



## POLICY BRIEFING – OCTOBER 2014

## AUTHOR

**Professor Piet Eeckhout**  
UCL Laws  
p.eeckhout@ucl.ac.uk

## EDITORS

**Dr Uta Staiger**  
Deputy Director  
UCL European Institute  
u.staiger@ucl.ac.uk +44(0)20 7679 8737

**Sarah Chaytor**  
Head of UCL Public Policy,  
Office of the UCL Vice-Provost (Research)  
s.chaytor@ucl.ac.uk

A partnership between the UCL European Institute, UCL Public Policy, the UCL Institute for Human Rights and the UCL Centre for Law and Governance in Europe.

## KEY CONCLUSIONS:

- The **system of EU competences linked to economic and monetary union (EMU) governance is unsatisfactory** and needs to be clarified and improved;
- **EU action outside of the EU Treaties should be contained**, as it risks eroding the legitimacy of the European system of judicial review;
- **The EU needs to reflect carefully on its competences** to ensure financial stability which may not be best served by the current dispersal of competences.
- The **UK has failed to make a meaningful contribution** to the resolution of the financial crisis and will need to **rethink its contribution to regulating EMU** in the future.

## The UK and European economic and monetary union governance

### Summary

This briefing considers the governance of economic and monetary union (EMU). It explores the current state of EU competences linked to EMU, the use of instruments outside the EU framework, the role of EU institutions, and the implications of banking union.

### Introduction

The financial crisis has exposed the defects and weaknesses of EU economic and monetary union (EMU). In terms of new instruments, the EU's response has been prolific. Whether these instruments are the right ones for ensuring a more stable and optimal governance framework for EMU is a different question.

The United Kingdom occupies a special position in EMU governance as it is both 'in' and 'out'. It is not part of the Eurozone, but is the seat of Europe's biggest financial centre. It has a huge interest in ensuring the success of EMU, in order for the City to prosper and for some of its main export markets to remain available and to grow. Its non-participation in EMU means that many policy instruments are not directly relevant to it. However, as new EMU governance extends to financial markets and products, internal-market-based instruments do apply to the UK.

This briefing looks at some of the main legal problems which arise from EMU governance, and which are relevant to the UK: the division of competences between the EU as a whole, the Eurozone, and the UK; the increasing use of instruments which are adopted outside the framework of the EU founding Treaties; and the UK's position as regards banking union and financial supervision.

### Division of competences

The question of who is competent to regulate EMU, and on what legal basis, is complicated. **Monetary policy falls within the EU's exclusive competences** in so far as the Euro is concerned whilst **the EU only has some powers of 'co-ordination' in matters of broader economic policy**. Additionally, the EU shares competences with Member States in terms of its powers to regulate

its internal market (including in financial services and instruments). This is a more significant competence than the general economic policy competence.

Within the broader project of responding to the financial crisis, it has been difficult to define in which sphere of competence a particular issue falls. Yet this definition lies at the core of much of the tension between the EU and Member States (such as the UK) which hope for less centralised policy-making and are concerned to have a say in how the new governance framework is constructed.

## Competences for the European Stability Mechanism

The European Stability Mechanism (ESM) was intended to be a more permanent financial support instrument for Eurozone countries facing difficulties with financing themselves on capital markets. The United Kingdom did not participate in the adoption of the Treaty to establish the ESM, which was concluded outside the framework of the EU Treaties, but for which an amendment to those Treaties had been introduced.

In 2012, the EU Court of Justice (CJEU) defined the scope of EU monetary policy solely by reference to the goal of price stability and decided that **the ESM was a measure of economic policy, for which Member States retain competence**. The Court's judgment in the *Pringle* case<sup>1</sup> found that, to the extent that the ESM is not solely concerned with price stability, **it does not fall within the Union's monetary policy**.

This judgement is problematic because price stability is not determined by monetary policy alone but also, for instance, by fiscal policy, and therefore cannot be the sole criterion for determining the scope of monetary policy. Such a **narrow and unclear definition of monetary policy renders Eurozone governance more difficult**. The judgment has been generally criticised for its poor definition of important concepts (e.g. economic policy and monetary policy) and for only superficially discussing implied powers, i.e. EU powers regarding activities that are corollary to the Union's main fields of competence and flow from the powers expressly conferred on it in the Treaties.

One example of the consequent difficulty in Eurozone governance is the implications of the *Pringle* judgement for the 2012 European Central Bank (ECB) policy on Outright Monetary Transactions (OMT) – announced but never implemented. The German *Bundesverfassungsgericht* (Constitutional Court) has argued that the OMT cannot be monetary policy because it is not solely concerned with price stability, and could therefore not have been legally adopted by the ECB<sup>2</sup>. This potentially jeopardises ECB President Draghi's most significant policy to date.

## Use of instruments outside the EU treaties

As the regulation of EMU does not fall strictly within the EU's exclusive competences, the Member States have resorted to the creation of instruments adopted largely outside the EU Treaty framework, such as the ESM, the Fiscal Compact and the Banking Union, in order to address the financial crisis. However, the regulation of the ESM (and thus other such instruments) is considered to a great extent to be an intergovernmental matter.

<sup>1</sup> Case C-370/12 *Thomas Pringle v Government of Ireland* EU:C:2012:756.

<sup>2</sup> BVerfG, 2 BvR 2728/13 vom 14.1.2014, Absatz-Nr. (1 - 105), available at [http://www.bverfg.de/entscheidungen/rs20140114\\_2bvr272813en.html](http://www.bverfg.de/entscheidungen/rs20140114_2bvr272813en.html); the Court made its further reference to the CJEU in this case: Case C-62/14, pending.

<sup>3</sup> Case C-270/12 *UK v EP and Council* EU:C:2014:18.

Because matters of economic policy remain within the competences of the Member State, the CJEU has limited power to decide on the legality of these instruments.

There are also issues relating to how EU rules should be applied to EU institutions, when these are acting outside of the Treaty framework – for example their involvement within the ESM. Their obligations under the EU Charter of Fundamental Rights, which is addressed to them directly, remain unclear. Increasing the role that EU institutions play outside of the EU framework poses significant risks to the legitimacy and credibility of the EU legal order and its judicial review system and is likely to be unsustainable in the longer run for all Member States, including the United Kingdom.

There is a further question raised by the use of non-EU instruments which is particularly relevant to the United Kingdom. The UK government consented to the setting up of the ESM (even if it did not itself participate) but did not agree to the Fiscal Compact. This is significant because the UK's position is that all Member States are legally required to give their consent to the introduction of non-EU instruments, in particular where use is made of EU institutions such as the Commission and the ECB. However, this position has not as yet been confirmed by the CJEU. **The adoption of instruments and decisions outside the normal EU framework returns to systems of purely intergovernmental cooperation**, which lack the kind of constitutional guarantees which have matured in the EU, such as involvement of the European Parliament, rule of law, limited competences, review by the courts.

## Banking union and financial supervision

The creation of a European Banking Union is of direct concern to the UK. Creating a Banking Union is central to deepening integration in the Eurozone and the UK is broadly supportive of this, in principle. However, the UK is less supportive of the supranational EU financial regulation involved in a potential Banking Union, which will apply to all Member States and which could affect the UK financial services market more substantially.

The UK is concerned that the ECB, rather than the European Banking Authority, will become the main supervisory actor and indeed the ultimate regulator in the Banking Union, in the aftermath of the financial crisis. It is particularly **concerned that the regulation of the stability of the Euro will feed into banking regulation**, thus adversely affecting the UK's interests as a non-Eurozone Member State of the EU.

## Impact on financial services in the UK

**Short-selling** is a specific example of an area of tension. The UK has previously challenged the regulation of short-selling by the European Securities and Markets Authority (ESMA) in the CJEU<sup>3</sup>, arguing that the EU financial authorities (which are EU agencies) do not have this kind of regulatory power. However, the Court did not accept this argument.

There is also discussion about a **UK exemption from ESMA, the Basel Capital Accords on banking supervision, and the Capital Requirements Directive for banks**.

The UK has also raised concerns about the ability to pay bonuses and other forms of compensation, which it currently regulates less than other Member States. The UK is particularly concerned that it may become less important as a financial centre if it becomes subject to centralised rules affecting the regulation of financial services.

## Conclusion

There are important issues still to be settled at the EU level regarding the regulation of the EMU. These include definitional issues regarding central concepts as well as the division of competences. Much of the EU's response to the crisis has been targeted at protecting financial stability, at public and private levels. The EU's current competences are ill-suited to developing this response. For the UK, there is a special problem in that it is bound by EU internal market law, but not by EU monetary policy. However, a project such as banking union sits across these distinct policy fields.

The UK's stance has been mostly one of seeking opt-outs regarding rules on financial regulation and supervision, rather than taking a leading role in devising these rules. This is not making a meaningful contribution to the resolution of the financial crisis. It is difficult to think of a major financial centre which has adopted a comparable stance under similar circumstances. Repercussions are therefore likely to follow and one of the questions that will confront the UK is what position it will take when another crisis comes along.

## BACKGROUND

In the academic year 2013-14, the UCL Faculty of Laws, the UCL European Institute, the UCL Institute for Human Rights and the UCL Centre for Law and Governance in Europe jointly hosted a project on 'Britain & Europe'. Through a series of public debates with experts from academia, the judiciary and policy-makers, and an accompanying resource collection, it sought to shed light on the contentious relationship between the United Kingdom on the one hand, and the European Union and the Council of Europe on the other. The project addressed key issues currently affecting this relationship, with a special focus on their legal dimension.

The seventh seminar of the Series was held at UCL on 18 March 2014 and concerned the governance of European Monetary Union, as well as questions of EU citizenship and public procurement; themes selected for the 2014 conference of the International Federation for European Law. This policy brief focuses on the position of the UK in the evolving EMU governance framework and is based on a report by Prof Piet Eeckhout (UCL) and Dr Michael Waibel (Cambridge).

