply much earlier in the process as the delays associated with the old regime undermined its effectiveness.

The failure of economic coordination and convergence, and the subsequent failure of the SGP, was due also, in part, to the focus on the quantitative fiscal aspects of economic surveillance and the disregarding of macroeconomic issues.[132] Excess levels of household debt, price and salary levels and an imbalance of trade and investment could be masked by the appearance of healthy public finances under the old regime.[133] Consequently, under Regulation 1176/2011[134] surveillance of economic policies of Member States is to be broadened beyond budgetary surveillance to include a more detailed and formal framework to prevent excessive macroeconomic imbalances and to enable corrective plans to be enacted before such divergences become entrenched. According to Article 2 "Excessive imbalances" are defined as severe imbalances that have the potential to jeopardise the proper functioning of economic and monetary union.[135] This broadening of surveillance should take place with deepening fiscal surveillance. Enacted on the basis of Art. 121 TFEU, the procedure provides for an early alert mechanism, under Article 3, for early detection of emerging macroeconomic imbalances based on an indicative "scoreboard" taking account of nominal and real convergence inside and outside the Euro area.[136] The indicators that comprise the scoreboard include internal imbalances that may arise from public and private indebtedness, financial and asset market developments, private sector credit flow and the course of unemployment.[137] In addition, external imbalances are also taken account of. These include the development of a state's current account and net investment positions in terms of real effective exchange rates, export market share, changes in price and cost developments and non-price competitiveness.[138] Under Article 5, the Commission is able to undertake an 'in-depth review' to determine whether a Member State's imbalances are

[132] N. De Sadeler, "The New Architecture of Economic Governance: A Leviathon or Flat-Footed Colossus?" Maastricht Journal of European and Comparative Law Vol. 19(3) (2012), pp. 354-483, p. 358.
[133] Ibid.
[134] Regulation 1176/2011 On the Prevention and Correction of Macroeconomic Imbalances.
[135] Ibid, Art. 2(2).
[136] Ibid, Art. 3(2).
[137] Ibid, Art. 4(3)(a).
[138] Ibid, Art. 4(3)(b).

excessive.[139] Where an imbalance is identified an excessive imbalance procedure can be initiated that may include the issuing of Council recommendations to the Member State in question.[140] The Commission will monitor the implementation of the Council recommendations and the Member State is obliged to present regular progress reports on the corrective action being taken.[141] The Commission is also able to carry out enhanced surveillance missions to the state concerned in liaison with the ECB.[142] In the assessment of the corrective action, the Commission prepares a report that allows the Council to determine whether the Member State has complied with the recommendations.[143] Where it is established that appropriate corrective action has not been taken, the Council on a recommendation from the Commission, will adopt a decision of non-compliance, with a recommendation setting new deadlines for corrective action.[144]

Moreover, under Regulation 1174/2011, provision is made for enforcement measures in relation to the correction of excessive macroeconomic imbalances. According to Article 3, an interest-bearing deposit will be imposed following a Council decision establishing non-compliance where it concludes that a Member State has not taken the recommended corrective action.[145] An annual fine will be imposed where a Member State fails to submit a sufficient corrective action plan or where there are two successive Council decisions relating to the same imbalance procedure, establishing non-compliance.[146] The interest-bearing deposit or annual fine is set at 0.1% of GDP in the preceding year of the Member State concerned.[147]

As if those measures were not enough in constraining the ability for Member States to conduct an autonomous economic and fiscal policy, two more regulations (known as two-pack) were enacted to further enhance the EU's economic pillar. The Commission was of the view that further improvements to budgetary coordination and surveillance were needed due to the level of euro Member States economic interdependence and susceptibility to

[139] Ibid, Art 5(2).
[140] Ibid.
[141] Ibid, Art. 9(1).
[142] Ibid, Art. 9(3).
[143] Ibid, Art. 10(1).
[144] Ibid, Art. 10(4).
[145] Regulation 1174/2011, Art. 3(1).
[146] Ibid, Art. 3(2).
[147] Ibid, Art. 3(5).

spill-over effects due to each other's fiscal decisions.[148] Regulation 473/2013 creates common provisions for the monitoring and assessment of Member States' draft budgetary plans and aims to ensure the correction of excessive deficits within the Euro area. According to Article 4, Member States are obliged to make public by 15 April, but no later than 30 April, their medium-term fiscal plans in accordance with their medium-term budgetary framework.[149] The draft budget for the forthcoming year for central government is to be made public no later than 15 October.[150] Both the medium-term fiscal plans and draft budgets are to be based on independent macroeconomic forecasts.[151] Subsequently, draft budgetary plans are to be submitted to the Commission and the Eurogroup demonstrating their consistency with the SGP.[152] The Commission will then adopt an opinion on the draft budget and where it identifies serious non-compliance with the obligations in the SGP, it will request a revised draft of the budget to be submitted as soon as possible.[153]

Furthermore, the procedure for the correction of an excessive deficit is also strengthened under the Regulation. Under Article 9, the Member State concerned is obliged to present an "economic partnership programme" detailing the policies and structural reforms that are needed[154] and to identify a number of specific priorities aimed to enhance competitiveness and longer-term growth.[155] To that end, the Member State concerned is subject to reporting requirements.[156] It is obliged to report regularly to the Commission and the Economic and Financial Committee the in-year budgetary execution and the budgetary impact of measures taken on both the expenditure and revenue side.[157] It is obliged to perform a comprehensive assessment of the current year's budgetary execution identifying the risks associated with contingent liabilities with potentially large impacts on the public budget.[158] If there is a risk of non-compliance with the deadline to correct the deficit, the Commission

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[148] Commission Press Release, 27 May, 2013, "'Two-Pack' enters into force, completing budgetary surveillance cycle and further improving economic governance for the euro area."
Available at: http://europa.eu/rapid/press-release_MEMO-13-457_en.htm (last accessed 16/05/20).
[149] Regulation 473/2013, Art. 4(1).
[150] Ibid, Art. 4(2).
[151] Ibid, Art. 4(4).
[152] Ibid, Art. 6(1).
[153] Ibid, Art. 7(2).
[154] Ibid, Art. 9(1).
[155] Ibid, Art. 9(2).
[156] Ibid, Art. 10(1).
[157] Ibid, Art. 10(3).
[158] Ibid, Art. 10(2).

will address a recommendation to the Member State concerning the full implementation of measures and/or the adoption of other measures within a timeframe for the correction of the excessive deficit.[159]

These measures build on the provisions in the accompanying Regulation 472/2013[160] concerning those Member States who are experiencing or threatened with financial instability or the unsustainability of their public finance or those who have requested or received financial assistance from the ESM, EFSF or the IMF. The Commission will assess whether a Member State's public finances are under threat by use of, among other parameters, the alert mechanism contained in Article 3(1) of Regulation 1176/2011.[161] The Commission takes account of:

> "the borrowing conditions of the Member State, the repayment profile of its debt obligations, the robustness of its budgetary framework, the long-term sustainability of its public finances, the importance of its debt burden and the risk of contagion from severe tensions in its financial sector…"[162]

In consideration of those factors, under Article 3, a Member State assessed as being under financial threat will be subject to enhanced surveillance.[163] It will adopt measures aimed at addressing the sources of those difficulties taking account of recommendations addressed to it under Regulation 1466/97.[164] Specifically, the Member State is obliged to inform the ECB of the developments in its financial system, including the results of any stress tests,[165] carry out regular assessments of its supervisory capacities over the financial sector[166] and inform the Commission any information needed for the monitoring of macroeconomic imbalances.[167] Where the Commission concludes that further measures are needed due to the financial and economic situation of that Member State and the potential for adverse effects on the financial stability of the euro area, the Council, by qualified majority, may

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159 Ibid, Art. 11(2).
160 Regulation 472/2013 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.
161 Ibid, Art. 2(1).
162 Ibid.
163 Ibid, Art. 3(1).
164 Ibid.
165 Ibid, Art. 3(3)(a).
166 Ibid, Art. 3(3)(c).
167 Ibid, Art. 3(3)(d).

recommend the adoption of precautionary corrective measures or the drafting of a macroeconomic adjustment programme.[168]

Furthermore, under Article 7, a Member State that requests financial assistance is obliged, in agreement with the Commission (liaising with the ECB and, where appropriate, the IMF), to draft a macroeconomic adjustment programme that will build on and substitute any economic partnership programme (above) that will include annual budgetary targets.[169] That adjustment programme should ameliorate those specific risks within the Member State with a view to restoring its ability to finance itself fully on the financial markets.[170] The Commission, ECB and, where appropriate, the IMF will monitor the progress made on the implementation of the adjustment programme.[171]

The provisions contained within the six pack of measures are certainly more stringent than those contained under the original SGP. The flurry of legislative activity, designed to quell the fears of the markets, reflects the political deference to a particular economic view. However, the tension between national economic requirements and obligations at the European level still persists. Both the new and old regimes are based on the Lisbon structure which, essentially, still consists of provisions founded on the basis of shared competence. However, there is a perceptible shift towards a form of economic governance based on contract rather than legislative imposition as a mechanism for the upholding of those obligations. It implies that the new arrangements are entered into voluntarily by contracting Member States when interacting with EU institutions in relation to national budgetary matters.[172] It also has the effect of increasing the complexity of the regulatory landscape and, resultingly, makes it difficult to ensure transparency and accountability of EU institutions due to the technocratic nature of budgetary assessment[173] as there is no consensus on the causal connection between austerity and economic growth and it is therefore questionable to conduct such assessments on the basis of technocratic

[168] Ibid, Art. 3(7).
[169] Ibid, Art. 7(1).
[170] Ibid.
[171] Ibid, Art. 7(4).
[172] P. Craig, "Economic Governance and the Euro Crisis: Constitutional Architecture and Constitutional Implications," in (eds. M. Adams, F. Fabrini, P. Laroche) *The Constitutionalization of European Budgetary Constraints* (Hart Publishing, Oxford and Portland, Oregon, 2014), p. 29.
[173] Ibid, P. Craig, p. 30.

expertise.[174] Resultingly, the interplay of the components outlined above exceeds the mere setting of quantitative constraints on Member States' budgets, it creates the potential for EU institutions to influence and shape decisions at the national level in areas which traditionally fall within national competence and which result from democratic discourse.[175]

Aside from these technical considerations, these enactments ultimately place the burden of adjustment on those lower in the socio-economic order: labour. Member States have less room to manoeuvre. A failure to respond to the recommendations made under the SGP can lead to a semi-automatic sanction, facilitated by reversed qualified majority voting. In order to bring their public finances within the tolerances of the Pact, governments must either enact policies that reduce wages, reduce public spending programmes, or more likely both. This is reinforced by the macro-economic imbalance provisions. With a trade imbalance, competitiveness of the deficit state can only be improved by reducing the costs of production, the greatest part of which is wages whereas, in the past, governments could have devalued their currency to make them more competitive. Resultingly, households have less spending power and will be more fearful of making significant purchases and, therefore, reduce their economic activity. If this takes place in conjunction with a reduction in government spending, where both the public and private sector are saving, growth is curtailed. More importantly, budgetary constraints will have redistributive effects that will be felt beyond the economic realm.[176] The Brussels-Frankfurt consensus is obsessed with austerity-based ordoliberal policies for which there is no scientific or empirical evidence that establishes a connection between their imposition and economic growth. The insistence on the 'structural reform' of labour markets has the dual effect, at both the national and European level of strengthening executive powers whilst weakening the input of democratic institutions.

[174] T. Biebricher, "Neoliberalism and Law: The Case of the Constitutional Balanced-Budget Amendment," German Law Journal Vol. 17 No. 5 (2016) pp. 836-856, p. 853.

[175] F. Costamagna, "The European Semester in Action: Strengthening Economic Policy Coordination while Weakening the Social Dimension?" LPF Working Paper No.5 (2013), p. 13. Available at: https://www.researchgate.net/publication/272302085_The_European_Semester_in_Action_Strengthening_Economic_Policy_Coordination_While_Weakening_the_Social_Dimension (last accessed 16/05/20).

[176] See Caritas Europa Report, "Poverty and Inequalities on the Rise – Just Social Models needed as the Solution!" (2015). Available at: https://www.socialjustice.ie/sites/default/files/attach/publication/3775/2015-02-19-cmr2015-publishedversion-final.pdf?cs=true (last accessed 16/05/20).

Moreover, the design and implementation of these measures is founded on certain assumptions. It is assumed that a voluntary internal programme of deflation, facilitated by reductions in public spending and wage cuts, will foster growth. Indeed, it is generally agreed by economists that it is preferable to maintain control over public debt over the medium and long term.[177] Therefore, from a broad perspective, these provisions could be considered not to be ideologically driven. However, the manner in which the Semester and accompanying legislation is framed continues to limit a counter-cyclical response to economic shocks which is firmly rooted in the monetarist paradigm. It assumes that reductions in spending during a downturn reduces public debt and fosters economic growth. This is accompanied by an ideologically coded narrative, framed in language that associates counter-cyclical policies with profligacy whereas the monetarist/neoliberal policy is described as prudent.[178] It is implied that the Treaties on which these measures are based contain a legal obligation to enact pro cyclical fiscal policies. This is, however, not the case; they could equally be interpreted to apply spending restraints during a period of economic growth.[179]

B: Compacting Fiscal Conservatism

Despite the political and legal initiatives discussed above, the markets remained nervous. This was not abated by the ECB's continued focus on price stability and the reiteration that it would not undertake a programme of quantitative easing or act as lender of last resort.[180] This, combined with the fact that financial markets were aware that national institutions lacked the means to back those assets did not ameliorate the situation. Consequently, a statement from the European Council announced a move towards "a genuine "fiscal stability union."[181] The statement recognised that the measures already taken were not sufficient in themselves and additional qualitative moves towards greater economic

[177] E. D. Domar, "The `'Burden of the Debt' and the National Income," American Economic Review Vol. 13(4) (1944), pp. 798-827, p. 800.
[178] C. Kaupa, "Has (Downturn-) Austerity Really Been 'Constitutionalized' in Europe? On the Ideological Dimension of Such a Claim," Journal of Law and Society Vol. 44(1) (2017), pp. 32-55, p. 37.
[179] Ibid, p. 38.
[180] Jean-Claude Trichet, President of the ECB, Frankfurt Am Main, 7th May 2009. Available at: https://www.ecb.europa.eu/press/pressconf/2009/html/is090507.en.html#qa (last accessed 16/05/20).
[181] Statement by the Euro Area Heads of State or Government. European Council, Brussels, 9th December 2011, p. 1. Available at: www.european-council.europa.eu/council-meetings/conclusions.aspx? (last accessed 17/05/20).

integration were required.[182] The fiscal Compact was agreed in order to facilitate "significantly stronger coordination of economic policies in areas of common interest."[183] Whereas the statement recognised that the measures could be enacted through a mixture of primary and secondary legislation, it acknowledged that the absence of unanimity forced them to be adopted by means of an international agreement.[184] The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG) was agreed and signed by 25 states (with exception of the UK and Czech Republic) on 2nd March 2012. The TSCG entered into force on 1st January 2013[185] with the intention, upon assessment, of it ultimately being incorporated into the legal framework of the European Union (EU).[186] The Treaty, however, is of significance as its effects are not limited merely to economic and fiscal matters, it raises issues concerning the legitimacy of states.[187]

The importance of the TSCG is that it intensifies the measures already enacted and increases the legal entrenchment of the neoliberal/monetarist principles that were not only the underlying cause of the crisis but which formed the basis of the response to it. Again, it is based on those economic assumptions that lie at the core of the economic constitution of the EU: fiscal 'profligacy' is deemed irresponsible, tends to crowd out the private sector and governments should be limited in their ability to provide economic stimulus. Moreover, it envisages further measures to be enacted in the future in which Contracting States express their readiness to support proposals from the Commission to further strengthen the SGP[188] and further ingrain that particular view of the political economy. A linkage is also formed between the TSCG and the ESM in that assistance under the latter is conditional (from 1st March 2013) on the ratification of the former and on the adoption of the "balanced budget" rule.[189] The result is the further entanglement of governments with a series of EU

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[182] Ibid.
[183] Ibid, p. 2.
[184] Ibid, p. 16.
[185] Following compliance with Art. 14(2) TSCG: "This Treaty shall enter into force on 1 January 2013, provided that twelve Contracting Parties ... have deposited their instrument of ratification, or on the first day of the month following the deposit of the twelfth instrument of ratification by a Contracting Party whose currency is the euro, whichever is the earlier."
[186] Art. 16, TSCG.
[187] P. Craig, "The *Stability, Coordination and Governance Treaty*: Principle, Politics and Pragmatism," Oxford Legal Studies Research Paper No. 47 Reprinted from European Law Review Vol. 37(3) (2012), pp. 231-248, p. 233. (Hereinafter Craig, "Principle, Politics and Pragmatism").
[188] Preamble, TSCG.
[189] S. Peers, "The Stability Treaty: Permanent Austerity or Gesture Politics?" European Constitutional Law Review Vol. 8 (3) 2012, pp. 404-441, p. 406. (Hereinafter Peers, "Austerity or Gesture Politics"). Whereas

provisions and international treaties that will limit the room for economic manoeuvre by governments, regardless of their political hue, and limit the ability of representative institutions to challenge and hold to account the actions of the executive.

Under Article 1 the Contracting Parties agree to strengthen the economic pillar of economic and monetary union by adopting a set of rules intended to:

> "foster budgetary discipline through a fiscal compact, to strengthen the coordination of their economic policies and to improve the governance of the euro area, thereby supporting the achievement of the European Union's objectives for sustainable growth, employment, competitiveness and social cohesion."[190]

Clearly, the inclusion of this Article is not controversial at face value. However, despite its aspirational nature, some commentators have argued that some of the austere measures that have resulted from such legislative provisions following the financial crisis have led to a decline in growth, employment and social cohesion.[191] Article 1 is also careful to confine the operation of the agreement to the strengthening of the economic pillar without interfering with the exclusive competence of the EU in relation to monetary policy.[192]

Article 2 states that the TSCG shall be applied and interpreted by the Contracting Parties in compliance with the EU Treaties.[193] Particular attention is drawn to compliance with Article 4(3) of the Treaty on European Union (TEU)[194] with regard to procedural law and where

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recitals are not generally binding, their legal status is regarded favourably. The same rule appears in the preamble to the ESM treaty which states that the two treaties are complimentary "in fostering fiscal responsibility and solidarity within the economic and monetary union. It is acknowledged and agreed that the granting of financial assistance in the framework of new programmes under the ESM will be conditional ... on the ratification of the [stability treaty] by the ESM Member concerned and, upon expiration of the transposition period referred to in Article 3(2) [of the stability treaty] on compliance with the requirements of that article."

[190] Art. 1 TSCG.

[191] N. Matjaz, B. Bojan, "The EU Fiscal Compact: Constitutionalization of Austerity and Pre-emption of Democracy in Europe," (September 1, 2012), p. 25-26. Available at SSRN: http://ssrn.com/abstract=2194475 or http://dx.doi.org/10.2139/ssrn.2194475 (last accessed 18/05/20).

[192] Craig, "Principle, Politics and Pragmatism," p. 234.

[193] Art. 2(1) TSCG.

[194] Art. 4(3) TEU: "Pursuant to the principle of sincere cooperation, the Union and the Member States shall, in full mutual respect, assist each other in carrying out tasks which flow from the Treaties ... shall take any appropriate measure ... to ensure fulfilment of the obligations arising out of the Treaties or resulting from the acts of the institutions of the Union. The Member States shall facilitate the achievement of the Union's tasks and refrain from any measure which could jeopardise the attainment of the Union's objectives."

adoption of secondary legislation is needed. As Craig notes,[195] the meaning of this provision is not clear. It would appear to contemplate EU legislation be enacted to further the goals of the TSCG which would obviously need to comply with existing provisions set out in the EU Treaties.[196] However, that does not validate the use of EU legislation to further the goals a non-EU treaty.[197]

The part of the Treaty which has attracted the most attention is found under Title III concerning the balanced budget rule. Thus, under Article 3(1)(a) the budgetary position of the general governments shall be balanced or in surplus.[198] Satisfaction of this requirement is attained if the annual structural balance is, at its country-specific medium-term objective, as defined under the revised Stability and Growth Pact, with a lower limit of a structural deficit of 0.5% of the gross domestic product at market prices. Contracting Parties are required to ensure rapid convergence towards their respective medium-term objective, which will be proposed by the Commission taking account country-specific risks. That progress will be evaluated on the basis of the overall assessment with the structural balance as reference, including an analysis of expenditure net of discretionary revenue measures in line with the revised Stability and Growth Pact.[199] However, temporary deviation from the medium-term objective is allowed only in exceptional circumstances.[200] Where the ratio of government debt to gross domestic product is "significantly below 60% and where risks in terms of long-term sustainability of public finances are low, the lower limit of the medium-term objective ... can reach a structural deficit of at most 1% of the gross domestic product..."[201] Interestingly, the draft TSCG contained a reference to potential deviation at the start of Title III:

> "The Contracting Parties may temporarily incur deficits only to take into account the budgetary impact of the economic cycle and, beyond such impact, in case of exceptional economic circumstances, or in periods of a severe economic

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195 Ibid, Craig.
196 Ibid.
197 Ibid.
198 Art. 3(1)(a) TSCG. This provision is often referred to as the "balanced budget" rule and is based on the German "debt brake" (schuldenbremmse) provision.
199 Art. 3(1)(b) TSCG.
200 Art. 3(1)(c) TSCG.
201 Art. 3(1)(d) TSCG.

> downturn, provided that this does not endanger budgetary sustainability in medium term."[202]

The equivalent of this provision is now to be found within the definition of exceptional circumstances that allow for deviation under Art. 3(3):

> "exceptional circumstances" refers to the case of an unusual event outside the control of the Contracting Party concerned which has a major impact on the financial position of the general government or to periods of severe economic downturn as set out in the revised Stability and Growth Pact, provided that the temporary deviation of the Contracting Party concerned does not endanger fiscal sustainability in the medium-term."[203]

This change of order and wording emphasizes the political determination to achieve economic convergence, over national fiscal sovereignty, and to meet the objectives set out in the preamble. In addition, reference to the revised SGP implies the imposition of stricter criteria with regard to deviation from the medium-term objective.

Consequently, Article 3 makes provision for a correction mechanism that is automatically triggered in the event of "significant observed deviations from the medium-term objective or the adjustment path towards it."[204] The correction mechanism includes the obligation of the Contracting Party to correct the deviation over a defined period of time.[205] Thus, in compliance with the Treaty, contracting Parties are obliged to put in place the correction mechanism at national level on the basis of "common principles to be proposed by the European Commission...Such correction mechanisms shall fully respect the prerogatives of national Parliament."[206]

During negotiation of the Treaty, Germany wanted the obligations regarding the balanced or surplus budget and the country specific medium-term objective to be constitutionally binding, and this was included in the draft Treaty. Germany had already amended its Basic Law in 2009 and anchored the debt brake (Schuldenbremse) constitutionally in Arts. 109 and 115 of the Basic Law. However, the final version of the Treaty now requires the

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[202] Art. 3(1)(a) draft TSCG.
[203] Art. 3(3)(b) TSCG.
[204] Art. 3(1)(e) TSCG.
[205] Ibid.
[206] Art. 3(2) TSCG.

correction mechanism to take effect in national law and to be of "binding force and permanent character, preferably constitutional, or otherwise guaranteed to be fully respected and adhered to throughout the national budgetary process."[207]

Some commentators have suggested that the measures contained within the TSCG amount to a reiteration of existing obligations under EU law.[208] Whereas this is true in a broad conceptual sense, there are differences in the wording which suggests a longer-term shift towards greater economic integration and a weakening of national fiscal autonomy despite the claim of respect for the prerogatives of national Parliaments.[209] This is particularly true when read in conjunction with the provision in the preamble requiring ratification of the TSCG in order to avail of financial assistance under the framework of the European Stability Mechanism. Whereas room for manoeuvre still exists at a national level, the boundaries of that space are being increasingly determined (and narrowed) at the European and intergovernmental level. Although Art. 2a of Regulation. 1466/97 (as amended by Regulation 1175/2011) contains similar wording[210] to that of Article 3(1)(b)[211] the TSCG is more stringent in that it imposes an annual deficit limit of 0.5% (as opposed to the annual deficit of between 0% and 1%).[212] However, as Peers notes, the apparently more stringent standards applied by the TSCG, which differ from existing EU law, is not absolute.[213] The wording of Article 3(1)(b) requires Contracting Parties to ensure "rapid convergence" towards the medium term objective which, in itself, creates further room for negotiation.[214] Of importance are the rules which assess the progress towards this goal: the final sentence

[207] Art. 3(2), TSCG.
[208]See *Craig*, "Principle, Politics and Pragmatism" and M. Maduro, "Another Legal Monster? An EUI Debate on the Fiscal Compact Treaty." EUI Working Papers, Law 2012/09.
[209] Art. 3(2) TSCG.
[210] Under Art. 2a Council Regulation 1466/97 each Member State will have a differentiated medium-term objective for its budgetary position. These objectives are country specific and a close to balance or surplus budgetary position is required within a safety margin of 3% of GDP government deficit ratio in order to ensure sustainability of public finances. In addition, under Art. 3, Member States are obliged to submit to the Council and Commission information necessary for the purpose of multilateral surveillance (in accordance with Art. 121 TFEU). In addition, Art. 5 Council Regulation states that the Commission and the Economic and Financial committee and Council will examine the budgetary objectives presented to them by Member States, and assess whether those economic assumptions, on which the stability programme is based, are plausible. Sufficient progress towards the medium-term objective is evaluated on the basis of an overall assessment with the structural balance as the reference, including an analysis of expenditure net of discretionary revenue measures.
[211]Peers, "Permanent Austerity or Gesture Politics?" p. 416.
[212] Ibid.
[213]Ibid.
[214] Ibid.

of Article 3(1)(b) makes reference to the revised Stability and Growth Pact[215] rules which are more detailed than those which refer to the assessment of progress within the TSCG and which are therefore incorporated by reference within Article 3(1)(b). The declared intentions of the TSCG are similar to those contained in the Euro Plus Pact. However, whereas the latter essentially consists of a political statement of intent, the Treaty is a legal instrument designed to implement those intentions at the national level and in a legally binding form.

The operation of Article 3 must be read in conjunction with the methods of enforcement contained in Article 8: the Commission is invited to present a report to the Contracting Parties on the provisions adopted by each of them in compliance with Article 3(2). The Commission, having given the Contracting Party the opportunity to submit its observations, can conclude that the state concerned has failed to comply with Article 3(2). The matter can be brought before the CJEU by one or more of the Contracting Parties. Thus, under Article 8(2), a Contracting Party may, on the basis of the Commission's assessment or on the basis of its own assessment, bring before the Court an action and request the imposition of financial sanctions (under the criteria established by the Commission pursuant to Article 260 TFEU).[216] If the CJEU finds that the state concerned has not complied with its judgment it may impose a fine in the form of a lump sum payment that shall not exceed 0.1% of gross domestic product. Article 8 of the draft treaty allows merely for mutual enforcement by Contracting Parties in the CJEU i.e. there is no mention of the role of the Commission. However, the wording in Article 8(1) states that where a Contracting Party has failed to comply with Article 3(2), one or more Contracting Parties "will" bring an action before the CJEU (as opposed to the word "may")[217] thus placing the obligation on them.

Breach of Article 3(2) is of itself dependent on breach of Article 3(1). Failure to address a breach in terms of governmental debt and/or deficit (notwithstanding the exceptions under Article 3(1)(c) and (d)), which should trigger an automatic correction mechanism,[218] is linked to the provision which obliges Contracting Parties to enact the provisions of the TSCG into national law. However, the provisions contained in Article 3(1) and 3(2) are not as clear as

[215] Regulation 1466/97 as amended by Regulation 1175/11.
[216] Art. 8, TSCG.
[217] Peers, "The Stability Treaty: Permanent Austerity or Gesture Politics?" p. 423.
[218] Art. 3(1)(e) TSCG.

first appears. The obligation to ensure "rapid convergence" towards the medium term objective[219] is so broadly drafted that it leaves enough room for discussion as to whether this provision has been breached.[220] In addition, the taking account of "country-specific sustainability risks" provides further room for argument when considering the Contracting State's compliance with the Treaty.[221] The same is also true of the obligation found under Article 3(1)(e), triggering the automatic correction mechanism when "significant observed deviations" occur, as the state concerned may argue that its failure to meet medium-term objective or deviation from the adjustment path towards it may fall within the "exceptional circumstances" found in Articles 3(1)(c) and 3(3)(b).[222]

The TSCG is concerned with fiscal stability, coordination and governance; an area of shared competence between the EU and Member States.[223] Whereas the Lisbon Treaty provides for states to proceed together where a veto has occurred, it does not provide justification for the operation of EU institutions in that the Treaty where not all Member States have agreed for that to happen.[224] As Craig suggests, if the veto is used to prevent change to Lisbon, it is unclear why an institution which exists as a result of the creation of the Treaty can then be used to pursue objectives vetoed by means of a different treaty.[225] In the absence of the use of amendment or the use of enhanced cooperation, is it possible to agree a new treaty, the subject matter of which is already covered under Lisbon, using the EU institutions, when not all Member States have agreed?[226] Whereas these observations are legally sustainable, it could be argued that the TSCG sits on the boundary between law and politics. It is essentially the legal expression of political deference to contestable economic principles.

From a substantive perspective, the concept of the 'structural deficit' is problematic in legal terms. Traditionally, a cyclical fiscal deficit is determined by the state of the economy: thus, in a boom tax, receipts tend to be higher and spending on unemployment tends to be lower. The structural fiscal balance, however, is that part of the deficit which is not related to the economic cycle and is, therefore, not related to the state of the economy: that part of the

[219] Art. 3(1)(b) TSCG.
[220] Ibid, Peers*, p. 410.*
[221] Craig, "Principle, Politics and Pragmatism," p. 238.
[222] Ibid.
[223] See Chapter 3.
[224] Ibid, Craig, "Principle, Politics and Pragmatism," pp. 238-239.
[225] Ibid.
[226] Ibid.

fiscal deficit will not disappear when the economy recovers. For example, a structural factor might be related to the longer-term effects of an ageing population. Under the TSCG, the requirement for governments' budgetary positions to be balanced or in surplus is further specified and deemed to be respected if the annual structural balance, that is allowing for the annual cyclically adjusted balance net of one-off or temporary measures is "with a lower limit of a structural deficit of 0.5% of [GDP] at market prices."[227] The structural deficit is, therefore, the deficit that exists after taking account of the effects of the economic cycle on public finances. However, it has been argued that the structural deficit concept is meaningless as a policy target because it is impossible to measure objectively.[228] This is due to the differing models of the economic cycle and where, within that cycle, the economy is. Moreover, with the economic interdependence between EU Member States, a model of the business cycle has to include the state of all economies and not just the national one making the model more complex and open to contestation in what is supposed to be a single market.[229] As a result, the legal enshrinement of the structural deficit concept within the economic governance model creates a "…depoliticised form of governance, in which state managers directly relinquish policy control over particular issues, delegating their day-to-day management to ostensibly non-political institutions or rule-based frameworks."[230] Given the indeterminate nature of the concepts which form the basis of those rules it is difficult to maintain that they are rules in the strict sense:[231] the wording is certain and appears stringent and yet substantively the provisions lack clarity and any decision made by the Commission in relation to a state's proposed budget will be an arbitrary, technocratic one based on data that attempts to forecast future economic conditions. The role of law, therefore, regarding the commitments under the TCSG reflects those intergovernmental political decisions.

Aside from the substantive concerns about the provisions relating to fiscal deficits, there are also broader conceptual issues surrounding the balanced-budget rule. Traditionally, the

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[227] Art. 3(1)(b), TSCG

[228] See H. Radice, "Enforcing Austerity in Europe: The Structural Deficit as a Policy Target," Journal of Contemporary European Studies Vol. 22(3) (2014), pp. 318-328.

[229]Menéndez, "Crisis of Law," p. 137.

[230] S. Kettell, "Does Depoliticisation Work? Evidence from Britain's Membership of the Exchange Rate Mechanism, 1990–92." British Journal of Politics and International Relations Vol. 10(4) (2008), pp. 634 –648, p. 641.

[231]Ibid, Menéndez.

balanced-budget rule has been viewed as a mechanism which ameliorates the short-term bias associated with democratic politics. The traditional neoliberal/monetarist view is that the operation of politics within democratic discourse acts against the interests of future generations and it is therefore unrepresentative.[232] Therefore, proponents suggest the rule maintains inter-generational justice. Moreover, the lack of such a rule undermines sovereignty due to the short-termism of political actors and their desire to remain in office, it allows for the accumulation of unsustainable public debt. The servicing of those debts consumes ever increasing amounts of resources leading to higher premiums on the money loaned. As a result, government is not in a position to carry out political projects as it does not have the financial resources.[233] However, such justifications are difficult to substantiate. It is highly problematic to attribute interests to individuals or classes of individuals who do not yet exist.[234] It might well be argued that current fiscal discipline could inhibit public investment in the future adversely affecting the interests of both current and future generations. It can also be argued that incurring debt in the present, with historically low interest rates, could pay for investment in (non-inflationary) public goods and services that would serve the interests of future generations and that, therefore, the citizenry might prefer debt over fiscal savings. Indeed, government funding of public goods and services could have the effect of exerting a downward pressure on wage demands thereby making the state more competitive. The obsession with operating a balanced or surplus budget is, at its heart, logically flawed: assuming what is good for the individual is also good for the collective. Clearly, if a household spends more than it earns then either it must spend less or increase its income. However, government budgets are not like household budgets.[235] A deficit is perceived as a negative feature of public finance. However, the running of a public deficit, especially in the event of an economic shock, creates a private surplus which encourages recovery through the multiplier effect.[236] When a government attempts to

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[232] J. Buchanan, *Liberty, Market and State: Political Economy in the 1980s* (New York University Press, New York, 1986), p. 217 *et seq*.

[233] Ibid.

[234] T. Biebricher, "Neoliberalism and Law: The Case of the Constitutional Balanced-Budget Amendment German Law Journal Vol.17 No. 5 (2016) 836-856, p. 846.

[235] L. Randall Wray, "Teaching the Fallacy of Composition: The Federal Budget Deficit," New Economic Perspectives, 10 April 2009. Available at: http://neweconomicperspectives.org/2009/08/teaching-fallacy-of-composition-federal.html (last accessed 19/05/20). Households are not able to issue currency, issue bonds or raise taxes on one another.

[236] Ibid.

reduce its deficit (by cutting spending and increasing taxes) it results in the reduction of private income, savings and financial balances.[237]

Moreover, it can be argued that fiscal policy should be determined, in democratically representative terms, by those affected by it. It might also be appropriate to place limits on fiscal policy within a legislative framework. It is, however, questionable, to enshrine the principle by constitutional fiat.[238] The decision to run a fiscal deficit is inherently political and should be cited in democratic space because the choice made has redistributive effects. As noted above, many Member States were reducing their deficits in the period 2000-2007. What purpose would such a constitutional norm serve when, as a result of the crisis, it would have to be set aside when it should be applied?[239] Public finances were thrown into disarray as result of the socialisation of private losses at the insistence of the proponents of a financialised economic model that prioritises fiscal prudence. The provisions contained in the TSCG have the potential to lead to a normative deficiency in political discourse.[240] The obligations contained therein, restrict the degree of policy manoeuvre for successive governments as fiscal conservatism became the dominant policy goal. As economic governance becomes more entrenched, political deference to the norms it promotes makes governments less responsive to the democratic demands of the electorate.[241]

Conclusion

Recent decades have seen the size and importance of the financial sector rise exponentially. It is founded on a neoliberal consensus and complacency that has an unshakeable faith in the wisdom of the market. The establishment of the Single Market facilitated their growth and facilitated the movement of capital both within the EU and from without; it flowed to those peripheral states seeking higher returns than might have otherwise been realised and, consequently, funded asset booms. The imbalances between Member States, and the unprecedented growth of private debt went unnoticed by regulators and supervisory

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[237] Ibid. See also S. Kelton, *The Deficit Myth: Modern Monetary Theory and the Birth of the People's Economy*, (Public Affairs, New York, 2020).
[238] Menéndez, "Crisis of Law," p. 136.
[239] Ibid, Menéndez.
[240] C. O'Cinnaide, "Austerity and the Faded Dream of a ``Social Europe''' in *Economic and Social Rights After the Global Financial Crisis*, ed. A. Nolan (Cambridge University Press, Cambridge, 2014), p. 169-170.
[241] S. Gill, "European Governance and New Constitutionalism Economic and Monetary Union and Alternatives to Disciplinary Neoliberalism in Europe," New Political Economy Vol. 3(1) (1998), pp. 5-26, p. 15.

authorities due to the weaknesses associated with economic modelling and a misguided focus on the maintenance of 'sound' public finances and low inflation.

When it became apparent that those assets were overvalued and as the risk of private default increased, those losses were transferred to the public balance sheet providing the pretext and justification for the imposition of austerity facilitated by the various legal mechanisms established since the onset of the crisis. The programmes of structural adjustment, insisted on, in return for financial assistance, are rooted in neoliberal ideology. The selling off and privatisation of public assets, the reduction in welfare and the insistence that public finances remain subject to the logic of financial markets have had profound social and political effects.

Rather than recognise the shortcomings of their economic model, EU institutions have reinforced it prioritising the interests of creditor institutions. As a result, national fiscal policy is determined by a new form of economic governance that consists of technocratic management locking in the principles of fiscal consolidation in pursuit of an economic surplus. This form of managerialism has had the effect of weakening the democratic and constitutional link between the citizenry and their governments in the realm of economic and fiscal policy due to a belief that these policy areas should be depoliticised. However, this has led to a decline in national executive accountability in policy areas that by their nature are inherently political. It was inevitable, given the profound nature of the responses to the Eurozone crisis, that legal challenges would be launched to question the validity of the measures in question.

Chapter Five

The Role of Interpretative Latitude

Ensuring Judicial Deference to the Political

Introduction

As the financial crisis spread to the European Union, the responses to it consisted of increasingly novel measures designed to restore a sense of financial stability to the Euro area. Mediated by means of both intergovernmental agreements and unconventional policy measures (within existing EU legal provisions) at the institutional level, the purpose was to re-establish the confidence of the financial markets. The effect of executive responses to the crisis led to legal challenges at both the domestic and EU level. This chapter is concerned primarily with the latter and critically analyses the CJEU's legal reasoning in its assessment of the legal validity regarding the European Stability Mechanism (ESM), the ECB's outright monetary transactions (OMT) programme announcement and the Cypriot bank bail-ins.

It is argued that the CJEU acquiesced to the exigencies of the time prioritising the political decisions made by the executive to maintain and continue the existing economic order rather than challenge the legality of those decisions. Contrary to the assertions of some authors,[1] the powers of the CJEU have not increased. Rather, in its judgments, the Court has employed a considerable degree of interpretative latitude: it prioritised the teleological over the literal approach based on the overriding goals of financial stability and continued economic integration. The emphasis placed on these overarching objectives not only allowed for an inversion of the meaning of the provisions under examination, but also provided an *ex post* legitimation of those political decisions whose conformance with Union law is at the very least questionable, and to which the Court remained deferential.

[1] F. Fabbrini*, Economic Governance in Europe: Comparative Paradoxes, Constitutional Challenges* (Oxford University Press, Oxford, 2016), p. 63: "the Euro crisis and the legal and institutional responses have dramatically increased the powers of the judiciary vis-à-vis the political branches, making economic and monetary affairs in Europe more judicialized than even in a hyper-judicialized system like the US."

The emphasis on financial stability and economic integration provided the financial markets with the assurance that their rights would be assured in a time of crisis.[2] The Court was, it is argued, prepared to adopt a softer standard in its interpretation of hard laws, during a time of crisis, in order to weaken constraints on policymakers.[3] This approach, it is argued, raises significant concerns. The inconsistencies in the interpretation of those enactments has the potential to threaten the integrity of the legal reasoning of the EU.[4] This, in turn, has undermined the rule of law at the European level which, in itself, should act to prevent the executive abuse of power: whereas, the consistency of application of EU law has been the case in more normal, less tumultuous times, it should have been, it is argued, of even greater concern to the Court during the Eurozone crisis. The cumulative effect of the judgments was to confer new powers on both the Commission and ECB while simultaneously weakening their accountability. By attempting to deal with one danger, the Court has created another: the creation of new constitutional norms with little or no support in the text of the Treaties.

1. Pringle, Interpretative Latitude and the Pursuit of Political Stability

The establishment of the European Stability Mechanism (ESM) was hailed as a milestone in the history of Economic and Monetary Union. Designed to assist those Member States experiencing severe financial problems, it represented the legal manifestation of an overwhelming political desire to convey a sense of credibility to the financial markets which continued to be nervous during the ongoing crisis. However, the strict conditionality associated with the operation of the mechanism was, and remains, controversial.[5] It was against this background that a number of cases concerning these measures were brought.[6]

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[2] M. Gulati, G. Vanberg, "Paper Tigers (Or How Much Will Courts Protect Rights in a Financial Crisis?)," in *Institutions and the Crisis* (eds F. Allen, E. Carlettie & M. Gulati) (EUI, Florence, 2018), p. 114.

[3] Ibid, p. 111.

[4] J. Tomkin, "Contradiction, Circumvention and Conceptual Gymnastics: The Impact of the Adoption of the ESM Treaty on the State of European Democracy," German Law Journal Vol. 14(1) (2013), pp. 169-189, p. 188.

[5] Financial assistance is granted in accordance with the terms of the Memorandum of Understanding requiring the implementation of an economic structural adjustment programme. See Chapter 4.

[6] B. De Witte, "Judicialization of the Euro Crisis? A Critical Evaluation," in *Institutions and the Crisis* (eds F. Allen, E. Carlettie & M. Gulati) (EUI, Florence, 2018), p. 104. De Witte notes a first category of cases brought questioning the nature of the ESM and TSCG as they took the form of international treaties rather than being founded within EU law proper. A second category of cases were brought by individuals challenging the austerity measures in programme countries.

Both the domestic and the EU courts were under considerable political pressure to provide an analysis of those provisions that would not only assuage the continuing volatility in the markets but also continue to legitimise a contested economic and monetary paradigm.

Following the onset of the Eurozone crisis, at the meeting of the European Council on 28 and 29 October 2010, the participating states agreed on the need to establish a permanent crisis mechanism.[7] On 16 December 2010, the Belgian Government had submitted a proposal for the revision of Article 136 TFEU, in accordance with the procedure set out under Article 48(6) TEU, to establish a permanent crisis mechanism proposing the addition of a paragraph stating that:

> "…Member States whose currency is the Euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the Euro area as a whole and stating that the granting of any required financial assistance under the mechanism will be made subject to strict conditionality."[8]

Consequently, The European Parliament, Commission and ECB issued their opinions on that proposal and Decision 2011/199 was adopted on 25 March 2011.

A: The Stability Mechanism – Legal Challenge and Predictable Outcomes

The establishment of the ESM was not uncontroversial. A number of actions were brought in various Eurozone countries in which litigants called for an *ex ante* or *ex post* review of the legality of the ESM Treaty (and the Treaty on Stability, Cooperation and Governance).[9] However, it was the challenge brought by Thomas Pringle before the Irish courts that would ultimately be considered at the European level. The Irish government had emphasised, in the face of the ongoing crisis, what it considered to be the political importance of the ESM as a funding backup mechanism in terms of financial market re-entry and leaving the EU-IMF programme of support.[10] The Minister for Finance stated:

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[7] European Council Decision 2011/199, Recital 2.

[8] Ibid, Recital 3.

[9] B. De Witte, "Judicialization of the Euro Crisis? A Critical Evaluation," in *Institutions and the Crisis* (eds F. Allen, E. Carlettie & M. Gulati) (EUI, Florence, 2018), p. 104. Actions were brought in Slovenia, Estonia, Germany, Austria, Hungary, France and Belgium.

[10] Michael Noonan, Dáil Debate, 7th June, 2012 available at: https://www.oireachtas.ie/en/debates/debate/dail/2012-06-07/19/ (last accessed 22/05/20)

> "Enacting the ESM Bill 2012 and ratifying the ESM treaty will ensure that Ireland has access to this funding safety net if our efforts to re-access the market are delayed in any way and we need to resort to further assistance."[11]

However, Dáil ratification of the ESM Treaty was facilitated by means of the guillotine procedure[12] such that close parliamentary analysis of the terms of the Treaty were precluded.[13] Mr Pringle was profoundly concerned at the constitutional implications of the ESM Treaty, believing that Irish sovereignty would be reduced with control over budgetary matters being severely limited.[14] He was also concerned that the Treaty with its focus on financial stability ran counter to the broader EU objectives, in particular, Article 2 TEU regarding the rule of law, respect for human dignity and human rights.

Mr Pringle brought an initial action before the High Court, in Ireland, arguing that the Decision 2011/199 was not lawfully adopted under the simplified revision procedure, under Article 48(6), as it allowed for the alteration of the competences of the EU contrary to the third paragraph of Article 48(6).[15] Mr Pringle also claimed that Ireland's ratification, acceptance or approval of the Treaty would entail obligations that would be in contravention of the EU Treaties concerning economic and monetary policy, specifically, it would impinge on the EU's exclusive competency in relation to monetary policy.[16] It was argued that the establishment of the ESM would create for those participating states an autonomous and permanent international institution "with the objective of circumventing the prohibitions and restrictions laid down by the provisions of the TFEU Treaty in relation to economic and monetary policy."[17] Moreover, it was claimed that the ESM Treaty would confer on the EU's institutions new competences and tasks that are incompatible with "the general principle of effective judicial protection and with the principle of legal certainty."[18]

In its judgment of 17 July 2012, the High Court dismissed all aspects of the claim save one which was to be subject to a preliminary reference to the CJEU: whether it was lawful for

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[11] Ibid.
[12] Ibid, Dáil Debate, 7th June, 2012.
[13] J. Noonan, M. Linehan, "Thomas Pringle v. The Government of Ireland, Ireland and the Attorney General," Irish Journal of European Law Vol. 17(1) (2014), pp. 129-138, p. 132.
[14] Ibid.
[15] *Pringle v. Government of Ireland* Case C-370/12, para. 24.
[16] Ibid, para. 25.
[17] Ibid.
[18] Ibid.

Ireland to ratify the Treaty before Decision 2011/1996 to amend Article 136 TFEU came into force.[19] On appeal against the dismissal of those failed claims, the Supreme Court stayed proceedings and decided to expand the number of questions of interpretation to be referred to the CJEU in accordance with Article 267 TFEU. The CJEU was asked to consider the validity of Decision 2011/199 regarding the use of the simplified revision procedure under Article 48(6) TEU and whether the proposed amendment led to an increase in the competences conferred on the EU under the Treaties and whether, in substantive terms, the amendment amounted to a violation of the Treaties or of the general principles of EU law. Secondly, the Supreme Court had a question relating to Articles 2, 3. 4(3) and 13 TEU, and Articles 2(3), 3(1)(c), 3(2), 119 to 123 and 125 to 127 TFEU: it asked these provisions, in addition to the general principles of effective judicial protection and legal certainty, prevent a Member State within the Euro area from agreeing and ratifying the ESM Treaty. Finally, the Supreme Court sought to ascertain whether those Contracting States could conclude and ratify the Treaty before the entry into force of the European Council Decision on which it was based.[20]

It was the Court's reasoning in answering the first two questions that demonstrated the interpretative latitude employed to support the political decision-making that was intended to alleviate the effects of the crisis. It is argued that the emphasis by the CJEU on a teleological approach afforded it a degree of flexibility that provided not only an *ex post* legitimation of those political decisions, but also provided a decision which is difficult to reconcile with the text of those provisions under examination.

In consideration of the first question assessing the validity of Decision 2011/199 and the use of the simplified revision procedure, several countries, together with the Council and Commission, questioned the jurisdiction of the CJEU under Article 267, suggesting that it was limited, if not excluded, as it related to the validity of primary law.[21] Clearly, there was a degree of nervousness concerning political implications of the Court's involvement and the potential for a finding against the legality of the ESM Treaty. Nonetheless, the Court quickly dealt with the issue. Firstly, the Court noted that, as the European Council is an institution of the EU under Article 13(1) TEU and, under Article 267(b) TFEU it is entitled to give

[19] *Pringle v The Government of Ireland & Others* [2012] IEHC 296.
[20] *Pringle v. Government of Ireland* C-370/12, [2012], paras. 27-29
[21] Ibid, para. 30.

preliminary rulings concerning the validity of the acts of those institutions. It therefore had jurisdiction to examine the validity of the decision in question.[22] The Court recognised that under Article 267(a) TFEU it did not have jurisdiction to question the validity of primary law. However, after the entering into force of the simplified revision procedure (in addition to the ordinary procedure) for Treaty revision, it is within the jurisdiction of the Court to ensure that measures taken under the simplified procedure comply with the conditions under that provision.[23] Under the simplified revision procedure all or part of the provisions under Part Three of the TFEU that relate to the internal policies and actions of the EU may be undertaken.[24] Such revision may take place following adoption of a decision by the European Council as long as that decision does not increase the competences conferred on the Union in Treaties.[25] The Court held that its role was to ensure that those conditions were complied with in the interpretation of the Treaties under Article 19(1) TEU in order to confirm the validity of the Decision.[26]

In substantive terms, regarding the form of Treaty amendment, the Court had to consider its approach carefully. Under Article 48(6) a Member State, The European Parliament or the Commission may make proposals to the Council for the revision of parts of Part Three of the TFEU relating to internal policies of the EU. “The European Council shall act by unanimity after consulting the European Parliament and the Commission, and the European Central Bank in the case of institutional changes in the monetary area”[27] subject to provision in the final paragraph of Article 48(6) which does not allow an amendment to increase the competences conferred on the Union in the Treaties.[28] Clearly Article 136 is found in Part Three of TFEU and therefore satisfies the condition laid down in the first and second paragraphs of Article 48(6) TEU. However, the Supreme Court in making its reference was also concerned whether the revision infringed the EU’s exclusive competence in the area of monetary policy and in the coordination of economic policy of Member States.[29]

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[22] Ibid, para. 31.
[23] Ibid, para. 32.
[24] Art. 48(6) TEU.
[25] Ibid.
[26] *Pringle v. Government of Ireland* C-370/12, [2012] E.C.R. I, para. 37.
[27] Art. 48(6), TFEU.
[28] Ibid.
[29] *Pringle*, para. 47.

In examining the question put forward by the Supreme Court, the CJEU noted the legal provisions set out under 119(2) under which Member States' activities consisted of the single currency and the conduct of a single monetary and exchange-rate policy. Monetary policy of the EU is provided for under Article 3(1)[30] and Articles 127 to 133 TFEU with the ECB and Member States' central banks (the Eurosystem) being conducted under Article 282(1) TFEU.[31] On the other side of the (Euro) coin, the Court also noted the commitment by Member States to the adoption of economic policy, under Article 119(1), based on close coordination of their policies, on the internal market and on the definition of common objectives "conducted in accordance with the principle of an open market economy with free competition."[32] The Court then established a link between the pursuit of economic and monetary objectives associated with the operation of the single currency: the primary objective of monetary policy is to maintain price stability under Articles 127(1) and 282(2) TFEU with the support of the European System of Central Banks (ESCB) whose role is to promote the general economic policies of the EU "contributing to the achievement of its objectives" under Article 3 TEU.[33] That connection was facilitated by the Court's recognition that the TFEU (conveniently) contains no definition of monetary policy. It refers, instead, to the objectives of the policy rather than the specific instruments of it.[34] Therefore, in order to assess the validity of the ESM, the establishment of which was envisaged by Article 1 of Decision 2011/199, it was necessary to examine the objectives of the mechanism and whether or not they fell within monetary policy for the purposes of Articles 3(1) and 127 TFEU.

In examining those objectives, the Court held that the purpose of the mechanism was to "safeguard the stability of the Euro area as a whole"[35] and that was "clearly distinct from the objective of maintaining price stability, which is the primary objective of the Union's monetary policy."[36] Whereas it was recognised that the stability of the Euro area may have repercussions on the stability of the currency, "an economic policy measure cannot be

[30] The EU has exclusive competence in the area of monetary policy for those Member States whose currency is the Euro.
[31] *Pringle* C-370/12, [2012], paras. 48-50.
[32] Ibid, para. 51. Economic policy of the EU is the subject of Articles 2(3) and 5(1) TFEU, and Articles 120 to 126 TFEU.
[33] Ibid, para. 54.
[34] Ibid, para. 53.
[35] *Pringle* C-370/12, [2012], para. 56.
[36] Ibid.

treated as equivalent to a monetary policy measure for the sole reason that it may have indirect effects on the stability of the Euro."[37] The Court went on to justify this view by noting that the stability mechanism, in the granting of financial assistance, constitutes an economic measure that does not fall within monetary policy.[38] The Court neatly sidestepped the issue raised by Pringle as regards the inflationary effects of bond purchasing by the ECB under the mechanism: any inflationary consequences would merely be the indirect consequence of the pursuit of economic policies under the ESM.[39]

In particular, the Court made reference to recital 4 of the Preamble to the Decision, in which the mechanism, as envisaged by Article 1, was designed to support and complement the new regulatory framework for strengthened economic governance,[40] noting that together with Articles 123 and 125 TFEU, they are essentially preventative in nature in terms of reducing the risk of public debt crises.[41] The purpose of the stability mechanism is to provide for the management of such crises should they arise notwithstanding the preventitive actions taken.[42] Consequently, in the view of the Court, the addition of a third paragraph to Article 136 TFEU, establishing the mechanism, does not affect the exclusive EU competence in the area of monetary policy under Article 3(1)(c) TFEU.

The Court noted the division of competences with regard to economic policy. It held that according to Articles 2(3) and 5(1) TFEU, the EU is restricted to coordinating measures as the Treaties "do not confer any specific power on the Union to establish a stability mechanism of the kind envisaged by Decision 2011/199."[43] Whereas Article 122(2) TFEU does allow for the *ad hoc* provision of assistance, it did not form the appropriate legal basis for the establishment of a permanent mechanism to safeguard the stability of the Euro area as a whole.[44] As a result, Member States were entitled to conclude among themselves measures such as the ESM Treaty provided that they continued to comply with EU law.[45] Therefore, the Court concluded that the use of the simplified revision procedure did not have the effect

[37] Ibid.
[38] Ibid, para. 57.
[39] Ibid, para, 97.
[40] Ibid, para. 58. See Chapter 4 for details of the regulatory framework for strengthened economic governance.
[41] Ibid, para. 59.
[42] Ibid.
[43] Ibid, para. 64.
[44] Ibid, para. 65.
[45] Ibid, paras. 68-69.

of increasing the competences of the EU.[46] The amendment of Article 136 TFEU does not, according to the Court, create a legal basis for the undertaking of any action which was not possible before the entry into force of the amendment. Despite the use of EU institutions under the ESM Treaty (specifically the Commission and the ECB), that does not affect the validity of Decision 2011/199 as it only provides for the establishment of the mechanism and is silent on the role of the EU institutions in that respect.[47] The Court concluded that the Decision does not increase the competences conferred on the Union by the Treaties.

B: Judicial Deference to the Political

The Court's deferential approach towards political decision-making in the interpretation of these provisions is not surprising. Indeed, some argue the outcome was predictable.[48] In following the Court's reasoning, it was essential that it established a link between the use of the simplified revision procedure and the finding that the ratification of the ESM Treaty did not amount to an increase in Union competences. The establishment of this link subsequently formed the basis for the justification of the Treaty being founded outside the EU legal order.

Notwithstanding the exigencies of the time, it would have been preferable to use the ordinary revision procedure which would have involved the participation of representatives and national parliaments that would have facilitated a more meaningful debate. The use of Article 48(6) limits the use of the simplified revision procedure to those amendments that do not increase the competences of the Union. Therefore, an amendment authorising financial assistance to be provided by the EU, where none had previously existed and which were expressly prohibited by the TFEU (see below), would increase the competences of the Union and prevent the use of the simplified revision procedure.[49] The use of the ordinary revision procedure would have placed the Mechanism firmly within the EU legal order and created a greater degree of accountability.

[46] Ibid, *Pringle*, para. 71.
[47] Ibid, paras. 72-76.
[48]See P. Craig, "Pringle: Legal Reasoning, Text, Purpose and Teleology," Maastricht Journal of European and Comparative Law Vol. 20(1) (2013), pp. 1-11.
[49] J. Tomkin, "Contradiction, Circumvention and Conceptual Gymnastics: The Impact of the Adoption of the ESM Treaty on the State of European Democracy," German Law Journal Vol. 14 No. 1 (2013), pp. 169-190, p. 183.

Moreover, the manner in which the Court addressed the Supreme Court's question of whether the revision infringed the Union's exclusive competence in monetary policy and the coordination of economic policies raises concerns. Article 119 (2) TFEU states explicitly that the operation of the single currency, the single monetary policy and the exchange rate policy is undertaken with the primary objective of maintaining price stability and to support general economic policies "*in the Union*." The Court's interpretative latitude is founded on the lack of a definition of monetary policy. It was able, therefore, to rely on the overarching objectives of Article 119(2) to justify its decision that the competences of the Union are not increased.

The provisions that were considered by the CJEU in *Pringle* are based on an economic paradigm to which political and institutional actors had submitted. The question then arises as to what extent political decisions are permitted to depart from those rules and to what extent should the courts uphold those decisions in the event of crisis?

The decision to establish the Mechanism within an international treaty was clearly designed to circumvent EU law. The establishment of EMU in the Maastricht Treaty was based, wisely or not, on the principle of a no bail-out economic and monetary paradigm democratically agreed by the participating Member States. In its resolution of 23 March 2011, the European Parliament stated that it regretted that the Council had not explored "all the possibilities contained in the Treaties for establishing a permanent stability mechanism…"[50] as it had the potential to undermine and posed "a threat to the integrity of the Treaty-based system."[51] The finding that it was within the gift of those Member States to agree an international treaty to pursue goals that would have been prohibited under EU law represents a circumvention and weakening of the rule of law.

This is particularly concerning with regard to the general principle of the effective judicial protection. The establishment of the ESM, outside the EU legal order, ensures that it is removed from the scope of the Charter of Fundamental Rights and, therefore, circumvents

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[50] Resolution of the European Parliament of 23 March 2011, para. 9. Available at: http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+TA+P7-TA-2011-0103+0+DOC+PDF+V0//EN (last accessed 22/05/20).
[51] Ibid, para. 7.

Article 47 of the Charter guaranteeing the right to effective judicial protection. According to Article 51(1) of the Charter, Member States are bound by its provisions only when implementing EU law and does not extend its application of EU law beyond the powers of the EU as defined in the Treaties.[52] The Court observed that those states, when establishing the ESM, were not implementing EU law within the meaning of Article 51(1) and that the ECB and Commission, operating under the ESM, did not have any powers to make decisions of their own.[53] Consequently, the general principle of effective judicial protection does not preclude the agreement of a treaty such as the ESM.[54]

This has led to criticism among legal scholars: "there is no basis upon which to conclude that fundamental rights and obligations can be circumvented on the pretext of a delegation of functions."[55] Indeed, the Court was not prepared to allow those cases which alleged infringement under the Fundamental Charter as a result of the granting of financial assistance.[56] The establishment of the ESM and its operation is not able to be challenged by those citizens whose rights are adversely affected due to the adjustment programmes associated with it.

Perhaps the most controversial aspect[57] concerned the Court's findings is with regard to the compatibility of various Articles of the TFEU concerning the general principles of legal certainty and the rule of law that might preclude Member States from concluding and ratifying the ESM Treaty. The Irish Supreme Court, in its reference, pointed to the applicant's argument that the ESM Treaty constitutes an amendment "…which fundamentally subverts the legal order governing economic and monetary union and which is incompatible with European Union law."[58] The Court employed the same degree of

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[52] Ibid, Resolution of the European Parliament of 23 March 2011, para. 179-182.
[53] Ibid.
[54] Ibid.
[55] M. E. Salomon, "Of Austerity, Human Rights and International Institutions," European Law Journal Vol. 21(4) (2015), pp. 521-545, p. 537.
[56] See Case T-541/10 *ADEDY and Others v. Council*, EU:T:2012:626; Case T-215/11 *ADEDY and Others v. Council*, EU:T:2012:626. This is despite the qualification announced by the CJEU in *Ledra Advertising and Others v. Commission and ECB*, EU:C:2016:701.
[57] G. Beck, "ECJ legal rulings designed to help the Eurozone are threatening the accountability of European governance," LSE European Politics and Policy (EUROPP) Blog (2014), p.2. Available at: http://eprints.lse.ac.uk/71591/1/blogs.lse.ac.ukECJ%20legal%20rulings%20designed%20to%20help%20the%20Eurozone%20are%20threatening%20the%20accountability%20of%20European%20govern.pdf (last accessed 22/05/20).
[58] Ibid, *Pringle*, para. 108.

latitude emphasising a teleological approach to interpretation that prioritised certain higher objectives of the Union that would avoid the constraints imposed by a literal textual analysis.

The particular provisions that were most important to the applicant's argument concerned Articles 122 to 125 TFEU and their interaction in determining whether the ESM Treaty was incompatible with Union law particularly in relation to the 'no-bailout' clause. Under Article 122(1), the Court noted[59] that measures may be adopted to alleviate severe difficulties experienced by a Member State in the supply of certain goods, notably in the area of energy.[60] Clearly this provision does not constitute a legal basis for financial assistance for Member States experiencing or threatened by severe financing problems and thus the ESM does not encroach on that provision according to the Court.[61] Indeed, this reflects the view of the Council which stated that Article 122 did not form an appropriate legal basis for the ESM.[62] Having recognised this, the Court moved[63] on to consider Article 122(2)[64] examining whether the provision "exhaustively" defined the exceptional circumstances in which financial assistance may be granted to Member States and whether that provision empowers only the EU's institutions in that regard. In order to reconcile this provision with the Mechanism, the Court drew a distinction between *ad hoc* financial assistance provided by the Union and that provided by Member States:[65] the existence of that provision is, therefore, not affected by Member States' decision to establish such a mechanism as long as it remains in compliance with EU law as the TFEU does not indicate that the EU has exclusive competence in the area of granting financial assistance.[66] The justification for this finding is based on the Court's opinion that the ESM supports the continuing coordination of

[59] Ibid, paras. 115-116.
[60] Article 122(1) TFEU: "Without prejudice to any other procedures provided for in the Treaties, the Council, on a proposal from the Commission, may decide, in a spirit of solidarity between Member States, upon the measures appropriate to the economic situation, in particular if severe difficulties arise in the supply of certain products, notably in the area of energy."
[61] *Pringle* C-370/12, [2012], para. 116.
[62] Decision 2011/199, Recital 4.
[63] *Pringle*, paras. 117-122.
[64] Article 122(2): "Where a Member State is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control, the Council, on a proposal from the Commission, may grant, under certain conditions, Union financial assistance to the Member State concerned. The President of the Council shall inform the European Parliament of the decision taken."
[65] Ibid, *Pringle*, para. 118.
[66] Ibid, paras. 119-121.

Member States' economic policies.[67] It was necessary for the Court to find that a permanent mechanism to safeguard the stability of the euro area was outside of the scope of Article 122(2) in order to determine that the Union did not have a competence in this area. The finding that it only provides for *ad hoc* financial assistance, as opposed to a permanent mechanism, allowed the Court to find that Decision 2011/199 did not impinge on the economic competences in the Treaties and that, therefore, the simplified revision procedure was the appropriate method for the addition of the third paragraph to Article 136(3) TFEU.

Next, the Court considered whether the ratification of the ESM Treaty was an attempt to circumvent the prohibition of monetary financing laid out in Article 123 TFEU.[68] The Court noted that the provision was addressed to the ECB and national central banks and therefore did not prevent the granting of financial assistance by one or more Member States to another as the provision was not aimed at them.[69] Article 123 TFEU is quite explicit in its prohibition of the granting of overdraft facilities or other types of credit facility by the ECB or other Member States' central banks. The finding that the Article is addressed specifically to the ECB and that therefore such assistance by a group of Member States would not be in breach of the prohibition is difficult to reconcile with that provision. The ESM, operating outside the EU Treaty framework, is performing precisely those functions, in cooperation with and parallel to the ECB, that the ECB is specifically prohibited from performing under EU law.[70] It should be noted that Articles 123-125 TFEU were considered the key components of the economic constitution designed to enforce the operation of market discipline when the Maastricht Treaty was negotiated.[71] A constitutional provision of this

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[67] Ibid.

[68] Article 123 TFEU:

> 1. Overdraft facilities or any other type of credit facility with the European Central Bank or with the central banks of the Member States (hereinafter referred to as 'national central banks') in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the European Central Bank or national central banks of debt instruments.
>
> 2. Paragraph 1 shall not apply to publicly owned credit institutions which, in the context of the supply of reserves by central banks, shall be given the same treatment by national central banks and the European Central Bank as private credit institutions.

[69] *Pringle*, paras. 125-126.

[70] J. Tomkin, "Contradiction, Circumvention and Conceptual Gymnastics: The Impact of the Adoption of the ESM Treaty on the State of European Democracy," German Law Journal Vol. 14 No. 1 (2013), pp. 169-190, p. 181.

[71] R. Smits, *European Central Bank Institutional Aspects* (Kluwer Law International, London, 1997), pp. 77-78.

nature is designed to act as a constraint on political and institutional actors. It is difficult not to conclude that the interpretative latitude employed by the Court, in support of political decisions, undermines the rule of law.

However, the greatest obstacle facing the Court concerned the 'no-bailout' clause under Article 125 TFEU.[72] In defining the purpose of the Article, the Court held that the apparent prohibition on the EU or other Member States' assumption of another Member State's commitments does not prevent the granting of *any* form of financial assistance whatsoever.[73] The Court justified this reading by reference to other articles relating to economic policy. Specifically, the Court noted the provision of *ad hoc* financial assistance that could be granted under Article 122(2) to those states experiencing or threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control: if Article 125 TFEU had intended such a prohibition then Article 122 TFEU would have stated that it derogated from Article 125 TFEU.[74] Furthermore, the Court reasoned, the prohibition of the granting of overdraft facilities or other forms of credit facility by the ECB and Member States' central banks, under Article 123 TFEU, is very specifically worded in a form that is stricter than that of the 'no bail-out' clause and thus Article 125 is not intended to prohibit any financial assistance whatsoever.[75]

This interpretation therefore raises the question as to what form of financial assistance would be compatible with Article 125 TFEU? In order to determine this, the Court considered the objective and origin of the Article. The origin of Article 125 TFEU is found in Article 104b of the EC Treaty which was inserted by the Maastricht Treaty.[76] In referring to the preparatory work leading up to the Maastricht Treaty, the purpose of the 'no-bailout'

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[72] Article 125, TFEU: 1. The Union shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of any Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project. A Member State shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of another Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project.
2. The Council, on a proposal from the Commission and after consulting the European Parliament, may, as required, specify definitions for the application of the prohibitions referred to in Articles 123 and 124 and in this Article.
[73] *Pringle*, para. 130.
[74] Ibid, para. 131.
[75] Ibid, para. 132.
[76] Ibid, para. 134.

clause was to ensure that Member States followed sound budgetary policies.[77] The objective of the clause was to ensure that Member States remained subject to the logic of the market with regard to public debt which should, in turn, force them to maintain budgetary discipline:[78] "compliance with such discipline contributes at Union level to the attainment of a higher objective, namely maintaining the financial stability of the monetary union."[79] Therefore, the Court reasoned, Article 125 is designed to prohibit the form of financial assistance whereby the incentive of the recipient Member State to conduct sound budgetary policy is diminished.[80] Where a state remains responsible for its commitments to creditors and complies with the conditions attached to the financial assistance provided to implement sound budgetary policy, that assistance is not prohibited by Article 125 TFEU.[81] The Court was satisfied that the attachment of strict conditionality to any support provided was designed to ensure compliance in the area of the coordination of economic policies underpinned by the pursuit of sound budgetary policy.[82]

The Court also dismissed Mr Pringle's argument that the capital calls under the ESM Treaty[83] are incompatible with the 'no bail-out' clause in that they imply that signatories to the Treaty are, in effect, guaranteeing the debt of the recipient of assistance.[84] The Court maintained the fiction that suggests market conditions continue to operate under the ESM. According to the Court, the ESM Treaty states that an ESM Member State that fails to pay the sum called for then a revised capital call is to be made on other ESM Members.[85] However, the ESM Member State that is in need of financial assistance "remains bound to

[77] Ibid, para. 135: The Court referred specifically to the Draft Treaty amending the Treaty establishing the European Economic Community with a view to achieving economic and monetary union, *Bulletin of the European Communities, Supplement* 2/91.
[78] Ibid.
[79] Ibid.
[80] Ibid, para. 136.
[81] Ibid, para. 137 et seq. According to the Court, the instruments employed for stability support demonstrate that the ESM is not acting as guarantor for the debts of the recipient state. Thus, the extension of a credit line under Article 14 ESM Treaty does not imply the assumption of debts of a Member State as it amounts to the creation of new debt. Similarly, regarding the proposed purchase of bonds on the secondary market, the Court was satisfied that the state in question remains liable for those debts.
[82] Ibid, para. 143.
[83] Article 25(2) ESM Treaty.
[84] *Pringle*, paras. 144-147.
[85] Article 25(2), ESM Treaty.

pay its part of the capital" and, therefore, the other Members are not acting as guarantors of the debt owed.[86]

The reliance on market discipline is combined with the higher objective of maintaining the stability of the single currency. Whereas, under normal circumstances these two principles complement one another, the financial crisis has placed them in conflict.[87] The unhindered operation of market discipline could have led to the collapse of the single currency. This is due to the failure of certain (monetarist) economic assumptions that underpin the economic constitution of the EU that ultimately weakened Article 125. An approach was needed that avoided uncertainty but, unfortunately, it perpetuated a belief in the need for fiscal consolidation, which has been increasingly contested by many economists[88] but which, nonetheless, allowed the proponents of this policy (and the Court) to remain convinced that the disciplinary effects of the market continued to operate following the interpretation of Article 125 in this form.

The no bailout clause, whilst recognising the operation of market forces, also recognised that the response of the markets was often excessive and provided the justification for the need to coordinate economic and budgetary policy with a view to avoiding excessive deficits which should, on that basis, avoid the need for a bailout.[89] The Court's interpretation of the no bail-out clause in relation to the ESM weakens the link between the operation of the market and its pricing of debt: the knowledge of the existence of a financial assistance mechanism would imply that default risk would not be priced properly: "…for the logic of the market to exert its magic, it is vital that creditors live in fear of losing their money…"[90] Contrary to the view of the Court, it is necessary to have the threat of default or instability in order for the logic to work and to promote stability. As a result, deference to political and economic principles in this form simultaneously recognises the fiction that is the logic of the

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[86] *Pringle*, paras. 144-147.
[87] V. Borger, "The ESM and the European Court's Predicament in Pringle," German Law Journal Vol. 14 No.1 (2013), pp. 113-140, p. 130.
[88] For example, see J. D. Ostry, P. Loungani, D. Furceri, "Neoliberalism: Oversold," International Monetary Fund, Finance and Development, Vol. 53, No. 2 (2016).
[89] J-V Louis, "Guest editorial: The no-bailout clause and rescue packages," (2010) 47 CML Rev 971.
[90] H. Schepel, "The Bank, the Bond, and the Bail-out: On the Legal Construction of Market Discipline in the Eurozone," Journal of Law and Society Vol. 44(1) (2017), pp. 79-98, p. 85.

market whilst providing for an intervention when the logic threatens the stability it is purported to promote.

However, the restricted access of Member States to the financial markets had been due to the increase of yields on bonds that accompanied the recapitalisation of their financial institutions due to a supervisory failure.[91] The Court's emphasis on the need for Member States' public finances to remain subject to the market was justified on the attainment of the higher objective: the maintenance of financial stability of monetary union. Thus, given that objective, the Court held that the granting of financial assistance from the Union and Member States would be prohibited where the incentive, on the part of the recipient state to maintain sound budgetary policy is diminished.[92]

Whereas the teleological approach can be justified,[93] the conclusions drawn may be contested: the CJEU held that where assistance is attached to strict conditions it is justified because it fosters sound budgetary policy and is therefore compatible with Article 125.[94] The ESM does not allow for the assumption of liabilities by other Member States for the recipient state and a margin is also payable. The recipient state is still responsible for its debts, subject to an *ersatz* market logic and not passing those liabilities to another Member State and paying some form of interest thus instilling sound fiscal policy. This argument is contested by Craig on two grounds. Firstly, the idea of the ESM is to provide assistance where it would not be forthcoming by ordinary markets which, it can be argued, diminishes the incentive for fiscal. In addition, the margin to be paid will be less than the ordinary market rates.[95] Secondly, strict conditionality does not offset the first argument. Those conditions might be strict and impose various hardships on the citizens of the State concerned. However, the incentive to maintain fiscal responsibility is still diminished as the

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[91] W.W Eubanks, "The European Union's Responses to the 2007-2009 Financial Crisis," Congressional Research Service 7-5700 (2010), p. 4. Differing regulatory approaches between Member States allowed their financial institutions to gain competitive advantages over one another to develop business models that allowed for the removal of risky assets from their balance sheets without the security of an appropriate amount of capital to protect them from exposure in the first place. Available at: https://fas.org/sgp/crs/row/R41367.pdf (last accessed 22/05/20).
[92] Ibid, *Pringle*, Para. 136.
[93] P. Craig, "Pringle: Legal Reasoning, Text, Purpose and Teleology," Maastricht Journal of European and Comparative Law Vol. 20(1) (2013), pp. 3-11, p. 8.
[94] Ibid.
[95] Ibid, Craig.

impact without that assistance would be greater.[96] If a state knows there is a chance of assistance, even with strict terms, it is still preferable to the consequences that follow where there is no bailout available. Thus, the incentive for budgetary responsibility is diminished.[97]

There is, therefore, a tension between the principles which underpin those political norms, informing the interpretation of the economic constitution, and the need to formulate a mechanism which allows an effective response to limit the spread of economic shocks in the Eurozone whilst operating within the bounds of market discipline as demanded by the TFEU. To that extent the ESM represents a compromise. Prior to the crisis, the emphasis was on the prevention of fiscal profligacy whilst respecting the notion of fiscal and economic sovereignty.[98] The faith in those norms that underpinned the legislative approach taken in the Treaty was based on certain key assumptions:[99] that the markets would exert strong pressure on euro area fiscal policies, secondly, that if that was not the case, that multilateral monitoring, peer pressure and sanctions would do the job.[100] Thirdly, the previous assumptions were reinforced by the notion that if a Member State were unable to implement sound fiscal policies, it would be left to its own devices.[101] However, reliance on those assumptions was misplaced.[102] As a result, EU institutions, rather than question the wisdom of the markets or the failure of the institutional design of EMU, placed responsibility on the ESM Member concerned. Ultimately, the prioritisation of the interests of creditors would inevitably necessitate the imposition of conditions that would ultimately diminish constitutional norms and undermine the values of the post-war social and democratic

[96] Ibid.
[97] Ibid, p. 9.
[98] Article 125 contains "no bailout" clause. Furthermore Article 123 TFEU prohibits overdraft facilities or any other type of credit facility with the ECB or with the central banks of the Member States in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, as is the purchase of them by the ECB or national central banks. Moreover, Article 124 TFEU prohibits the state from gaining privileged access to financial institutions. These provisions when viewed together with Art. 126 (to avoid excessive deficits) were designed to form an integral element of fiscal stability within the EU.
[99] "Challenges for the Euro Area, and the World Economy." Speech by Lorenzo Bini Smaghi, Member of the Executive Board of the ECB, 63rd Plenary Session, Session I: The Crisis of the Eurosystem, 28 May 2010, available at:
file:///G:/TSCG%20and%20Integration/ECB%20%20Challenges%20for%20the%20Euro%20Area,%20and%20the%20World%20Economy.htm. (last accessed 22/05/20).
[100] Ibid, smaghi "Challenges for the Euro Area, and the World Economy."
[101] Ibid.
[102] Ibid.

state.[103] The establishment, and legal sanctioning, of the ESM not only protected the sanctity of markets, it minimised the losses sustained by creditors. It preserved the hierarchy of economic interests, based on questionable economic assumptions, and rejected the application of the normative values for those citizens whose governments were forced to undertake structural adjustment programmes in return for financial assistance.

The CJEU was aware of the political significance of the ESM Treaty and determined that the case would be dealt with quickly: it sat as a full court for the first time in order to deal with a preliminary reference. Every Member State ensured it had high level representation throughout the hearing together with legal counsel from the Commission, European Parliament and European Council.[104] A number of judges were, according to Mr Pringle's legal representatives, clearly concerned by the issues they had to address.[105] However, as the following section will show, the use of such interpretative latitude employed to circumvent EU law to justify political decisions made raises significant questions regarding European democracy and the rule of law.

2. Interpretative Latitude and the Sanctioning of the Expanding Role of the ECB

The judicial reasoning in *Pringle* provided the legal basis for subsequent decisions in cases where political decisions were called into question. In addition to the establishment of the ESM, the ECB adopted certain non-conventional monetary measures that were intended to assuage the allegedly irrational doubts of the markets and return them to normality.[106] These measures were designed to address concerns about medium term financial stability with regard to bond prices. However, in arriving at its judgment the Court expanded institutional discretion by interpreting the relevant provisions through the lens of the primacy of the market and the belief in its efficiency. It was, in effect, the extension of the political by judicial means. When it became apparent that the wording of the treaties was

[103] A.J. Menéndez, "The Crisis of Law and the European Crises: From the Social and Democratic Rechtsstaat to the Consolidating State of (Pseudo-)technocratic Governance," Journal f Law and Society 44(1) (2017) pp. 56-78, p. 57. (Hereinafter Menéndez, "Crisis of Law").

[104] J. Noonan, M. Linehan, "Thomas Pringle v. The Government of Ireland, Ireland and the Attorney General," Irish Journal of European Law Vol. 17(1) (2014), pp.129-137, p. 135.

[105] Ibid.

[106] Menéndez, "Crisis of Law," p. 58.

no longer compatible with those newly determined political objectives, the Court's interpretative approach was such that the rule of law was effectively suspended in order to add legitimacy to those goals.

A: The Court, Non-Conventional Monetary Policies and the Primacy of the Market

In September 2012, the ECB issued a statement that it would be prepared to buy bonds on the secondary markets issued by those states experiencing bond price difficulties.[107] The purchase of these bonds would only occur if the Member States in question had committed to the EFSF/ESM programme which also required a commitment to the provisions of the TSCG. This represented a significant shift in policy; the ESCB had, in the past, adopted a more cautious reading of the ECB competences, stating that the lender of last resort in relation to specific institutions with liquidity issues was a task within the competence of the national central banks (NCBs) in accordance with Article 14(4) of the ESCB Statute.[108]

However, this announcement was viewed as a method of sidestepping parliamentary control as the decision of the Governing Council of the ECB on Technical Features of Outright Monetary Transactions is not subject to the influence of parliaments.[109] This is particularly salient as the OMT program had no quantitative limit.[110] This is in contrast to the funds underpinning the ESM that are approved by the parliaments of the participating states, as opposed to the OMT programme which exposes taxpayers to the default risk attached to unlimited volumes of bonds without prior parliamentary approval.[111] However, the problem associated with the EFSF/ESM programmes is that the funds do not hold enough money to avert a crisis. It was on this basis that the ECB justified its OMT Decision; an *ex ante* unlimited bond purchase would remove the threat of a liquidity crisis and avert a

[107] Available at https://www.ecb.europa.eu/press/pr/date/2012/html/pr120906_1.en.html (last accessed 22/05/20). Note that the ECB had previously embarked on the Securities Markets Programme, announced in May 2010, in order to maintain price stability.
[108] R. Lastra, "The Evolution of the European Central Bank," Queen Mary University of London, School of Law Legal Studies Research Paper No. 99/2012, p. 6.
[109] F. C.Mayer "Rebels Without a Cause? A Critical Analysis of the German Constitutional Court's OMT Reference," German Law Journal Vol. 15(2) (2014), pp. 111-146, p. 132.
[110] D. Murswiek, "ECB, ECJ, Democracy, and the Federal Constitutional Court: Notes on the Federal Constitutional Court's Referral Order from 14 January 2014," German Law Journal Vol. 15(2) (2014), pp. 147-165, p. 149.
[111] C. Gerner-Beuerle, E. Kucuk, E. Schuster, "Law Meets Economics in the German Federal Constitutional Court: Outright Monetary Transactions on Trial," German Law Journal vol. 15(2) (2014), pp. 281-320, p. 284.

self-fulfilling solvency crisis.[112] This represents a further attempt to depoliticise the transmission of monetary policy in that it is founded on those market-based norms which underpin EMU but which have, simultaneously weakened the democratic oversight of national parliaments.

However, the legality of the OMT decision was challenged by a number of parties in the German Constitutional Court which referred its decision to the CJEU. In its decision, on 7 February 2014, the German Constitutional Court referred the question of whether the ECB had exceeded its mandate to the CJEU. In making that referral, the Court made its view as to the legality of the bond purchases quite clear.[113] The German Constitutional Court stated that, in its opinion, the purchase of bonds of individual member states under the OMT Decision to be contrary to EU law. The primary objective of such purchases is to achieve a reduction in interest rates that Member States will have to pay on the capital markets for new government bonds.[114] The Court considered such purchases to be incompatible with Article 119 and 127 TFEU and Article 17 of the ESCB Statute because it exceeded the mandate of ECB and encroached on the Member State's responsibility for economic policy. In addition, the Court stated that, in its opinion, the OMT Decision is contrary to the prohibition of monetary financing of the budget under Article 123, TFEU.

The justification for this conclusion results from the Court's analysis of the distribution of powers between the EU and Member States regarding economic and monetary policy.[115] In so doing, the Court appears to have approved the decision in *Pringle*[116] where the CJEU held that the act in question, namely the establishment of the ESM, could not be treated as a monetary policy act on the basis that it might have an indirect effect on the stability of the Euro. Consequently, the German Constitutional Court, in applying this principle to the purchase of government bonds, concluded that the OMT Decision does not qualify as an act of monetary policy merely because it may also indirectly pursue monetary policy objectives.[117] One might therefore question the function of the ECB under the provisions of

[112] Ibid, Gerner-Beuerle, Kucuk, Schuster.
[113] BVerfG, Case No. 2 BvR 2728/13 (Jan. 14, 2014), http://www.bundesverfassungsgericht.de/en/index.html (last accessed 15/05/20).
[114] Ibid, Para 56.
[115] Ibid, Para 64.
[116] See above.
[117] Ibid, BVerfG, Case No. 2 BvR 2728/13, Para 64.

the ESM. However, the CJEU had upheld the legitimacy of the Treaty as the wording contained reference to secondary legislation such as part of the new regulatory framework aimed at strengthening economic governance. It is therefore assumed that the operation of the ECB under the ESM Treaty is legitimate as it is performing its monetary task in support of economic policies under Article 119 and 127 TFEU.[118] In addition, the fact that the OMT Decision links the purchase of bonds to economic policy conditionality of the EFSF and the ESM as part of economic policy contradicts the ECB's stance that the programme is part of its monetary policy remit; at least in as much as it is possible to separate the two.[119] This position is further enhanced, according to the Court's reasoning, by the fact that the purchase of bonds is also an activity engaged in by the EFSF and ESM and that the CJEU had held in *Pringle* that the aims and objectives of that mechanism is an activity pertaining to the field of economic policy.[120] Furthermore, the Court held that the OMT Decision did not fall within ECB's monetary policy because of its selectivity in the purchase of certain Member States' bonds.[121] The Court's reasoning for this conclusion is based on reference to the monetary policy guidelines[122] adopted by the ECB under which monetary policy does not have a targeted approach as opposed to the OMT Decision which is designed to target government bonds of selected Member States.

However, the CJEU's opinion differed.[123] Of primary concern was the question of whether the OMT programme fell within monetary or economic policy. The Court was prepared to accept that ECB's competences included mechanisms designed to aid the transmission of monetary policy.[124] The Court acknowledged the obligation of the ESCB to comply with the guiding principles of sound public finances[125] and any purchasing programme should not act as incentive to Member States to allow their finances to deteriorate and that, therefore, the programme in question should not go beyond the confines of monetary policy framework as laid out in the primary law.[126] The Court stated that the purchase of bonds, subject to

[118] Ibid.
[119] Ibid, Para 74.
[120] Ibid, Para 76.
[121] Ibid, Para 73.
[122] Annex I no. 1.1 of Guideline of the European Central Bank, 20 September 2012, on monetary policy instruments of procedures of the Eurosystem.
[123] *Gauweiler* EU: C:2015: 400 C-62/14.
[124] Ibid, para. 50.
[125] Article 127(1), TFEU.
[126] *Gauweiler*, para. 61

compliance with a macroeconomic adjustment programme would ordinarily be regarded as falling within economic policy undertaken by the ESM.[127] However, the Court drew a distinction between that programme and the ECB's proposed OMT programme which was being undertaken in order to preserve the price stability of bonds (whereas the ESM is intended to ensure the stability of the euro area, an objective that does not fall within monetary policy).[128] Furthermore, whereas Article 123(1) TFEU prohibits all (direct) financial assistance from the ESCB to a Member State,[129] according to the principle from *Pringle,* it does not "preclude generally, the possibility of the ESCB purchasing from the creditors of such a State, bonds previously issued by that State."[130]. Therefore, according to the Protocol of the Statute of the ESCB (Article 18.1), the ESCB, in achieving its objectives, is able to operate in financial markets by purchasing and selling those marketable instruments as long as the nature of open market operations is not disregarded.[131] The Court was convinced by the explanations provided by the ECB that made clear that the implementation of the programme such as that announced were to be subject to conditions intended to ensure that the ESCB's intervention on secondary markets would not have an effect equivalent to that of a direct purchase of government bonds on the primary market.[132]

Moreover, regarding the question of selectivity, the Court stated that the programme was intended to rectify the disruption of monetary policy resulting from the particular situation of certain government bonds in some Member States. It was the view of the court that the ESCB was entitled to adopt a selective bond buying programme in order to rectify that disruption:[133]

> "It is undisputed that interest rates for the government bonds of a given State play a decisive role in the setting of interest rates applicable to the various economic actors in that State, in the value of the portfolios of financial

[127] Ibid, para. 63. This is a reiteration of the principle in *Pringle* C-370/12, EU:C:2012:756, paragraph 60.
[128] Ibid, para. 64.
[129] Ibid, para. 93.
[130] *Pringle*, C-370/12 EU:C:2012:756, para. 132.
[131] *Gauweiler*, paras 95 and 96. The CJEU stated: "the ESCB is entitled to purchase government bonds — not directly, from public authorities or bodies of the Member States — but only indirectly, on secondary markets. Intervention by the ESCB of the kind provided for by a programme such as that at issue in the main proceedings thus cannot be treated as equivalent to a measure granting financial assistance to a Member State para 100" at para 100.
[132] Ibid, para. 105.
[133] Ibid, para. 89.

> institutions holding such bonds and in the ability of such institutions to obtain liquidity. Therefore, eliminating or reducing the excessive risk premia demanded of the government bonds of a Member State is likely to avoid the volatility and level of those premia from hindering the transmission of the effects of the ESCB's monetary policy decisions to the economy of that State and from jeopardizing the singleness of monetary policy."[134]

The justification for this approach is based on the faith in the technocratic expertise of the ECB and its vision of how it considers the market should operate, aided by such interventions, which would appear to bend the 'logic of the market' to its will in order to correct those prices it considers excessive. As the German Constitutional Court pointed out, the difference in the price of bonds between states (spreads) reflected the scepticism of the market that Member States would show sufficient budgetary discipline which is a feature of the design of the TFEU.[135] It is, the Court stated: "an expression of the independence of national budgets, which relies on market incentives and cannot be lowered by bond purchases by central banks without suspending this independence."[136] Whereas the views of the CJEU and the German Constitutional Court differ, both are proponents of 'market fundamentalism' as an economic norm with the former relying on the ECB's ability to ensure a form of equilibrium by way of intervention based on hypothesis and the latter recognising the actual behaviour of market participants based on their hopes and fears.[137] However, the OMT programme in conjunction with the operation of the ESM ensures the minimisation of default and reduces the risk to the holders of those bonds. As noted above, without the real risk of default it is hard to justify the spreads on bond yields as they reflect the scepticism of the market towards the state in question. The interventions of the ECB, in attempting to reduce volatility have in addition further reduced the risk to the holders of those instruments by taking them onto its balance sheet.

It is clear that in both the *Pringle* and *Gauweiler* cases that the CJEU has prioritised objectives rather than effects: the judgments have had the effect of fusing both economic

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[134] Gauweiler, para 78.
[135] BVerfG, Case No. 2 BvR 2728/13 (Jan. 14, 2014), para. 97.
[136] Ibid.
[137] H. Schepel, "The Bank, the Bond, and the Bail-out: On the Legal Construction of Market Discipline in the Eurozone," Journal of Law and Society 44(1) (2017), pp. 79-98, p. 96.

and monetary policy and that has created the potential for immense institutional discretion.[138] These decisions represent an extension of the political by judicial means, facilitated by certain methods of interpretation. Indeed, it has been suggested that the *Pringle* decision has crossed the line between legal reasoning and political judgment to find the legal justification that would legitimise the ESM Treaty and, by extension, the OMT programme.[139] Clearly it is common for textual analysis to be informed by an appreciation of teleological assumptions or objectives with the wording of that text creating a form of constraint on the Court's recourse to the background purpose.[140] However, the CJEU has adopted an interpretative method that is highly flexible and creative in nature. It prioritised an integrationist approach, as a higher objective, when the issues at hand touch the fundamental institutional interests of the EU.[141] In the case of emergency the wording of the TFEU no longer seemed compatible with the newly defined political objects of the institutions of the EU. In that sense, the rule of law, or constraints, is suspended as the flexibility is needed to fulfil the objectives dictated by the onset of the crisis.[142] As a result, there is a tension between the employment of textual and teleological analysis in the legal reasoning of the Court in these decisions. As Craig points out, the use of teleogical and textual methods are not mutually exclusive and must be used together, not in opposition.[143] The approach of the CJEU, in terms of teleology, is to determine economic integration as the central objective in the treaties. With regard to the decisions made in response to the crisis, the teleological approach might allow the Court to depart from the constraints imposed by textual analysis which, presumably, provides the justification for the avoidance of financial contagion and the collapse of the single currency. Indeed, the Court recognised that the provision of financial assistance, facilitated by the ESM, would not be compatible with Article 125 TFEU unless it was necessary for the safeguarding of the stability of the euro

[138] T. Tridimas* N. Xanthoulis, "A legal Analysis of the Gauweiler Case," 23 Maastricht Journal of European and Comparative Law (2016) pp. 17-39, p. 33.
[139] G. Beck, "The Legal Reasoning of the Court of Justice and the Euro Crisis - the Flexibility of the Cumulative Approach and the Pringle Case," Maastricht Journal of European and Comparative Law Vol. 20(4) (2013), pp. 635-648, p. 635.
[140] P. Craig, "Pringle and the Nature of Legal Reasoning," Maastricht Journal of European and Comparative Law Vol. 21(1) (2014), pp. 205-220, p. 206.
[141] G. Beck, *The Legal Reasoning of the Court of Justice of the EU*, (Hart Publishing, Oxford, 2012), p. 446.
[142] Ibid.
[143] Ibid, Craig, p. 210.

area.[144] Similarly with the OMT decision, the Court is prepared to adopt a flexible interpretative approach in order to preserve higher order political objectives.

However, whereas the pursuit of higher political objectives, facilitated by the CJEU's interpretative approach, designed to ensure the survival of the single currency might be justified in existential terms, the situation becomes more problematic when the courts are called on to adjudicate in cases where individual rights have been affected by the operation of those mechanisms.

B: Bail-ins and Burden Shifting and the Undermining of Individual Rights

As the crisis progressed, decisions were taken in the form of unconventional measures to provide financial institutions with liquidity. Those decisions, whilst welcomed at the time, are now judged critically.[145] The role of the judiciary during the crisis in assessing institutional actions was limited to performing a legality test, ensuring compliance with the law yet without evaluating the merits of those decisions.[146] Nonetheless, as financial stability continued to be threatened new mechanisms were developed to recapitalise financial institutions using private capital rather than public money.[147] The Commission stated:

> "…in order to limit distortions of competition between banks and across Member States in the single market and address moral hazard, aid should be limited to the minimum necessary and an appropriate own contribution to restructuring costs should be provided by the aid beneficiary. The bank and its capital holders should contribute to the restructuring as much as possible with their own resources."[148]

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[144] Case C-370/12 Pringle v. Government of Ireland, Ireland and the Attorney General, para. 136.

[145] C. Zilioli, "Justiciability of central banks' decisions and the imperative to respect fundamental rights," in *Shaping a New Legal Order for Europe: A Tale of Crises and Opportunities*, ECB Legal Conference (2017), p. 91. Available at: https://www.ecb.europa.eu/pub/pdf/other/ecblegalconferenceproceedings201712.en.pdf (last accessed 18/05/20).

[146] Ibid, p. 93.

[147] S. Grünewald, "Legal Challenges of Bail-in," in Shaping a New Legal Order for Europe: a tale of crises and opportunities, ECB Legal Conference 2017, September 2017 p. 287. Available at: https://www.ecb.europa.eu/pub/pdf/other/ecblegalconferenceproceedings201712.en.pdf (last accessed 22/05/20).

[148] Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis (OJ C 216, 30.7.2013), para. 15. Available at:

Subsequently, the Bank Recovery and Resolution Directive (BRRD)[149] and Regulation on the Single Resolution Mechanism (SRMR)[150] created a formal legal basis for the bail-in mechanism[151] which made it mandatory, since January 2016, to bail in shareholders and creditors for a minimum of 8% of total liabilities before the resolution-financing mechanism can be availed of.[152] It had developed significant momentum when many of the world's regulatory authorities developed regimes that allowed, in principle, banks to be recapitalised without resorting to public funding by internalising those costs.[153] Importantly, these provisions, requiring the prior participation of bank creditors, interact with the ESM as the latter acts as a component of them.[154] It should be noted that bank bail-ins had taken place before the enactment of these provisions but complied with them *ex ante*[155] with the Commission fulfilling the role of a resolution authority.

The justification of such measures was founded on the concern that governments undertaking bank bail-outs significantly weakened their fiscal position.[156] Moreover, it was considered that state support created moral hazard and tended to undermine market discipline.[157] Therefore, the Commission considered that to reduce moral hazard aid should only be granted on terms which involve adequate burden-sharing by existing investors.[158]

Consequently, the bank bail-in would have profound implications for the property rights of depositors (as creditors) who would call on the courts to enforce them. Whereas the

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https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2013:216:0001:0015:EN:PDF (last accessed 22/05/20).

[149] 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.

[150] 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.

[151] Art. 43, BRRD.

[152] Art. 45, BRRD.

[153] E. Avgouleas, C. Goodhart, "Critical Reflections on Bank Bail-ins," Journal of Financial Regulation 1 (2015), pp. 3-29, p. 4.

[154] Ibid, see European Stability Mechanism By-Laws, October 2012.

[155] Ibid, E. Avgouleas, C. Goodhart.

[156] Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis (OJ C 216, 30.7.2013), para. 18.

[157] Ibid, para. 40.

[158] Ibid.

decisions in *Pringle* and *Gauweiler* were concerned primarily with the overarching principles concerning the legality of the various institutional interventions designed to tackle the financial crisis,[159] attention began to focus on the operation of such provisions and the effect they would have on individual rights particularly in light of the operation of the ESM.

It should be noted that the operation of the ESM Treaty restricts the justiciability of the ESM's operations. Under Article 37(2), disputes between Members can be ruled upon by the Board of Governors and, if necessary, by the CJEU.[160] There is no provision within the Treaty that establishes a process by which individuals may challenge a decision by the Board of Governors when their rights have been adversely affected.[161] As noted above, this principle was confirmed in *Pringle* with the CJEU holding that observance of the EU Charter of Fundamental Rights in the conduct of ESM activities did not involve the implementation of EU law.[162] In addition to the recognition that the Commission and ECB did not have any decision-making powers conferred upon them by the Treaty,[163] the operation of the ESM could not be challenged under Article 263 TFEU. In terms of effective judicial protection, therefore, and given the terms agreed under Memorandum of Understanding (MoU) in the granting of financial assistance, the operation of the ESM could have profound effects on individual rights. However, the Court did note that under Article 13 ESM there is a requirement to ensure that MoUs are consistent with EU law.[164] Therefore, the possibilities of future actions in this respect were not precluded.

At the beginning of 2012, some Cypriot banks, including Cyprus Popular Bank and the Bank of Cyprus were experiencing financial difficulties. The government considered it necessary for them to be recapitalised and consequently made a request to the President of the Eurogroup for financial assistance from the EFSF or the ESM. In its statement of 27 June 2012, the Eurogroup acceded to the request and agreed to provide financial assistance, within the framework of a macro-economic adjustment programme contained within a

[159] In addition to the decision in *Kotnik* Case C-526/14 which confirmed the validity concerning the Commission's Banking Communication [2013] OJ C216/1, which clarified the conditions under which state aid may be used to support banks in order to ensure financial stability.
[160] Art. 37(3), ESM Treaty.
[161] J. Cotter, "Keep Calm and Carry On: EU Legal Developments in 2016," JCMS Vol. 55 Annual Review (2017), pp. 88-101, p. 90.
[162] Ibid*, Pringle (*Case C-370/12) at paras 179–180.
[163] Ibid, para. 161.
[164] Ibid, para. 164.

MoU, negotiated by the Commission, with the ECB and IMF and the Cypriot authorities. An agreement on the draft Memorandum was reached in March 2013. Some of the measures, insisted on by the Eurogroup, included a levy on bank deposits. On 25 March 2013, The Governor of Cyprus' Central Bank announced resolutions, the application of which, resulted in a substantial reduction in the value of certain deposits. This was despite the provision under EU law, on deposit guarantee schemes, that protected the first €100,000 of savings in the event of a banking crisis.[165] However, following public protests, a revised MoU was agreed on 26th April 2013. It provided for the division of the Cyprus Popular Bank into a 'good bank' and a 'bad bank' with the former being transferred into the Bank of Cyprus whilst the latter would cease to exist. As a result, losses on uninsured deposits in excess of €100,000 were borne by depositors.

The applicants in *Ledra*[166] brought an action before the General Court in which they sought firstly, judicial protection for the uninsured losses and, secondly, the annulment of the alleged unlawful passages in the MoU that facilitated that loss.[167] They therefore sought an order for the Commission and the ECB to compensate them at a level equivalent to the diminution in the value of their deposits, under Article 340 TFEU, and they sought an annulment of the disputed paragraphs of the MoU. The General Court rejected their application.[168] On appeal, the applicants argued that the General Court had erred in law by failing to apply Article 13(4) of the ESM Treaty by disregarding the fact that the Commission had signed the MoU that contained an unlawful condition.[169] According to the appellants, the inaction of the Commission and the ECB in this respect, allowed for the inclusion of MoU provisions that were not in conformity with EU law because they breached their property rights under Article 17 of the Charter and Article 1 of Protocol No. 1 of the Convention for the Protection of Human Rights and Fundamental Freedoms.[170] They therefore sought an

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[165] Art. 6(1), Directive 2014/49/EU of the European Parliament and of the Council, 16 April 2014, On Deposit Guarantee Schemes. A. Poulou, "The Liability of the EU in the ESM Framework," Maastricht Journal of Euopean and Comparative Law Vol. 24(1) (2017), pp. 127-139, p. 128: The protests were caused by the Cypriot bank rescue package which introduced a 'stability fee' of 6.75% on deposits between €20,000 and €100,000.
[166] *Ledra Advertising and Others v. Commission and ECB* Joined Cases C 8/15 P to C 10/15 P.
[167] Ibid, paras. 42-45.
[168] Ibid.
[169] Article 13(4) ESM: "The European Commission shall sign the MoU on behalf of the ESM, subject to prior compliance with the conditions set out in paragraph 3 and approval by the Board of Governors." Paragraph 3 states that the MoU shall be "…fully consistent with the measures of economic policy coordination provided for in the TFEU, in particular any act of European Union law…"
[170] *Ledra*, paras. 42-45.

action for annulment of the offending provisions contained in the MoU under Article 263 TFEU which allows for the review of the legality of the legislative acts of the Council, Commission and the ECB that are intended to produce legal effects *vis-à-vis* third parties.

The applicants questioned the General Court's assessment of the role of the Commission and ECB in the adoption of the MoU, in particular, that those institutions were the authors of the bail-in implemented in Cyprus and that the Commission had failed to ensure the MoU was in conformity with EU law.[171] The appellants disagreed with the finding of the General Court that the MoU did not originate with the Commission and ECB and that, therefore, it did not have the jurisdiction to rule on the actions for compensation.[172] Moreover, they challenged the finding by the General Court that they had not established that the damage they claimed to have suffered was caused by the Commission's failure to ensure that the Memorandum was in conformity with EU law.[173] The General Court justified this view[174] by noting that the adoption jointly of the MoU by the ESM and Cyprus (under Article 13(4) ESMT) was signed by the Commission on behalf of the ESM and cited *Pringle* stating that the duties conferred on the Commission and ECB within the ESM Treaty, do not entail any power to make decisions of their own.[175] Furthermore, the Court noted that despite the fact that one or more of the EU institutions play a role within the ESM framework it does not alter the nature of those acts which fall outside the EU legal order.[176] However, whilst that finding might affect the conditions governing the admissibility of an action for annulment of the offending paragraphs of the MoU under Article 263 TFEU, it cannot prevent an action for compensation against the Commission and ECB under Article 268 TFEU and the second and third paragraphs of Article 340 TFEU.[177] The reasoning behind this finding was based on the fact that the tasks conferred on the Commission and ECB under the ESM Treaty do not alter the essential character of the powers conferred on them by the EU Treaties, as stated in *Pringle*.[178] As a result, the Commission remains under an obligation to 'promote the

[171] Ibid, para. 49.
[172] Ibid, para. 50.
[173] Ibid.
[174] Ibid, para. 53.
[175] *Pringle v. Government of Ireland*, C-320/12, para. 161.
[176] *Ledra*, para. 54.
[177] Ibid, paras. 55-60.
[178] Ibid.

general interests of the Union' and 'oversee the application of Union law.'[179] Moreover, the role of the Commission, under Article 13(3 and (4) of the ESM Treaty, is obliged to ensure that the MoU concluded by the ESM are consistent with EU law.[180] The Commission is therefore obliged to refrain from signing a MoU when it doubts its consistency with EU law.[181] Having acknowledged the admissibility of the claim for compensation under Articles 268 and 340 TFEU as regards the disputed paragraphs in the MoU, the Court then considered whether the conditions for non-contractual liability were fulfilled: the fact of damage and the existence of a causal link between the conduct of the institution and the damage caused as a sufficiently serious breach of rule of law.[182] The Court held that whereas the Charter is not addressed to Member States within the context of the ESM Treaty regarding the protection of property rights under the Charter, the Charter is addressed to the institutions of the EU when they operate outside the EU legal framework.[183] The adoption of an MoU, such as that concluded by the ESM and Cyprus, obliges the Commission to ensure that the memorandum is consistent with the fundamental rights guaranteed under the Charter.[184] However, in assessing whether the Commission contributed to a sufficiently serious breach of the appellants' right to property, the Court noted that the guarantee to that right was not absolute and may be subject to restrictions justified by the objectives of general interest pursued by the EU.[185] Consequently, under Article 52(1) of the Charter, restrictions on the right to property may be imposed if they are in line with those objectives and do not constitute a disproportionate and intolerable interference "impairing the very substance of the right guaranteed."[186] In the application of those principles to the appellants' case, the Court noted that under Article 12 of the ESM Treaty, the role of the Commission is aligned with the general objective pursued by the EU, that is, the objective of ensuring the stability of the banking system of the euro area as a whole.[187] The Court, drawing on the *Kotnik* decision,[188] identified the role that financial

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[179] Ibid, Article 17(1) TEU.
[180] Ibid.
[181] Ibid.
[182] *Ledra*, paras. 63-65.
[183] *Ledra*, para. 66.
[184] Ibid.
[185] Ibid, paras. 68-70.
[186] Ibid.
[187] Ibid, para. 71.
[188] *Kotnik and Others*, C-526/14.

services played in the national and EU economy, noting the role that financial institutions fulfil, as a source of funding for businesses, their interconnectedness and, therefore, the potential for contagion in the event of failure was so significant as to justify the measures taken.[189] Moreover, the Court held that the risk of financial losses to which depositors would have been exposed should the banks have failed meant that such measures did not constitute a disproportionate and intolerable interference with the substance of the appellants' right to property.[190]

The finding that the General Court had erred in law regarding effective judicial protection is, at first glance, welcome: the notion of a bank 'bail-in' with the concomitant adverse effects on individual property rights, without an appropriate degree of institutional accountability, is not sustainable. Had the General Court's ruling been upheld then the actions of the Commission in negotiating MoUs would not be subject to judicial scrutiny.[191] However, it is difficult to envisage how many claimants would be able to meet the standard of the test established by the Court.

During the financial crisis, decisions were taken under pressure, to protect the public good of financial stability and, in the process overruled private rights. This raises the question as to whether private rights deserve the same level of protection when, after the enactment of subsequent legal provisions driven by political pressures, they are in conflict with those enactments. On the face of it, some institutions, such as the ECB, appear to respect the decision in *Ledra*[192] stating that in considering the policy decisions taken, when the Court would normally exercise restraint, the "alleged breach of a fundamental right will be considered in depth…"[193] However, the Court in *Ledra* did not apply the proportionality test in detail when compared with other cases alleging infringement of human rights.[194] The

[189] *Ledra*, para. 72.
[190] Ibid, para. 74.
[191] J. Cotter, "Keep Calm and Carry On: EU Legal Developments in 2016," JCMS Vol. 55 Annual Review (2017), pp. 88-101, p. 92.
[192] See, for example, C. Zilioli (Director General of Legal Services of the ECB), "Justiciability of central banks' decisions and the imperative to respect fundamental rights," ECB Legal Conference 2017 Shaping a new legal order for Europe: a tale of crises and opportunities, September 2017 p. 101. Available at: https://www.ecb.europa.eu/pub/pdf/other/ecblegalconferenceproceedings201712.en.pdf (last accessed 24/05/20).
[193] Ibid.
[194] Ibid, Cotter, "Keep Calm and Carry On."

Court was clearly prepared to extend a greater degree of latitude to the Commission out of deference to the political decisions made at an intergovernmental level.

The development of the concept of bank bail-ins was driven by a desire to find an alternative to the publicly funded bail-out process which was viewed as a source of moral hazard that would undermine market discipline. The bail-in process is seen as a component of the adjustment programme associated with the activities of the ESM in conjunction with the Bank Recovery and Resolution Directive requiring the prior participation of creditors in restoring the financial health of the bank in question. Those who carry the burden of a bail-in include not only investors in the form of financial creditors, such as bondholders, but also banking creditors such as retail and wholesale depositors. There is a significant difference between those creditors who are institutional or individual investors in the institution and those who are retail customers using the service in order to manage their finances. Indeed, the effect on these creditors could be particularly egregious and have a negative economic impact. In the case of a purely domestic bank the use of the bail-in allocates the loss on one set of domestic creditors.[195] It is not apparent if, and why, this group could be considered to be better able to absorb these losses.[196] It also implies an obligation on the depositor to monitor the bank in question so as to mitigate any loss *ex ante*.

The *Ledra* judgment does offer some hope in that it recognises the potential liability of the Commission when acting (or failing to act) in the implementation of financial assistance programmes. It has provided some clarity regarding EU practices in a non-EU legal environment. However, despite the declaration that EU institutions are bound by the Charter when acting in a non-EU context, the principles in *Pringle* still apply. Whereas EU institutions are obliged to comply with the Charter, Member States are not when implementing the conditions attached to financial assistance. The faith placed by the CJEU in the economic assessment of the Commission and ECB continues to raise concerns. The appropriate legal framework remains underdeveloped and lacks clarity regarding the obligations incumbent on the ECB, Commission and ESM.[197] This is of particular importance

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[195] C. Goodhart, E. Avgouleas, "A Critical Evaluation of Bail-ins as Bank Recapitalisation Mechanisms," Centre for Economic Policy Research Discussion Paper 10065 (2014), p. 24.
[196] Ibid.
[197] A. Karatzia, M. Markakis, "What role for the Commission and ECB in the European Stability Mechanism?" Cambridge International Law Journal Vol. 6(2) (2017), pp. 232-252, p. 251.

as measures designed to maintain stability have the potential to disproportionately affect the economic interests of different parties within the Member State that is subject to the readjustment programme. It is clear that the threshold for successfully arguing that the interference with property rights, leading to those losses, seems very high.

Conclusion

Courts are tempted in times of emergency to transform hard laws into softer standards thereby weakening the constraint on policymakers.[198] It is of note that the CJEU has not struck down any of the crisis measures undertaken either on an intergovernmental or institutional basis. The Court has remained deferential to the decisions of the Eurogroup and the ECB. Such an attitude of deference might be explained by the enormity of the Eurozone crisis. The single currency and consequently the EU faced an existential threat. Nonetheless, the decisions taken by political actors, in terms of the allocation of losses, were discretionary and alternative approaches could have been taken whilst remaining in compliance with Union law.[199] The rule of (EU) law should act as a bulwark against the executive abuse of power occurring at both the national and European level. Indeed, this has been the case in normal, less tumultuous times. During the Eurozone crisis, however, the Court's cumulative approach treated the law as the "continuation of politics by other means."[200]

In acquiescing to those decisions, the Court, in an attempt to deal with one danger, has created another: the inconsistent application of EU law that threatens the integrity of the legal reasoning of the EU.[201] The issues at hand were viewed from the perspective of market efficiency and the ongoing belief in its ability to temper government excesses. However,

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[198] M. Gulati, G. Vanberg, "Paper Tigers (Or How Much Will Courts Protect Rights in a Financial Crisis?)," in *Institutions and the Crisis* (eds F. Allen, E. Carlettie & M. Gulati) (EUI, Florence, 2018), p. 111.
[199] See Chapter 4.
[200] G. Beck, "ECJ legal rulings designed to help the Eurozone are threatening the accountability of European governance," LSE European Politics and Policy Blog, 10 December 2014. Available at: https://blogs.lse.ac.uk/europpblog/2014/12/10/ecj-legal-rulings-designed-to-help-the-eurozone-are-threatening-the-accountability-of-european-governance/ (last accessed 26/05/20).
[201] J. Tomkin, "Contradiction, Circumvention and Conceptual Gymnastics: The Impact of the Adoption of the ESM Treaty on the State of European Democracy," German Law Journal Vol. 14(1) (2013), pp. 169-189 p. 188.

viewing these matters through the 'moral hazard lens' does not lead to sound policies.[202] Moreover, it creates an institutional imbalance whilst simultaneously weakening accountability: the Commission was viewed as the 'agent of creditors' and as the enforcer of austerity in debtor countries, whilst simultaneously considered too lenient in creditor countries.[203] The attitude of deference has extended the mandate of both the Commission and ECB whilst setting a particularly high threshold for those who wish to challenge those institutions' decisions.

[202] M. Buti, "Economic policy in the rough: a European journey," CEPR Policy Insight No. 98 (2020), p. 4. Available at: https://cepr.org/sites/default/files/policy_insights/PolicyInsight98.pdf (last accessed 26/05/20).
[203] Ibid, p. 6.

Conclusions

On her visit to the London School of Economics, Queen Elizabeth famously enquired why nobody saw the financial crisis coming.[1] However, a number of economists had warned of the impending economic turmoil.[2] In a manner that was predictable, governments and right-wing media outlets portrayed such concerns as doom-mongering and the talking down of the economy. However, the neoliberal economic hegemony had succeeded in creating a deregulated international financial environment in which participants, by means of financially innovative products, allowed for the spread of toxic assets the world over, predicated on the legally contestable and flawed conception of money. It is argued that the most recent crisis is merely the latest occurrence in a repeating cycle. The notion that money emerges from the market free of governmental interference, a key tenet of the neoliberal paradigm, is not supported by any historical or empirical evidence. Nonetheless, institutional arrangements and policies were constructed on the basis of that fiction. The inevitable collapse of that system should not have been a shock. Whereas there have been minor reforms, there have been no major systemic reforms that challenge that flawed monetary concept.

Traditionally, the control of monetary policy was viewed as an extension of state sovereignty. The exercise of sovereignty within the monetary realm mediated economic relations both horizontally and vertically within the constitutional architecture of the nation state: it provides the mechanism that allows for the settlement of legal obligations not only among the citizenry but also between the citizen and the state. However, monetary sovereignty has tended to be viewed through the lens of positive legal norms.[3] The historical development of the normative components, concerning the production and use of money

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[1] Daily Telegraph, 5 November 2008. Available at: https://www.telegraph.co.uk/news/uknews/theroyalfamily/3386353/The-Queen-asks-why-no-one-saw-the-credit-crunch-coming.html (last accessed 7/07/20).

[2] For example, Ann Pettifor, director of Policy Research in Macroeconomics, Steve Keen, head of the School of Economics, History and Politics, Kingston University and Raghuram Rajan, governor of the Reserve Bank of India.

[3] The right to issue currency; the right to determine the value of the unit of account and the right to regulate the production and use of currency. See: F. Gianviti, "Current Legal Aspects of Monetary Sovereignty." General Counsel IMF1, May 24, 2004.

have not been given the attention it deserves. The attempt to depoliticise the management of the money supply is representative of the institutional instinct to maintain control and, as the locus of that control has shifted, we have witnessed an emergent tendency to abuse the production of currency. The cycle of control and abuse regarding monetary matters has been repeated throughout history. Indeed, I argue that the financial crisis and eurozone sovereign debt crisis represent the continuation of that historical pattern.

The origins of this cycle are rooted in the evolution of sovereignty in its absolutist form. It established a single and ultimate source of political authority within the nation and was accompanied by a normative component under which the sovereign was subject to divine and natural laws and acted, therefore, as guarantor for the observance of natural equity.[4] By extension, the authority over money with the exercise of the royal prerogative, imposed an obligation on the sovereign to ensure public faith in the currency in order to ensure contractual and economic stability.[5] The practical manifestation of the doctrine was the centralisation of the production of currency in a manner that forms the foundation of the modern monetary system that exists today. However, the abuse of the currency, driven by the ruler's political priorities, essentially amounted to a transfer of wealth from the economic and political bottom to the top, reducing the purchasing power of the citizenry in an inflationary manner that not dissimilar to what can be observed today.

Indeed, the constitutional recognition, by the courts, of the sovereign right to engage in the alteration of currency was the legal endorsement of the nominalistic principle which confirmed the executive prerogative over money. It had the effect of weakening the face value of money from the asset that backed it. There is clearly a legal logic underpinning the development of the doctrine of nominalism: the value of money is determined by law and its acceptance by the society using it. This would, of course, imply a societal or political capacity for oversight. However, the development of the institutional oversight in monetary affairs would be configured in such a manner that the potential for abuse would continue to ensure the economic interests of those at the apex of the economic pyramid. The ongoing operation of the nominalistic principle would allow for the creation of different categories

[4] J.H. Franklin, *Jean Bodin On Sovereignty, Four Chapters from the Six Books of the commonwealth* (Cambridge, CUP, 1992), p. 35.

[5] J. Bodin *The Six Bookes of the Commonweale* Translated by Richard Knolles (London, 1606), Book 1 Ch. 10 p. 175.

of money that would ultimately be insulated from effective public scrutiny. That being said, the link between the face value of currency and the asset that backed it was not entirely broken. The influence of liberal thinkers, in particular John Locke, created the fiction that money arises from the state of nature operating within a market that was antecedent to governmental interference.[6] Therefore, under the influence of liberal philosophy, the operation of the Gold Standard, designed to stabilise the degree of outflow of precious metals would entrench the control over money in the markets. However, the automaticity of its operation in terms of maintaining an equilibrium regarding balance of payments would require the imposition of an internal devaluation affecting those most economically vulnerable in deficit states (in a manner not dissimilar to the effects seen after the rise of the Eurozone crisis). Whereas the Gold Standard is no longer in operation, the underlying theory used as its justification would form the ideological basis for monetarist and neoliberal ideology and, in particular, provide the theoretical basis for the introduction of the single currency in the EU.

With the ultimate abandonment of the Gold Standard, western economies adopted fiat currencies. Without the backing of a tangible asset that had previously limited a government's ability to inflate the currency beyond the amount of gold it held, the role of central banks became more important. The focus was on price stability (in terms of domestic inflation and exchange rates) using monetary policy as the primary instrument. However, due to the nature of economic modelling and the flawed nature of financial intermediation theory[7] – a key strand of monetarist/neoliberal economic thinking – monetary authorities did not recognise the significance of money creation in the commercial banking sector.

This complacency was due to the development of commercial banking practices, specifically fractional reserve banking, facilitated by certain legal interventions, that allowed for the inflation of the money supply through the credit creation process. At the time of the financial crisis the credit creation process accounted for 94% of the bank-based money

[6] This view would be reiterated by the Austrian economists in the nineteenth century. See: C. Menger, "On the Origins of Money," Economic Journal (1892), pp. 239-55.
[7] See: "Money Creation in the Modern Economy," Bank of England Quarterly Bulletin Q1 (2014).

supply.[8] This has had the effect of inflating certain classes of assets and creates, within the population, the illusion of economic wellbeing. The reality is that the level of private debt is accumulated to unsustainable levels and secured against assets which are overvalued. The fuelling of asset inflation combined with the development of novel financial instruments, designed to avoid the limitations set by the regulatory structure is an abuse by the commercial banking sector of the populace. Moreover, governments are not inclined to legislate against such practices. Again, the justification for this state of affairs is founded in classical liberal theory: in monetary terms the protection of property rights is a private matter antecedent to the role of government. However, by allowing the growth of the money supply by commercial banks, governments impose an inflation tax on their populations as the purchasing power of individuals is gradually eroded by inflation. These features of the modern monetary system are exacerbated in the event of an economic shock. In a deflationary environment, borrowers struggle to service their debts at an individual level. At a societal level, policy decisions are designed to protect creditors and any losses are eventually shouldered by the public. This amounts to an unjustified upward distribution of wealth that rewards imprudent lending driven by the desire to increase shareholder value regardless of the societal cost.

The reason for this state of affairs is that the modern globalised financial system is rooted in the conception of money that emerged from Britain in the seventeenth century. Many of the most important features are rooted in the liberal ideology that developed at that time and were rediscovered and applied within the neoliberal/monetarist movement that gained traction in the 1970s. However, in order for money to operate in a form that would benefit the investor class, public finances had to be configured in a manner that would shore up the economic relationship between government and the markets. Again, many of the features of that relationship were developed in Britain in the seventeenth and subsequent centuries. That model, containing the modern vocabulary of value, has been recreated across the globe today,[9] become more entrenched and impervious to refutation as its proponents and the elites it supports levy a disproportionate level of influence on the political process.

[8] C. Desan, "Money as a Legal Institution" in D. Fox and W. Ernst (eds.), *Money in the Western Legal Tradition* (2016), p. 34.

[9] C. Desan, *Making Money. Coin, Currency and the Coming of Capitalism*, (Oxford University Press, Oxford, 2014), p. 6.

The law played a pivotal role in the reconfiguration of public finances. It facilitated the rebalancing of power among Britain's elites and paved the way for the development of financial markets that enhanced both the political and economic interests of those higher in the social order. Liberal philosophy, during a period of legal activism, created a set of political norms that would prioritise the property rights of the investor/creditor class. Those rights, based on the state's accumulation of debt, would be financed by a commitment of future revenues received from those lower in the social and economic order. Moreover, the law was configured in such a way that supported the contrived and flawed conception of the naturalisation of markets, placing the interests of economic and financial elites beyond the reach of the state and protected them from democratic challenge. The entrenchment of those interests is rooted in a subsequent legal inertia as the artificial separation of the legal, political and economic spheres limits the potential for meaningful legal intervention as markets are considered a natural and self-regulating phenomenon.

The abandonment of feudalism and the increasing doubts regarding absolutism, created an environment that allowed for the elevation of the protection of individual property rights. It ushered in an era that paved the way for the introduction of capitalism. Based on a dubious approach to natural law,[10] liberals envisaged a paradigm that created markets in capital, land and labour. The purpose of government is to preserve that property with taxation only being imposed with the consent of those who own that property.[11] However, the acquisition of such rights was by no means universal in nature. It was limited to an economic elite comprising of the merchant and financial classes.

In a series of legal interventions, the development of state capacity provided creditor protection as well as the ability of the state to finance itself in the form of the undertaking of long-term debt secured on the basis of future revenues. There was an increased emphasis on liberal individualism as government became increasingly entwined with the emergent financial markets. Control over the 'power of the purse' enabled the legislature to determine executive spending and amend or approve new taxes as well as take on new sovereign debt. However, parliament consisted of men of property, suffrage was limited and the system that emerged tended to benefit that class.

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[10] John Locke, *Second Treatise on Civil Government*, Chapter 5. Accessed online: http://www.earlymoderntexts.com/assets/pdfs/locke1689a.pdf (last accessed 7/07/20).
[11] Ibid, para. 140.

Thus, in constitutional terms, gaining of control over public finances by parliament led to an increased emphasis on separation of powers, limited government and the rule of law and, consequently, the property rights of government creditors would not only be recognised but also enforced. This was an essential component of the new system: markets and the purchasers of government bonds needed to be confident that the government would honour its commitments.[12] Indeed, when the Crown did attempt to renege on its commitments to bondholders,[13] the courts, in an act of judicial activism, prioritised the rights of investors and protected their property rights from expropriation by the state.[14]

The significance of these developments cannot be underestimated. The repositioning of constitutional powers, within the context of the finances of the state, limited the government's ability to appropriate property through the subjugation of individual rights whilst allowing parliament to assert its right to control the distribution of revenue. The endogenous role of political institutions was necessary as, with the emergence of free markets, there had to be some restrictions on the ability of the state to manipulate economic or financial rules in order to allow private rights (of investors/creditors) to prevail.[15] However, the notion of the autonomy the market used to justify the prioritisation of public creditors' rights can be criticised in legal terms: those rights do not equate to a set of rights that are generally accessible to any individual, and nor does it represent a body of rights. Moreover, with the redesign of the revenue system the rights of taxpayers were subjugated in favour of creditors. Thus, such rights are not self-defined but rather the result of legal intervention.[16] This contradicts the oft repeated mantra that the conception of property rights in relation to capital markets operates outside of politics and is therefore immune from regulation and intervention.

Key to the development of this model was the further institutional development, building on the preceding innovations, of central banking. The establishment of the Bank of England paved the way for the introduction of new forms of currency and the use of paper money as

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[12] *The Case of the Bankers* in T.B. Howell, *A Complete Collection of State Trials and Proceedings for High Treason and other Crimes and Misdemeanours, Vol. XIV 1700 – 1708* (London, T.C. Hansard, 1812), p. 1.
[13] Ibid, *The Case of the Bankers*.
[14] This also represented a further constitutional shift towards the separation of the judiciary and executive.
[15] D. North and B. Weingast, "Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth-Century England." The Journal of Economic History V.XLIX (1989).
[16] Desan, Making Money, p. 292.

a medium of exchange. The result was the creation of a hierarchy of money that supported an implied dual relationship between the ability of the state to raise taxes on the one hand and the creation of money on the other. The operation of the Bank was mutually beneficial to its subscribers and government: it allowed the periodic calling in of capital from subscribers, who had the use of that money in the meantime, whilst the Bank could issue notes greater than the amount of capital it held. Moreover, when the circulating medium was accepted for the settlement of tax obligations to the state, a demand for that currency is created. Thus, the relationship between government borrowing and future revenue is more firmly established. Furthermore, in a further innovation, the Bank became established as the lender of last resort as the ultimate source of liquidity for the financial system and government with an inexhaustible source of domestic legal tender.[17]

However, despite the apparent success of such arrangements, concerns about the levels of public debt began to be voiced. This represents the origin of the contemporary debate concerning public spending levels. The fears articulated first by David Hume[18] and later Adam Smith[19] would go on to form the intellectual and ideological basis for monetarist and neoliberal objections to what is considered excessive public debts and spending. Despite the fact that Britain became a leading actor in international markets due to such financing arrangements, the fear of public debt remained in place, informing policy decisions, well into the twentieth century. The fear of the crowding out of private finance due to public spending still exists and is indeed viewed as an essential component of the economic constitution underpinning the single currency.

The values that inform policy decisions in many western economies today are symptomatic of monetarist or neoliberal hegemony which took its roots in those reforms that took place in Britain during the 17th and 18th centuries. Indeed, they have been elevated to a global level. Despite the adoption of alternative policies during the post-war period, the turmoil of the 1970s presented an opportunity for the reassertion of those values arguably in a more extreme form. The repackaging of those principles, in rejecting Keynesian economics,

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[17] See H. Thornton, *An Enquiry Into the Nature and Effects of the Paper Credit of Great Britain*, 1802 (Rinehart and Co., New York, 1939).
[18] D.Hume, "Essays, Moral, Political, and Literary," Of Public Credit, II.IX. http://www.econlib.org/library/LFBooks/Hume/hmMPL.html?chapter_num=37
[19] A. Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, S.M. Soares (ed.) (Metalibri Digital Library, 2007)

presented an opportunity, initially in the UK and US, to develop policies that prioritised the role of a (deregulated) financial sector in the economy wherein the interests of the investor/creditor class were prioritised. This was accompanied by the “liberalisation” of the labour market, weening the public off their dependence on social protection and “rolling back the frontiers of the state”[20] in order to unleash the potential of the markets. To be sure, as the European integration project progressed, those values would be inculcated into the legal architecture surrounding Economic and Monetary Union (EMU).

In Europe, economic cooperation was informed by the memories of the interwar years; the collapse of international trade following the Great Depression, the turn to economic nationalism and the political instability that followed. As a main driver of EMU, Germany was particularly focussed on monetary and financial stability[21] and, as a result, the economic project has been particularly focussed on controlling inflation.

The Organisation for European Economic Coordination oversaw the effort to increase trade liberalisation and promote export-led growth. This was set against the broader background of the Bretton Woods System and the establishment of the IMF that sought to promote international trade, high levels of employment and exchange rate stability to avoid competitive devaluations. Indeed, as the Treaty of Rome was agreed, the recognition of the need to coordinate economic and monetary policies continued.[22] However, sovereignty in these areas was retained by Member States despite the commitment to cooperation. This is an important aspect of the fledging community for two reasons. Firstly, it recognised the democratic link between policy makers, at the national level, and the citizenry who are affected by those policy decisions. Secondly, it also recognised the economic diversity of the original founding states and, thus, it allowed national governments to formulate policies that would provide a degree of social protection that would insulate the population from those negative externalities associated with international trade.

However, the relative stability of the post-war period began to wane as the 1970s approached. The collapse of the Bretton Woods System and the oil crises created a period

[20] Margaret Thatcher, Conservative Party Conference Speech, 10 October 1986. Available at: https://www.margaretthatcher.org/document/106498 (last accessed 7/07/20).
[21] See: H. Ungerer. *A Concise History of European Monetary Integration: From EPU to EMU* (Quorum Books, Westport, CT,1997).
[22] Article 108, Treaty of Rome.

of instability particularly in relation to inflation and exchange rates. Pierre Werner had recognised that the increasing penetration of economies had weakened national autonomy for economic policy formation and had argued for the need for economic and monetary union to counter prevailing international economic conditions.[23] Moreover, there was also the recognition for the need to centralise monetary policy in order to achieve a greater degree of stability. Nonetheless, during the thirty-year post-war period western economies had achieved significant economic growth and low unemployment due to the application of Keynesian principles. The post-war monetary and financial regulations had created a degree of stability until the collapse of that system. Against this background, the 1970s saw the rise of monetarism, now generally referred to as neoliberalism, that emphasised the belief in the causal link between the money supply, price stability and national income. The corollary of this paradigmatic shift was, of course, the rejection of Keynesian principles and, specifically, the refusal to use fiscal measures to counter economic shocks.[24] In addition, the decline in volatility and inflation, known as the Great Moderation, instilled a sense of confidence in policy makers. This was, after all, the "end of history:"[25] western liberal free-market capitalism was the only economic system that worked. This led to a level of complacency and overconfidence in the architects of the Euro. The single currency would be characterised by a set of asymmetries of which they were aware but did not address. True to the monetarist tradition, faith was placed in the ability of the central bank to pursue its primary mandate of maintaining price stability. Financial stability and economic convergence would naturally follow.

The policy approach enshrined in the Maastricht Treaty was a result of German dominance: from the instability of the 1970s to the ERM, the D-Mark had retained international credibility which led to the hegemony of German monetary policy in Europe. Other EC central banks copied, if reluctantly, the Bundesbank principles with the increasingly important financial markets acting to reduce inflationary pressures. It might be argued that EMU was necessary as, in an increasingly globalised trading environment, Europe needed to

[23] P. Werner, "Report to the Council and the Commission on the realization by stages of economic and - monetary union in the Community." Luxembourg, 8th October 1970, pp. 7-10.
[24] The ECB and the financial crisis Rigid theory vs a pragmatic approach European Parliament Briefing, July 2015, p.1. Available at: http://www.europarl.europa.eu/RegData/etudes/BRIE/2015/565876/EPRS_BRI%282015%29565876_EN.pdf (last accessed 7/07/20).
[25] F. Fukuyama, "The End of History" The National Interest No. 16 (1989), pp. 3-18.

maintain international competitiveness.[26] Moreover, with a prolonged period of economic growth in Europe since the 1980s, continued faith in limited government and deregulation, in terms of the removal of barriers to trade within Europe, was maintained.

Indeed, the single currency was sold on the basis that it would increase competitiveness due to the reduction in transactional costs, currency fluctuation risks and promote greater price transparency. Whereas these factors are undoubtedly true, it was within the underlying theoretical basis, on which the project was founded, that certain flaws were apparent. Optimum Currency Area theory[27] informed the formation of the currency. However, the institutional arrangements around the Euro do not comply with OCA theory. Most significantly, as would be shown during the crisis, OCA theory requires the central bank to act as lender as last resort whereas the ECB confined its operations to maintain price stability (both internally and externally) acting more as a currency board. OCA theory also recognises the potential for fiscal transfers within a federal structure for country-specific economic shocks, a feature that was not incorporated into the structure of the single currency.[28] Furthermore, the theory, developed in the 1960s, did not account for the contemporary operation of deregulated finance and highly mobile capital. It is possible that the architects of the single currency, as proponents of monetarist policies, were not overly concerned with this issue as they believed that a centralised monetary policy would address these risks. This myopic view ignores the link between political sovereignty, fiscal authority and money creation which was weakened by the single currency. Indeed, the depoliticization of monetary policy in this form was very appealing to the Euro's architects as it complied with those ideological precepts. Such complacency would ultimately exacerbate the eurozone crisis.

The construction of the EU economic constitution, needed to support and maintain the stability of the Euro, required, under the Lisbon Treaty, a high degree of economic convergence leading to the elevation of that policy area the European level in order to

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[26] R. 0. Keohane, S. Hoffmann, "Institutional Change in Europe in the 1980s" in Keohane and Hofmann (eds.), *The New European Community* (Boulder, CO: Westview Press, 1991), pp. 22-23

[27] R. Mundell, "A Theory of Optimum Currency Areas." The American Economic Review, 51(4), (1963), pp. 657–665.

[28] Recently proposals for a limited 'central stabilisation capacity' have been made that would help cushion country-specific economic shocks. See: ECB Research Bulletin No. 48 July, 2018. Available at: https://www.ecb.europa.eu/pub/economic-research/resbull/2018/html/ecb.rb180711.en.html (last accessed 7/07/20).

promote price stability as a result of a sustainable balance of payments and sound public finances. Therein lies another asymmetry: a commitment to coordinate economic policies in accordance with the Treaties, whilst domestically attempting to allocate resources according to the needs and expectations of the electorate whilst at the same time avoiding fiscal profligacy. There was an optimistic sense that eurozone members would be able to align their economies prior to further, if any, political integration despite their heterogenous nature in political and social terms.

However, with the disciplinarian nature of Article 126 TFEU and related secondary legislation, the commitment to pro-cyclical fiscal policies in the event of an economic shock would have profound redistributive effects that could cause governments, in the light of public opposition, to attribute blame to the EU. There was, therefore, an institutional gap in the absence of greater political integration. The centralisation of monetary policy-making was not accompanied by a decision-making mechanism that could take account of competing political priorities and social values.[29] Moreover, Member States agreed to comply with the limits on public debts and deficits based on the technocratic assessment of their budgetary policies. As a result, this distorted the picture of national finances as new forms of public procurement, such as Private Finance Initiatives, gave the illusion of compliance as such policies made public balance sheets look healthy. In reality, according to the nature of those contracts, governments were paying more over the long term for public goods and services purchased from the private sector, facilitated by the increased mobility of capital, despite the fact that they would have been in a position to borrow more cheaply than the private sector on the international money markets.[30] The disjuncture in monetary and fiscal competences created a constitutional lacuna that was tolerated due to the unjustified faith in the pursuit of 'sound' public finances. This was despite the failure of France and Germany to abide by those rules when their economies were experiencing difficulties in the early noughties and should have been cause for concern: it challenged the normative assumptions that were used to justify the ideological commitment to pro-cyclical fiscal policies. Indeed, the complacency and unjustified faith in monetarist principles

[29] F. Snyder, "EMU Revisited. Are we Making a Constitution? What Constitution are we Making?" EUI Working Paper LAW No. 98/6, p. 55.

[30] See, for example: R. Ball, M. Heafey, D. King, "The Private Finance Initiative in the UK," Public Management Review Vol. 9(2) (2007), pp. 239-310. Analysis suggests that PFI contracts represent poor value for money for the taxpayer.

masked a series of profound economic imbalances that would be exposed in the eurozone crisis.

The strength of the neoliberal hegemony cannot be underestimated. Even social democratic governments had adopted its values, particularly with regard to macro-economic policies (that would ultimately cause the demise of centre-left politics in Europe). In the period leading up to the crisis governments displayed a combination of complacency and hubris as their politicians deferred to the wisdom of the markets and the economic theories that underpinned it. The growth in the international financial sector and the opaque nature of its operation disguised profound problems through the creation of the illusion of economic wellbeing. Nonetheless, when the crisis hit, political elites would double down on the principles that had caused it: in order to preserve the system and the interests of economic and financial elites, the 'mismanagement' of public finances by bloated states would be deemed the cause.

However, government debt in Europe, as a proportion of GDP, had been falling in the years leading up to the crisis.[31] Nonetheless, during the same period, there was significant growth in household, bank and corporation debt.[32] The ECB's monetary policy during this period did not take account of the role of the financial sector and its effect on the real economy. The result was the creation of imbalances in capital flows. The ECB continued to believe in the efficiency of self-equilibrating financial markets[33] while political actors deferred to this view.

The ECB's response to the crisis, initially at least, was to deploy conventional monetary policies with lowering of interest rates and the provision of liquidity in accordance with the narrow interpretation of its functions regarding price stability and the ongoing belief in the efficiency of self-regulating markets. However, as the crisis deepened with the emerging threat of sovereign default, the asymmetric nature of the architecture of EMU was brought into stark relief. The financial markets had begun to discriminate among government issuers. The markets knew that eurozone members lacked the means to resolve banking

[31] See: S. Storm, C.W.M. Naastepad, "Myths, Mix-ups and Mishandlings: What Caused the Eurozone Crisis?" Paper written for the panel on "The Eurozone Crisis: Fiscal Profligacy or Capital Flows as Final Causes," Institute for New Economic Thinking, Annual Conference, April 11, 2015, P. 6.
[32] Ibid.
[33] "The European Crisis and the role of the financial system," Speech by Vítor Constâncio, Vice-President of the ECB, at the Bank of Greece conference on "The crisis in the euro area" Athens, 23 May 2013. Available at: https://www.ecb.europa.eu/press/key/date/2013/html/sp130523_1.en.html (last accessed 7/07/20).

problems and the ECB had previously stated that, effectively, it would not back those assets as a lender of last resort. As a result, capital flows across borders stopped and investors repatriated funds to reduce their exposure. The use of public funds to support national financial institutions caused concerns regarding the fiscal implications of government intervention leading to higher bond premiums. The financial markets and institutions retain a great degree of power over governments implicitly or explicitly threatening economic catastrophe if policies in response to an economic shock adversely affect their interests.[34] The resulting socialisation of losses provided the justification for the imposition of policies of fiscal contraction based on a narrow interpretation Treaty provisions that are, in turn, founded on pre-conceived political and socio-economic norms.

The EU's response to the crisis was concerned primarily with reassuring financial markets to prevent the risk of further contagion. The resulting emphasis was focussed on financial stability: coordinated economic policy to ensure stability and eliminate productivity that caused the imbalances between savings and investment and, therefore, reduce the risk of default leading to lower risk premia.[35] Governments and European institutions were bound by the opinions and concerns of financial market actors.[36] In short, the responses to the crises were based on the continued deference by the political to the economic in the form of a market fundamentalism, protecting the interests of markets and facilitated by an elective and therefore contestable interpretation of the economic constitution.

Many core banks, particularly in France and Germany, were exposed to significant losses in peripheral countries and the responses to the crisis were designed to ensure that government creditors, the banks, would have their balance sheets protected.[37] This came, of course, at a tremendous social cost as the mechanisms that were established in response to the crisis demanded fiscal consolidation affecting those lower in the economic order as the price to bail out the assets of those at the top.

The establishment of the ESM and its predecessors is symbolic of the deference shown by political elites to the economic, that is, the continued depoliticisation of monetary and

[34] D. M. Woodruff, "Governing by Panic: The Politics of the Eurozone Crisis," Vol. 44(1) Politics and Society (2016), pp. 81-61, p. 83.
[35] S. Micossi, "On the Tasks of the European Stability Mechanism," CEPS Policy Brief, No. 235, March 2011.
[36] Ibid, Woodruff.
[37] J. Rocholl, A. Stahmer, "Where did the Greek bailout money go?" ESMT White Paper No. WP–16–02 (2016).

economic policy founded on the belief in the ‘logic’ of the market. The stability mechanism provided the means to insulate the interests of creditors, specifically their asset values, justifying its operation on the basis of prevention of financial contagion whilst maintaining market discipline. The strict conditionality associated with the financial assistance programmes and, at German insistence, the prominent role of the IMF, a champion of austerity, would severely inhibit the sovereignty of the ESM Member concerned. Thus, whilst adversely affecting the social and economic interests of the citizenry, it also weakens the democratic link between the government and the people.

Moreover, the ESM weakens the link between the function of the market and its pricing of debt. The fact that it exists implies that default risk would not be priced properly. It undermines the logic of the market if institutional intervention reduces the fear of creditors losing their money. As a result, the Mechanism allows for the transfer of those losses to the public. This of course was accompanied by the ongoing fiscal consolidation, ensuring returns to creditors but with the imposition of internal devaluation dictated by the Memorandum of Understanding.

The legal response to the crisis in this form is driven by the perceived necessity to convey a sense of credibility to the markets in order to maintain their confidence. The manner in which the economic constitution is worded and interpreted is based on certain assumptions that are derived from the economic orthodoxy.[38] Fiscal discipline would be ensured by the pressure exerted by the market, together with multilateral surveillance, peer pressure and potential sanctions. However, reliance on those assumptions was misplaced.[39] Rather than question the institutional design or an alternative manner of interpretation of the Treaties, the institutional response was to subordinate societal interests to the operation of market discipline. Thus, political deference to the economic model and its ideological basis has allowed the secession of law to political power and, in so doing, undermined the normative

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[38] “Challenges for the Euro Area, and the World Economy.” Speech by Lorenzo Bini Smaghi, Member of the Executive Board of the ECB, 63rd Plenary Session, Session I: The Crisis of the Eurosystem, 28 May 2010, available at: file:///G:/TSCG%20and%20Integration/ECB%20%20Challenges%20for%20the%20Euro%20Area,%20and%20the%20World%20Economy.htm. (last accessed 7/07/20).
[39] Ibid.

values that should seek to achieve human dignity, social justice, transparency and democratic participation.[40]

Moreover, the shift towards economic governance, introduced to ensure a greater commitment to budgetary discipline, limiting the policy choices of Member States' governments. The drafting of those provisions is sufficiently imprecise to render them essentially non-justiciable, undermining the rule of law and creating a regime of pseudo-technocratic governance thus undermining the role of democratic input at the national level. The strengthened SGP has increased the complexity of the legal landscape and despite the technocratic nature of budgetary assessment, there is no consensus on the relationship between fiscal consolidation and economic growth, therefore raising questions as to the nature of assessment on that basis, especially given the ability for the EU institutional influence at the national level.

Furthermore, the nature of adjustment places the burden on those lower in the economic order at the national level, particularly labour. With a trade imbalance, a deficit state can only improve its competitiveness by reducing production costs, resulting in the reduction of household spending power. The combination of this with reduced government spending, means that both the private and public sector are saving at the same time stymieing growth. It is not suggested that the pursuit of control over public debt should be abandoned. However, the manner in which the new provisions have been framed severely limits the potential for a counter-cyclical response to an economic shock which is firmly rooted in the ordo/neoliberal paradigm.

Similarly, the agreement of the Fiscal Compact raises concerns. Aside from the definitional problems associated with the notion of a structural deficit and the lack of a means of objective assessment, there are broader concerns regarding the balanced budget rule. The justification for such a provision is that it avoids the short-termism associated with political actors and, as such, the neoliberal/monetarist view is that it prevents the enactment of policies that act against future generations which, from that perspective, is deemed

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[40] "The Economy for the Common Good: a sustainable economic model geared towards social cohesion" The Economic and Social Affairs Committee, ECO/378, September 2015, para. 1.1

undemocratic.[41] The combination of limiting the role of the state in terms of public finance and the purported fear of intergenerational injustice is difficult to justify. It is equally possible to justify current expenditure in the incurring of debt in the present to invest in public goods and services for the benefit of present and future generations. The decision to run a fiscal deficit is inherently political and should not be reduced to a technocratic exercise; it should be the result of political discourse, as should the decision to run a surplus, as either policy choice will have redistributive effects. The inherent contradictions under the old regime of economic coordination and the new one of governance seem have been overlooked: before the eurozone crisis when public debts and deficits were broadly in decline, why were budgetary provisions set aside when they should have been applied? Moreover, the entrenchment of budgetary rules will limit the democratic space for future governments as fiscal conservatism becomes the dominant goal and deference to it inhibits government's ability to respond to the demands of the public.

The adoption of conventional and unconventional measures in terms of monetary policy, together with the move towards economic governance, was designed to reassure the markets. This was a reflection of contemporary (neo)liberal thought: firstly, to exert disciplinary pressure on political actors and, secondly, to encourage economic growth by prioritising the rights of investors and allaying fears of the expropriation of their property. In so doing, theoretically at least, markets should be reassured in times of crisis. Given the foregoing, the question then arises as to the extent to which institutional responses will abide by those rules in order to maintain those interests. The institutional response in the EU was characterised by a broad interpretative approach to existing rules. This extended to the judiciary when responding to the legal challenges questioning the validity of the measures put into place and their compliance with the Treaties. However, a consequence has been the weakening of democracy and the rule of law at the European level. The CJEU facilitated this by its deference to the political decisions that had been made in response to the crisis. The Court's approach displayed a significant degree of interpretative latitude in which it prioritised the teleological over the literal in order to achieve the goals of financial stability and the objective of further economic integration and, in so doing, provided legal cover for the political decisions made.

[41] J. Buchanan, *Liberty, Market and State: Political Economy in the 1980s* (New York University Press, New York, 1986), p. 217 et seq.

The Court's approach in *Pringle*[42] demonstrated that latitude and deference to political decisions. In determining whether the revision of the TFEU establishing the ESM infringed the EU's exclusive competence in the area of monetary policy, the Court blurred the line between what is considered monetary policy and what is economic policy primarily by focussing of on the objectives of the Stability Mechanism and reading it in reference to the TFEU. The objective of maintaining the "stability of the euro area as a whole" under the Mechanism was deemed to be clearly distinct from price stability and, thus, the granting of financial assistance is an economic measure.[43] Nor does it increase the competences of the Union. The interpretation of the TFEU in this form is problematic to say the least. The use of the simplified revision procedure bypassed the participation of representatives and Member State parliaments that would have allowed for a more detailed and informed debate. The finding that the establishment of the Mechanism did not increase the competences of the Union, allowing for the granting of financial assistance to struggling Member States, where none previously existed, is questionable. The role of the Commission and the ECB (and the IMF), under the ESM, outside the EU legal order, is clearly creating new competences and the use of the simplified revision procedure should have been prevented when creating a new institution in the form of the Stability Mechanism.[44] Furthermore, the Court's approach was aided by the lack of a definition of monetary policy. The interpretative latitude employed by the Court enabled it to rely on the overarching objectives of Article 119(2) TFEU to justify its finding that the competences of the Union were not increased.

The ESM was clearly designed to circumvent Union law by means of an international treaty. Whether one agrees with it or not, Maastricht was agreed, democratically, on the principle of a no bail-out economic and monetary system. The manner in which the ESM was established has the potential to undermine the integrity of the Treaty-based system[45] by allowing Member States to agree an international treaty to pursue objectives that would be prevented under EU law. This is particularly salient in the light of the doctrine of effective

[42] *Pringle v. Government of Ireland* Case C-370/12
[43] Ibid, para. 56.
[44] J. Tomkin, "Contradiction, Circumvention and Conceptual Gymnastics: The Impact of the Adoption of the ESM Treaty on the State of European Democracy," German Law Journal Vol. 14 No. 1 (2013), pp. 169-190, p. 183.
[45] Resolution of the European Parliament of 23 March 2011, Available at: http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+TA+P7-TA-2011-0103+0+DOC+PDF+V0//EN (last accessed 7/07/20).

judicial protection with the Charter of Fundamental Rights falling outside the scope of the ESM.

Moreover, Articles 123-125 TFEU were specifically included in order to enforce market discipline within the economic order[46] and act as a constraint on political and institutional actors. Nonetheless, the Court found that financial assistance was possible when interpreting those provisions in the light of the higher objective of maintaining the stability of the single currency. However, the combination of market discipline and the maintenance of the stability of the currency could have led to its collapse. Thus, the reasoning of the Court perpetuated the belief that the disciplinary effects of the market continued to operate following its interpretation of the no-bailout clause. Thus, financial assistance is permissible where the incentive on the part of the recipient state to maintain sound budgetary policy is not diminished. This represents a fiction created by the Court: assistance is granted when funds are not available on the ordinary markets and, thus, the incentive for fiscal responsibility is diminished, especially when the rates are lower despite the strict conditionality associated with the MoU.[47]

The reasoning of the CJEU in *Pringle* formed the basis for subsequent decisions that would provide the *ex post* justification of those political decisions. In the *Gauweiler*[48] case, the Court, in upholding the right of the ECB to purchase bonds under the OMT programme, accepted the ECB's explanation that it was intended to reduce excessive risk premia and avoid the volatility that would hinder the transmission of monetary policy. This was despite the fact that the difference in the price of bonds between states reflects the scepticism of the market that Member States would exercise sufficient fiscal restraint. Interventions such as the ESM and OMT programmes have the effect of minimising potential losses to bond holders.

The result of these decisions, based on objectives rather than effects, has created the potential for substantial institutional discretion with the extension of the political by judicial means. The Court has adopted an interpretative method that is highly flexible and creative to the extent that it has arguably crossed the line between legal reasoning and political

[46] R. Smits, *European Central Bank Institutional Aspects* (Kluwer Law International, 1997) pp. 77-78.
[47] P. Craig, "Pringle: Legal Reasoning, Text, Purpose and Teleology." Legal Research Paper Series, Paper No. 53, Maastricht Journal of European and Comparative Law (2013).
[48] Gauweiler EU:C:2015:400 C-62/14.

judgment.[49] Of greater concern is the extension of this approach in the case of the adjudication of individual rights adversely affected by the political responses to the crisis.[50]

Courts often soften their stance with regard to the application of legal rules in times of emergency and, therefore, expand the freedom of policymakers to adopt courses of action that might otherwise be deemed unlawful.[51] The CJEU has not struck down any of the crisis measures undertaken on either an intergovernmental or institutional basis. The deference shown by the judicial to the political might well be due to the existential threat presented by the crisis. However, the political decisions taken were the result of deference shown to flawed economic concepts which the judiciary, in turn, deferred to. The result was the disproportionate allocation of losses when alternative strategies could have been followed. Judicial acquiescence, in attempting to deal with one danger, has created another in a form that threatens probity of the Court's legal reasoning that simultaneously weakens institutional accountability across the institutions of the EU.

The causes of the Eurozone crisis have been commonly attributed to the asymmetry inherent in its structure. However, in addition to those weaknesses, It is argued that the underlying monetarist and legal conception of money has also contributed significantly to the crisis. The prevailing monetary orthodoxy, couched within the neoliberal paradigm, created a degree of complacency on the part of the currency's architects; they were either unaware or chose to ignore it during the relatively benign economic conditions in the early years of the euro. The judicial and legislative responses to the sovereign debt crisis demonstrated their continuing faith in the logic of the market exercised through an automatic system of adjustment at the national level. The deflationary impact required by domestic structural adjustment programmes in those countries worst affected is reminiscent of the effects of the Gold Standard in the inter-war period. More importantly, the effects of those adjustments create social and political instability.

That instability is a consequence of the failure to insulate those who are more economically vulnerable to the operation of free markets and symptomatic of the gradual shift away from the embedded liberalism that had previously provided such protection, as part of the post-

[49] G. Beck, *The Legal Reasoning of the Court of Justice of the EU*, (Hart Publishing, Oxford, 2012), p. 446.
[50] *Ledra Advertising and Others v. Commission and ECB*
[51] M. Gulati, G. Vanberg, "Paper Tigers (Or How Much Will Courts Protect Rights in a Financial Crisis?" in *Institutions and the Crisis* (eds F. Allen, E. Carlettie & M. Gulati) (EUI, Florence, 2018), p. 111.

war consensus, and that has been further eroded since the onset of the crisis. Traditionally, those protections operated primarily at the domestic level in order to counterbalance the negative effects of international trade. However, with the emphasis on economic liberalism at the core of the European project it was to a degree inevitable that welfare provisions and social protections would be sacrificed on the altar of international free trade.

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