

### Continuity and change – how the challenges of today prepare the ground for tomorrow

ECB Legal Conference 2021





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### Introduction

#### By Chiara Zilioli\*

It is a great pleasure, and an honour, to introduce *Continuity and change* – *how the challenges of today prepare the ground for tomorrow*, a book which is the outcome of the presentations and the discussions held at the ECB Legal Conference 2021.

Since 2015, on a yearly basis, the ECB Legal Services have brought together academics, judges, practitioners and lawyers from the Legal Services of the ECB, other EU institutions, international and financial institutions, national central banks and national supervisory authorities to discuss topical legal issues which are important for the functioning of the ECB and the Economic and Monetary Union.

Over the years we have built up a network of interested people, colleagues and, in the end, friends that follow this event with great interest. Every year we note with pleasure and surprise that this network keeps increasing in size and coverage. This year, some of the speakers reached the European shores from the Near East, the United States and the Caribbean. Have we gone viral?

Joking aside, the virus that has changed the daily lives of each and every one of us in a way that was unimaginable two years ago, and we were even prevented from meeting in person as originally planned this time, in 2021. This was very disappointing for all of us: although virtual interaction is a great substitute for physical interaction, it remains a substitute, and a suboptimal one. This is confirmed both by scientific research and our own individual experience. True, a virtual setting is very helpful in facilitating the delivery of content to a broader audience in more diverse locations; however, this comes at the cost of spontaneous interaction and opportunities for creative brainstorming among participants. Nevertheless, the impressive level of the contributors we lined up and the fact that the topics included in this book are both very interesting and salient, considering the most recent developments, demonstrate that we have managed to preserve the essence of such interaction.

In this introduction I would like to focus on why we chose certain topics for discussion in 2021; why they matter to us and should matter to the readers as well.

Let me start with the Symposium on proportionality, which was preceded by a keynote speech by the President of the Court of Justice of the European Union (CJEU), Koen Lenaerts, whom we had the great privilege to host at our conference this year. The principle of proportionality is of course of

Director General Legal Services, European Central Bank, Professor at the Law Faculty of the Goethe University in Frankfurt am Main.

fundamental importance for an institution that creates, applies and complies with EU law on a daily basis. Indeed, the ECB seeks to respect this principle in all its decisions, and its importance is recognised in the ECB's recent Monetary Policy Strategy Statement<sup>1</sup>, which confirms that the proportionality assessment is an integral part of monetary policy decisions. But since the German Federal Constitutional Court issued its judgment on the Public Sector Purchase Programme on 5 May 2020 (for those interested in historical recurrences, exactly 199 years after the death of Napoleon) we considered it appropriate to take the opportunity to further reflect on the topic, as there appear to be multiple ways of understanding the principle of proportionality in the context of EU law. This is not only striking, but also problematic in view of the need for consistent application of the core principles underpinning the EU legal system.

Alongside this substantive legal issue is a broader set of questions regarding the dialogue between courts in the context of the interpretation and adjudication of EU law – guestions which are gaining increasing relevance and are discussed in the first panel. The integration of the legal systems is demonstrated by the daily direct application of EU law by national courts, but also by the fact that the CJEU can in some (exceptional) cases intervene directly in the national legal order to annul a national decision taken under national law on grounds of EU law, as in the *Rimšēvičs* case<sup>2</sup>. In addition, since the introduction of the Single Supervisory Mechanism, the ECB is required to apply the national law that implements EU law and to operate as national competent authority: this has exposed new rifts between EU and national laws, also in the field of criminal law, where the ECB is now called upon to contribute in national criminal proceedings in various capacities, from interested competent authority to expert witness. Likewise, the guestion of how to combine the ECB's independence and prerogatives under EU law with the principle of sincere cooperation with national authorities is being raised more frequently.

The second panel deals with the relevance of the rule of law for the EU: the recent judgment of the Polish Constitutional Court, which surprised everyone with its claim that EU law cannot prevail over Polish law, has taken us back a half century, to before *van Gend & Loos*<sup>3</sup> and *Costa v ENEL*<sup>4</sup>. The fundamental question is whether a basic principle of EU law can be left to national interpretation, or whether the meaning that CJEU jurisprudence gives to it should be protected in the context of EU law from external interference of any kind. Underlying this dispute between the CJEU and the Polish Constitutional Court is the issue of whether we are a Union of values or a mere common market: the dispute over this issue is also one of the reasons that led to the decision of the United Kingdom to

<sup>&</sup>lt;sup>1</sup> The ECB's Monetary Policy Strategy Statement and Overview of the ECB's Monetary Policy Strategy Statement.

<sup>&</sup>lt;sup>2</sup> Judgment of the Court of 26 February 2019, *Rimšēvičs* v *Latvia*, Joined Cases C-202/18 and C-238/18, EU:C:2019:139.

<sup>&</sup>lt;sup>3</sup> Judgment of the Court of 5 February 1963, van Gend & Loos, C-26-62, EU:C:1963:1.

<sup>&</sup>lt;sup>4</sup> Judgment of the Court of 15 July 1964, *Costa* v *ENEL*, C-6/64, EU:C:1964:66.

leave the EU a few years ago (to the regret of most of us). It is not by chance that some scholars have advanced the theory that the Polish judgment might potentially act as a trigger for a "Pol-Exit", or at least a Polish secession from the EU legal order.

In the third panel another topical question is discussed, namely the role of the market in the EU, and whether the logic of the market should prevail over that of law. This question has practical implications which are relevant for the day-to-day decisions of our institutions. For example, in recent years some scholars have argued over the need for the ECB to act in accordance with an alleged *principle of market neutrality* (which is nowhere to be found in the Treaty). This debate has gained particular prominence in the context of the discussion on the role that the ECB could and should play in the fight against climate change.

This is not, however, a new question for us, and it would not be correct to restrict its relevance to this field only. In the context of the Great Financial Crisis, the ECB had challenged the axiom of the wisdom and infallibility of the markets when it announced that, to remedy excessive spreads in the sovereign markets, which were not justified by economic fundamentals but caused by the panic surrounding the "redenomination risk" and were threatening to hamper the functioning of the ECB monetary policy transmission mechanism, it would intervene with the Outright Monetary Transactions programme. The sole announcement, taken by the market as *the law*, corrected the market failure, and the spreads reconverged to the justified differences.

For the avoidance of doubt, this is not to suggest that the market should generally be seen as a problem. In fact, we have not thus far managed to engineer a better institutional device to promote innovation and efficiency. This is evidenced by continuous developments in relation to the digitalisation of finance, which are taking place at a speed that makes them difficult to follow. These developments are very relevant, in particular for a central bank, and are discussed in the fourth panel. While the central bank community is of course focusing its efforts on the development of central bank digital currencies, the private sector is deploying a panoply of innovations which will radically transform the way finance works. The Commission is proposing legislation to regulate these innovations. But some disruptive technological developments are already displaying their effects before our eyes. Our first objective should therefore be to understand in which direction these developments are going, in particular those related to artificial intelligence (AI). As is usually the case with new technologies, these are neutral tools which can be put to good or evil purposes depending on the use which is made of them. From a lawyer's point of view the use of certain AI algorithms to bar access to credit for certain sectors of the population is of course very concerning from the perspective of the equality principle and in the wider context of fundamental rights. On the other hand, we are going to hear how these new technologies can be used to broaden access to finance, especially in contexts where financial market infrastructures are less developed.

Finally, in the fifth panel we have devoted some time to reflect on one of the most important outcomes of the COVID-19 crisis, which could have a potentially transformative effect on the way our Union will function in the economic and fiscal domain: the Next Generation EU recovery plan and the Support to mitigate Unemployment Risks in an Emergency programme. Although this might be considered a political rather than a legal topic, several legal questions are worthy of further consideration. A historical opinion of the Legal Services of the Council has contributed to overcoming the taboo on the limits to the borrowing capacity of the EU. Whether or not this may constitute a template for future debt issuances once the crisis is over is after all still an open question.

As I mentioned at the beginning, on top of these very interesting panels, and of the participation of the President of the European Court of Justice, we had the honour and privilege of having several of our Executive Board Members acting as Chairs of these panels and, in the cases of the President and Frank Elderson, delivering keynote speeches.

Frank Elderson is the Executive Board Member for DG Legal Services and a lawyer by training. He has followed our work in preparing for the conference with much interest, and I would like to thank him again for his support.

I think that this book, which has resulted from the high level contributions of all the speakers and the active participation of the audience in the debates at the conference, will be a very valuable tool for legal scholarship in the continuing legal reflection on these important issues.



# Change and continuity in law – Keynote speech

By Christine Lagarde\*

#### 1 Introduction

The first President of the European Commission<sup>5</sup>, Walter Hallstein, famously said that the European Union is a "community of law" – an expression which was then picked up by the European Court of Justice in its judgments. The rule of law is one of the basic principles of the EU, and one we have to defend – especially at times when it is put at risk of being attacked.<sup>6</sup>

This principle means that EU law is the cement that keeps the European construction together. It is the precondition for the very existence of the EU institutions, including the ECB, and for the policies that the law mandates them to carry out. But there is an ever-present tension between the role of law as an immutable anchor of society, and its need to adapt as the world changes.

Europe's reaction to the COVID-19 crisis has led to a number of institutional innovations, leading some to deem it a "Hamiltonian moment for Europe". This epithet primarily reflects Alexander Hamilton's leading role in creating the US fiscal and monetary institutional setup. But there is also a second reason why the description fits. Hamilton – a lawyer – was one of the first to introduce the question of the relationship between change and law, and of the role that interpretation, and in particular authoritative interpretation by judges, can have in this context.

This issue has developed into a decades-long debate between "originalism" and "realism" in US scholarship. The same question has also shaped the way in which the notion of an ever closer union, the foundation of the EU Treaties, has been developed by the jurisprudence of the Court of Justice. And it continues to shape Europe's future direction today.

In my remarks this morning, I would like to review the evolution of this debate in US law, starting with Hamilton himself. I will then turn to EU law and ask whether the lessons we can draw from legal history can help give us a sense of direction for the challenges of today and tomorrow.

<sup>\*</sup> Christine Lagarde, President of the European Central Bank.

<sup>&</sup>lt;sup>5</sup> See Hallstein, Walter (1979), "Die EWG—Eine Rechtsgemeinschaft", Rede anlässlich der Ehrenpromotion (Universität Padua, 12. März 1962), in "Europäische Reden", Vol. 341, pp. 343-44.

<sup>&</sup>lt;sup>6</sup> The Programme of the ECB Legal Conference is available at www.ecb.europa.eu/pub/ conferences/html/20211125\_4th\_ECB\_legal\_conference.en.html

#### 2 Hamilton and the Constitution

Hamilton is nowadays credited with having been the father of the US fiscal union, and – as a further proof of how these two things go hand in hand – he was also the father of the first central bank of the United States. The US legislature then twice abolished and re-established a nationwide central bank, until it finally settled on the Federal Reserve System in 1913.

Change is the result of a process of trial and error, which can easily end up back at square one – as happened with the repeated attempts to do away with the institution of a central bank altogether to create a new monetary system. To cater for the right balance between the aspiration to carry out a trial experiment, and the need to limit errors, legal frameworks include provisions of constitutional rank. These rules<sup>7</sup> provide an element of continuity which anchors the whole system and to which "regular" laws are hierarchically subordinated: laws can be passed by the majorities of the time, but the constitution is typically very difficult to amend.

However, change in law is not only pursued by enacting new laws, but also in the way law is interpreted and applied. And, because they are difficult to amend, this is particularly important for legal provisions having a constitutional rank. Factual contexts can change, and the question then arises whether there is scope for the interpretation of such provisions to change as well, which may be better suited to new social or economic circumstances.

This question is primarily for courts that have been tasked with interpreting provisions with a constitutional rank to decide. But it also applies to other institutions which have to apply those provisions.

Hamilton famously wrote that judges, in order to preserve the people's rights and privileges, must have authority to check legislation and acts of the executive for constitutionality. But at the same time, the judiciary, by the very nature of its functions, will always be "the least dangerous" branch of government, for judges hold neither the sword nor the purse of the community; ultimately, they must depend upon the political branches to effectuate their judgments.<sup>8</sup>

Hamilton was pointing to the very delicate balance which must be struck between the political legitimation of democratic bodies, which relies on the people; and the authority of independent institutions such as the judiciary – or even central banks – which relies on the law. Since the law is the sole and only source of legitimation of these institutions, the exact meaning and scope of the law – in other words, its interpretation – becomes an issue of crucial importance.

<sup>&</sup>lt;sup>7</sup> Which can bear the name of constitution or not, as is the case for the Treaties in the EU legal framework.

<sup>&</sup>lt;sup>8</sup> See Hamilton, A., "The Federalist Papers", No. 78.

# 3 The original meaning of the law in US legal scholarship: continuity and change

If the authority of courts – and the powers of other independent institutions – indeed relies on the law, a question that may be asked is "which law?"

Nobody would disagree with the law being narrowly defined, i.e. the provisions under a certain legal framework, having been approved by a certain authority which is entrusted with this power, and following a certain procedure. But the answer becomes more complicated if one considers a broader interpretation, such as the adjudication of the law by the courts.

According to a traditional view, judges are just "the living voice of the Law"<sup>9</sup>, while others opine that the idea of the law should be stretched to include judicial adjudication.<sup>10</sup> This fascinating debate has been at the centre of legal scholarship for most of the last century, and in the United States it represents the divide in the US Supreme Court across which contentious wedge issues have spanned.

The more traditional, "formalist" approach posits that the legal system is composed of a hierarchical system of norms where each level is validated by a superior one. The prevalent view in US legal scholarship in the first part of the last century, which is still represented in the Supreme Court today, is that the aim of interpretation should be to find out the original meaning of the law as drafted by the legislators – or the alternatively original intention of these drafters. The Constitution should not only be *lex legum*, a law of laws, but also *lex immutabilis*, unalterable law, unless explicitly changed via the amendment process. This school of thought is known as "originalism".

In the 1930s, an opposing movement – the "realist movement" – arose in US legal scholarship. This movement challenged the understanding and very meaning of the concept of law, which in their view should have a much broader scope than legislation alone. It should include, inter alia, decision-making by judicial authorities, since "judges do and must legislate" – although only to the extent of filling gaps between positive norms by way of interpretation.<sup>11</sup>

<sup>&</sup>lt;sup>9</sup> See Montesquieu (1748), in "De l'esprit des lois": "Les juges ... ne sont que la bouche qui prononce les paroles de la loi, des êtres inanimés qui n'en peuvent modérer ni la force ni la rigueur".

<sup>&</sup>lt;sup>10</sup> For some, the idea of the law extends even to interpretation as such, and to the factual context insofar as it influences such interpretation (and thereby judicial adjudication).

<sup>&</sup>lt;sup>11</sup> Southern Pac. Co. v. Jensen, 244 U.S. 205, 221 (1917) (Holmes, J., dissenting). Even the father of the "*Reine Rechtslehre*", Hans Kelsen, admitted that in applying the law to an individual case some margins for interpretation by judicial authorities are inevitable, see von Bernstorff, J. (2017), "Hans Kelsen's Judicial Decisionism versus Carl Schmitt's Concept of the One 'Right' Judicial Decision: Comments on Stanley L Paulson, 'Metamorphosis in Hans Kelsen's Legal Philosophy'', 80(5) MLR, pp. 860-894.

This debate between the originalist and realist schools of thought has animated US legal doctrine during the last century, and in more recent times has been personified in the amicable dissent between Supreme Courts Justices Scalia and Ginsburg.<sup>12</sup> According to the realists, the very high bar to amending the US constitution means that the originalist approach introduces an element of rigidity into the legal framework. And this becomes increasingly burdensome as time goes by and the world changes more and more from that which existed when the US Constitution was originally drafted. This is why the realist school has advocated using interpretation to blow dynamism back into the legal framework, allowing society to adapt to evolving circumstances.

The Fourteenth Amendment, one of the Amendments adopted after the War of Secession, extending citizenship and civil rights, has been the battlefield *par excellence* for this debate. And it has been an extremely concrete debate for those people who did not originally benefit from constitutional rights and protections. Indeed, the first part of US constitutional history was defined by the extension of these rights and safeguards to once-excluded groups, such as people from ethnic minorities (including those who were formerly enslaved), men without property, and women.<sup>13</sup>

Yet these important changes – which sound obvious to us today – happened to a large extent without changes to the text of the Constitution, so much so that originalist scholars rebelled against what they saw as an abusive use of powers by the Court.<sup>14</sup> In her Madison lesson, Justice Ginsburg recalled that many of the framers of the Constitution spoke publicly against extending even voting rights to women or black people, whom they explicitly saw as a danger.<sup>15</sup>

However, the US Constitution, which did not originally speak about "equality" with regard to individual rights, developed the potential, in particular through its "equal protection" and "due process" Clauses, to become the foundation on which the rights of women and minorities could be grounded. Remarkably, Justice Ginsburg herself mentioned in the same Madison lecture that "with prestige to persuade, but not physical power to enforce, with a will for self-preservation and the knowledge that they are not 'a bevy of Platonic Guardians'... the Justices generally follow, they do not lead, changes taking place elsewhere in society".<sup>16</sup>

<sup>&</sup>lt;sup>12</sup> Monaghan, H. P. (2004), "Doing Originalism", 104 COLUM. L. REV. 32.

<sup>&</sup>lt;sup>13</sup> See Morris, Richard B. (1987), "The Forging of the Union, 1781-1789", at pp.162-163.

<sup>&</sup>lt;sup>14</sup> See Berger, R. (1997), Government by Judiciary: The Transformation of the Fourteenth Amendment, 2<sup>nd</sup> edition, Liberty Fund Inc.

<sup>&</sup>lt;sup>15</sup> Ginsburg, R. (1992), "Speaking in a judicial voice", in New York University Law Review, 67/6, p. 1185 ff.

<sup>&</sup>lt;sup>16</sup> In doing so, Justice Ginsburg referred to a piece of scholarship by Archibald Cox, quite tellingly entitled: "The Role of the Supreme Court: Judicial Activism or Self-Restraint?," 47 Md. L. Rev. 118, pp. 124-25 (1987).

#### 4 The Treaty as a new step in the process of creating an ever closer union

This debate has shown that there is an inherent tension in law between change on the one hand and the preservation of the legacy of the past on the other. Cutting across the ideals of change and continuity are the roles of legislation and interpretation of the law. It should be no surprise that this tension also exists in EU law.

On the one hand, several elements can be used to argue in favour of the immutable nature of the Treaties as drafted by the *Herren der Vertraege*: above all, the principle of conferral and, to a lesser extent, the principle of subsidiarity and the reference to constitutional identities. The burdensome process for introducing amendments also points in this direction.

On the other hand, the very wording of the Treaties lends itself to a dynamic interpretation, most tellingly when they refer to a "process of creating an ever closer union", of which the Treaties themselves are only "a new step". Indeed, there are several Treaties provisions that explicitly cater for the need to adapt to changes.

First, there is the general enabling clause, which envisages that the Council of the European Union can unanimously adopt the measures necessary to attain one of the objectives of the Treaty when the Treaties have not provided the necessary powers.<sup>17</sup> Second, there are other more specific provisions which allow the expansion of the tasks and powers assigned to the EU and its institutions. These include the provision on the basis of which the prudential supervision of banks was assigned to the ECB in 2014, without a Treaty change.<sup>18</sup>

There are also several provisions which, in a changing world, can be interpreted to cover new developments. Consider the digital euro or climate change: in both cases the provisions are already there but need to be interpreted to apply to new phenomena. To be the source of authoritative interpretation of EU law, including its founding Treaties, is a role that is assigned by the Treaties specifically to the European Court of Justice.

The discussions in the EU today on upholding the rule of law are a clear example of how a legal basis in the Treaties has been reinterpreted as the foundation of a whole new framework – a framework which had not been expressly provided for by the drafters of the Treaties, but which the Treaties had the potential to express, and which is in itself providing the basis for the independence of the judiciary in the national context. Even concepts such as the direct effect and primacy of EU law do not stem from the

<sup>&</sup>lt;sup>17</sup> Article 352 of the Treaty on the Functioning of the European Union (TFEU).

<sup>&</sup>lt;sup>18</sup> Article 127(6) TFEU.

Treaties directly, but from their interpretation in early groundbreaking judgments such as *van Gend & Loos*<sup>19</sup> and *Costa Enel*<sup>20</sup>, respectively.

The jurisprudential origin of these concepts has been used by some Member States to challenge the legitimacy of the Court's role and of the primacy of EU law itself. This challenge has taken place in the alleged defence of the real intention of the *Herren der Vertraege* when they signed the Treaties.

Proponents of change often call for new legislation to make change happen – most of the time because it is deemed that only legislation can provide the necessary degree of clarity and certainty. However, pursuing the route of legislative change can serve as a way to resist reforms which would otherwise be possible in the context of the continuity of existing rules and their adapted interpretation. This is particularly true in a multilateral context like that of the EU, where a double majority in the European Parliament and Council is required to adopt legislation. The bar becomes even higher in the case of changes to the Treaties themselves, where the unanimity of Member States is required, including national ratification procedures which sometimes require referenda.

Member States provide important – although often silent – testimonials to the possibility to use the flexibility in the Treaties to adapt to change without amending the text itself. If Member States do not oppose an interpretation of the law which is developed in view of changed circumstances, it can be seen as a validation mechanism for interpretative change. Indeed, since the Treaty of Lisbon entered into force, there have been almost no changes to the text of the Treaties<sup>21</sup>, yet in this period the EU went through the global financial crisis, the migration crisis and more recently the COVID-19 crisis. The evolutive nature of EU law has allowed it to expand and refine the profile and type of intervention that the EU can propose in reaction to a crisis. Today, many measures are possible which 15 years ago would have not seemed even plausible.

Proponents of careful scrutiny of the action of EU institutions to avoid them overstepping their mandate stress that an evolutive interpretation was not the law which was written in the Treaties and that this represents an undue interference by the Court of Justice in the sovereign decisions of Member States. At the same time, one has to observe that Treaty amendments are nowadays invoked as being required for changes which are often of a technical nature and relatively narrow in scope. This stands in contrast to the incremental evolution which took place in EU law during the first decades in the absence of any change to the founding treaties.

<sup>&</sup>lt;sup>19</sup> Judgment of the Court of 5 February 1963, Case 26-62, NV Algemene Transport- en Expeditie Onderneming van Gend & Loos v Netherlands Inland Revenue Administration, EU:C:1963:1.

Judgment of the Court of 15 July 1964, Case 6/64, Flaminio Costa v E.N.E.L., EU:C:1964:66.

<sup>&</sup>lt;sup>21</sup> With the important exception of the addition of a new paragraph to Article 136 TFEU.

In a complex, multi-layered institutional framework such as the EU, one should not look at this issue as limited to a looming conflict between independent courts and Member States. Courts can rightly argue among themselves around different interpretations of the law, and even on the extent to which another court has been given a mandate by the law to give a binding interpretation.

Yet, we have challenges which our US friends do not have, because within a single system with a single ultimate jurisdictional authority, a reconciliation is possible at the top. The language of legal pluralism has been useful to keep everything together, but there is a limit at which the presence of multiple voices, which claim for themselves the role of ultimate deciders, turns from being a resource into a risk – that is, the risk of perennial standstill, where no move is possible without Treaty change.

While this may be seen as a virtue by some – the EU version of the originalists – it is a risk insofar as such a system is inflexible and the idea that change is possible in continuity is denied. It therefore increasingly becomes apparent that only discontinuity can deliver change. As institutions which are devoted to continuity, central banks should question whether this is what we want.

#### 5 Conclusion

Change can be pursued in many ways, and it is not necessarily true that those which are more eye-catching are also the most effective. Particularly effective are those changes which take place in continuity. One particular case is that of the law, which can be interpreted in a way that makes sense and adapts to societal changes, while remaining coherent with the fundamental principles of the legal system. This ensures continuity in the meaning of the law, in the sense that the text of the law has not changed at all.

Against this background, events like this conference are extremely important, because they offer an occasion to foster discussions, new ways of thinking and possible new ways of interpreting the law, without changing it, in a way that better suits the needs of today.

Following the lesson of Justice Ginsburg, independent institutions which ground their legitimation on the law should stand ready to adapt to the changes which happen in society. And they should interpret and apply the law consequentially, in the way that best serves the needs of the societies and polities which these institutions are meant to serve.

# Part I



# Introduction of the President of the European Court of Justice

By Christine Lagarde\*

#### 1 Introduction

I am honoured to welcome the many distinguished speakers from the judiciary and the academia who agreed to participate in this Symposium and, in particular, the keynote speaker for this afternoon session, the President of the Court of Justice of the European Union, Professor Koen Lenaerts.

Before giving the floor to President Lenaerts, who will give his keynote speech on the important topic of proportionality, I would like to briefly share with you a few thoughts on the specific role of the courts in their adjudicatory function and of the Court of Justice of the European Union (CJEU) in particular when it comes to the European Union (EU) legal order and on our keynote speaker. As President Lenaerts is someone who does not need an introduction, I will focus on the important legacy that the CJEU, under his leadership is building up in recent years.

#### 2 The role of courts in our legal system(s)

The broad range of topics for which the principle of proportionality is relevant provides an opportunity to reflect on the specific role of courts in general, and of the CJEU in particular. Specialised institutions (like the ECB in the field of central banking and now also banking supervision) and agencies are mandated to use their powers to define and apply the law in specific cases. Courts stand in between these institutions and the law, since when they review the acts of these public bodies, they are required to review the way in which either the Treaty is applied, for example in the definition of a policy in legislation, or the law is interpreted by those who are entrusted public powers for the purposes of its application. The importance of court adjudication is such that a segment of legal scholarship argues that the notion of law should be extended to include adjudication together with the law on the books as more narrowly defined. This is however a topic I would like to discuss with you in my intervention of tomorrow.

Now, coming back to the role of courts and of the CJEU in particular, I would like to highlight once more the character of our Union as a community of law, as it is often – but never too often – defined. Most polities have been created and extended by the sword. By contrast, the EU

Christine Lagarde is President of the European Central Bank (ECB)

is a creature of the law, and the history of its development and extension is to a vast extent a history of how the scope of EU law has developed and expanded throughout the years. And this, to a vast extent, is a history of the achievements of the CJEU.

The CJEU, which will celebrate its 70th birthday next December, has indeed played a crucial role in shaping EU law since its establishment. Its importance for safeguarding the rule of law in the EU and for developing the interpretation of EU law cannot be stressed enough. The CJEU has also had a significant impact on the understanding and the application of the proportionality principle contained in the EU Treaty.

#### 3 President Lenaerts

Before leaving him the floor, I would like to briefly introduce President Lenaerts, and mention the important role that he has managed to achieve for himself in the history of the CJEU and of the EU itself. Certainly, it is difficult to select a single label to define his Presidency, which is illustrative of how intense his term has been until now. Indeed, under his Presidency the CJEU has had to opine on the withdrawal of one of its Member States from the Union<sup>22</sup> – certainly not an easy topic for any of the institutions which were involved in this regrettable setback in our integration process. After this came a series of Opinions on the relationship of the EU legal order with arbitration, from Achmea<sup>23</sup> to the Energy Charter.<sup>24</sup> And more recently we had a series of judgments concerning the relationship with national constitutional courts<sup>25</sup>, and the underlying question on the scope of the powers under EU law (and the question of ultra vires) and the importance of the rule of law as a fundamental principle of EU law which requires an independent judiciary. The "fil rouge" which connects these important judgments is the defence of the autonomy of EU law. As I have said before, the action of the CJEU may be compared to what was in the past the action of a sword in defending our Union. Or perhaps of a shield, to protect the borders of the EU's legal system under siege, in such a difficult moment where we are under attack from many fronts. (The CJEU could be seen as "les chevaliers de la table ronde" defending our "Camelot", with the President as King Arthur.)

It is to my immense pleasure that the President of the CJEU, Professor Koen Lenaerts has accepted our invitation to open this Symposium.

<sup>&</sup>lt;sup>22</sup> Judgment of the Court of 10 December 2018, Wightman and Others v Secretary of State for Exiting the EU, C-621/18, EU:C:2018:999.

<sup>&</sup>lt;sup>23</sup> Judgment of the Court of 6 March 2018, Achmea, C-284/16, EU:C:2018:158.

<sup>&</sup>lt;sup>24</sup> Judgment of the Court of 2 September 2021, *Moldova* v Komstroy LLC, C-741/19, EU:C:2021:655.

<sup>&</sup>lt;sup>25</sup> For instance, the judgments of the German constitutional court on the ECB: BVerfG, Judgment of the Second Senate of 5 May 2020 - 2 BvR 859/15 and the Polish constitutional court on the conformity of selected provisions of the Treaty on European Union with the Polish Constitution, Ref. No. K 3/21. See also the decisions by the French Conseil d'Etat, 21 April 2021, Nos 393099, 394922, 397844, 397851, 424717, 424718, and the Danish Supreme Court, Case no. 15/2014, *Ajos*.



Proportionality as a matrix principle promoting the effectiveness of EU law and the legitimacy of EU action – Keynote speech

By Koen Lenaerts\*

The Court of Justice has incorporated several constitutional traditions common to the Member States into the constitutional fabric of the European Union (EU). The principle of proportionality is one of them. According to it, public authorities, when they are competent to act, cannot act in a manner that exceeds the limits of what is necessary to achieve the objectives of public interest that they pursue. Very early on, the Court of Justice integrated proportionality into its case-law<sup>26</sup>, before establishing it as a general principle of EU law.<sup>27</sup> With the Maastricht Treaty, the principle of proportionality was "constitutionalised" and is now reflected in Article 5(4) of the Treaty on European Union (TEU). That provision requires that any action of the EU "[does] not exceed what is necessary to achieve the objectives of the Treaties".

The proportionality principle has undeniably gained importance in the EU legal order over time. It originally served as justification put forward by the Member States when they introduced or maintained restrictions to fundamental freedoms of the internal market. However, it quickly spread to other situations falling within the scope of EU law. Thus, various expressions of proportionality can be identified in the EU legal order.

*First*, the principle of proportionality is based directly on the first subparagraph of Article 5(4) TEU, which provides that "[u]nder the principle of proportionality, the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties". This horizontal requirement applies not only to legislative or regulatory action by the EU institutions or bodies but also to situations where they adopt decisions entailing adverse effects for individuals or undertakings, such as a decision

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<sup>&</sup>lt;sup>26</sup> Judgment of 29 November 1956, Fédération charbonnière de Belgique v High Authority, 8/55, EU:C:1956:11.

<sup>&</sup>lt;sup>27</sup> Judgment of 17 December 1970, *Internationale Handelsgesellschaft*, C-11/70, EU:C:1970:114.

whereby the European Commission imposes a fine on an undertaking for a breach of EU competition  $law.^{28}$ 

Second, as a general principle of EU law, proportionality also applies to the Member States when they implement EU measures or when their action entails a restriction of fundamental freedoms. For example, as I will explain later on, the Court of Justice of the European Union (CJEU) applied the principle of proportionality in a case in which it was asked under what conditions a Member State can deprive a national of that Member State of his nationality and, by extension, of his rights as an EU citizen.

*Third*, proportionality is an essential tool for protecting fundamental rights both when EU institutions or bodies act and when the Member States implement EU law, namely when the EU Charter of Fundamental rights ("the Charter") applies. That function of proportionality is essentially reflected in Article 52(1) of the Charter, which requires that any limitation on a fundamental right is proportionate to the objectives pursued.

I will come back to each of these aspects in this speech, which will be divided as follows. I will first define what the principle of proportionality is in EU law and explain what it is not (Section 1). I will then examine in more detail the scope of the proportionality principle and the extent to which an EU measure can be subject to judicial review from that perspective (Section 2). In the third part, I will focus on the proportionality principle applied to the Member States in cases falling within the scope of EU law (Section 3).

# 1 The functions of the proportionality principle in EU law and its relationship with the principles of conferral and subsidiarity

Article 5 TEU describes the main principles governing the EU's competences, namely the principles of (i) conferral, (ii) subsidiarity and (iii) proportionality. Its first paragraph sets out the respective functions of these principles: "[t]he limits of Union competences are governed by the principle of conferral", while "[t]he use of Union competences is governed by the principles of subsidiarity and proportionality".

It follows from that distinction that an issue of *proportionality* of a given EU measure arises after the issue of whether its author had competence to adopt it. The wording of the first subparagraph of Article 5(4) TEU plainly confirms that when it refers to the "content and form of Union action". Since the EU legal order is based on the principle of conferral<sup>29</sup>, there can be no

<sup>&</sup>lt;sup>28</sup> Judgment of 28 April 2010, Amann & Söhne and Cousin Filterie v Commission, T-446/05, EU:T:2010:165, para. 171.

<sup>&</sup>lt;sup>29</sup> Whilst that principle is set out in Article 5(1) TEU, Article 4(1) clarifies its main consequence, namely that "competences not conferred upon the Union in the Treaties remain with Member States".

"Union action" when the Treaties fail to provide a sufficient basis for it. Conversely, proportionality should not play a role when assessing whether the EU had a competence to adopt a measure at issue.

Likewise, the principle of *subsidiarity* comes into operation prior to that of proportionality. Although both principles relate to the use of an EU competence and not its existence, subsidiarity determines whether, in areas of non-exclusive competence, it is the EU or the Member States that should address the issue. Thus, Article 5(3) TEU allows the EU to act, in an area which does not fall within its exclusive competence, "only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central or at regional and local level". The proportionality principle set out in Article 5(4) TEU only becomes relevant if a given EU measure satisfies that requirement, the focus shifting to the correlation between the objective of public interest that that measure pursues and the means used to achieve it.

That specific function of proportionality is also reflected in Article 5 of Protocol (No 2) on the application of the principles of subsidiarity and proportionality. According to that provision, any draft legislative act should take account of "the need for any burden, financial or administrative, that that legislative act is likely to create, in particular for the Member States, to be minimised and commensurate with the objective [pursued]".<sup>30</sup> That principle does not therefore aim to protect Member States' competences as such.

The CJEU applies the methodology that I have just described consistently. For example, in *Poland* v *Parliament and Council*, a Member State challenged Directive (EU) 2018/957<sup>31</sup> (on posted workers) inter alia on grounds of an allegedly incorrect legal basis. The Court first examined whether the relevant provisions of the TFEU concerning harmonisation in the internal market<sup>32</sup> constituted an appropriate legal basis for adopting that directive, before separately addressing the issue whether the directive constituted a proportionate restriction on the freedom to provide services<sup>33</sup>.

Similarly, in *Czech Republic* v *Parliament and Council*<sup>34</sup>, the Court confirmed in a first step that Article 114 TFEU constituted the appropriate legal basis for adopting a new directive on the marketing of firearms in the internal market.<sup>35</sup> Only in the subsequent part of the judgment did the Court

<sup>&</sup>lt;sup>30</sup> Article 5, Protocol (No 2) on the application of the principles of subsidiarity and proportionality.

<sup>&</sup>lt;sup>31</sup> Directive (EU) 2018/957 of the European Parliament and of the Council of 28 June 2018 amending Directive 96/71/EC concerning the posting of workers in the framework of the provision of services (OJ L 173, 9.7.2018, p. 16).

<sup>&</sup>lt;sup>32</sup> Namely Article 53(1) and Article 62 TFEU.

<sup>&</sup>lt;sup>33</sup> Judgment of 8 December 2020, *Poland* v *Parliament and Council*, C-626/18, EU:C:2020:1000.

<sup>&</sup>lt;sup>34</sup> Judgment of 3 December 2019, *Czech Republic* v *Parliament and Council*, C-482/17, EU:C:2019:1035.

<sup>&</sup>lt;sup>35</sup> Directive (EU) 2017/853 of the European Parliament and of the Council of 17 May 2017 amending Council Directive 91/477/EEC on control of the acquisition and possession of weapons (OJ L 137, 24.5.2017, p. 22).

verify the proportionality of various measures in that directive limiting contractual or commercial freedom in order to reconcile the objectives of facilitating cross-border trade and protecting public order and national security.

The same methodology applies to monetary policy. Like the other institutions, bodies and agencies of the EU, the European Central Bank (ECB) must comply with both the principle of conferral and the proportionality principle.<sup>36</sup> Its actions are therefore subject to judicial review of proportionality by the CJEU, which is all the more important since the ECB has a central role in European economic and financial governance.

In *Gauweiler*<sup>37</sup>, a case concerning the validity of the decisions of the ECB establishing the Outright Monetary Transactions (OMT) programme<sup>38</sup>, the Court first recalled the EU's exclusive competence in this field for Member States whose currency is the euro. It then relied both on the objective of the disputed OMT programme and on the means available to the European System of Central Banks (ESCB) to conclude that such a programme fell within the area of monetary policy.<sup>39</sup> Only then did the Court deal with proportionality. A similar methodology can be seen in the *Weiss* judgment.<sup>40</sup> The Court relied on the objective of the public sector asset purchase programme (PSPP)<sup>41</sup> at issue and on the means used to achieve that objective to conclude that that programme was a monetary measure.<sup>42</sup> The Court addressed the question of proportionality only once it had confirmed, in essence, that the ECB was competent to adopt the PSPP.

As I have explained, that methodology is required by the Treaties themselves. For that reason, I cannot accept the objection raised by the *Bundesverfassungsgericht* in its decision of 5 May 2020 in *Weiss*<sup>43</sup>, arguing that proportionality should have been applied by the Court already when distinguishing between the EU's competences in the areas of monetary and economic policy. Proportionality cannot influence that distinction, nor have a "corrective function" for the purpose of protecting the Member States'

<sup>&</sup>lt;sup>36</sup> Subsidiarity is admittedly of lesser relevance here because the monetary policy for the Member States whose currency is the euro falls within the scope of the Union's exclusive competence (Article 3(1)(c) TFEU).

<sup>&</sup>lt;sup>37</sup> Judgment of 16 June 2015, *Gauweiler and Others*, C-62/14, EU:C:2015:400.

<sup>&</sup>lt;sup>38</sup> Decisions of the Governing Council of the European Central Bank (ECB) of 6 September 2012 on a number of technical features regarding the Eurosystem's outright monetary transactions in secondary sovereign bond markets.

<sup>&</sup>lt;sup>39</sup> Gauweiler and Others, op. cit., paras. 41-56.

<sup>&</sup>lt;sup>40</sup> Judgment of 11 December 2018, *Weiss and Others*, C-493/17, EU:C:2018:1000.

<sup>&</sup>lt;sup>41</sup> Decision (EU) 2015/774 of the European Central Bank of 4 March 2015 on a secondary markets public sector asset purchase programme (OJ L 121, 14.5.2015, p. 20).

<sup>&</sup>lt;sup>42</sup> Weiss and Others, op. cit., paras. 53 to 70.

<sup>&</sup>lt;sup>43</sup> BVerfG, 5 May 2020, 2 BvR 859/15.

competences.  $^{44}$  Such an interpretation would be at odds with the principle of conferral set out in Article 5(1) TEU.  $^{45}$ 

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## The scope of proportionality and judicial review of that principle applied to EU measures

In a union based on the rule of law, compliance with the proportionality principle should be subject to judicial review. However, proportionality relates to *substantive* choices made by a public body, including the legislator. It is therefore essential to keep such judicial review within limits to avoid the Court becoming a political organ. As early on as in the *Meroni* case of 1958<sup>46</sup>, the Court referred to the "balance of powers" as a "characteristic of the institutional structure of the Community". A specific expression of that balance is to be found in Article 19(1) TEU, which provides that the Court "shall ensure that in the interpretation and application of the Treaties the law is observed". Like any other court, the CJEU decides the cases brought before it in accordance with the law *and only* the law.

It comes as no surprise in that context that the Court carefully avoids encroaching upon the margin of assessment which other institutions or bodies enjoy within the limits of their competences, when ascertaining whether their action complies with the proportionality principle. That is the context in which judicial review limited to manifest errors of assessment started to develop (Section 2.1). Even within that broad margin, however, EU institutions or bodies must fully comply with fundamental rights (Section 2.2). Moreover, "process-oriented" review counterbalances the limits of judicial review of proportionality (Section 2.3).

## 2.1 The idea of a "broad margin of (political) assessment" coupled with "limited" judicial review

The Court has regularly referred to the political margin of assessment of the EU legislature when carrying out judicial review. Thus, in two famous cases concerning Directive 2001/37/EC<sup>47</sup>, which set out conditions which cigarettes must satisfy in order to be sold in the internal market, the Court stressed that the objective of ensuring a high level of human health

<sup>&</sup>lt;sup>44</sup> ibid., para. 133.

<sup>&</sup>lt;sup>45</sup> Wendel, M., "Paradoxes of Ultra-Vires Review: A Critical Review of the PSPP Decision and Its Initial Reception", *German Law Journal*, vol. 21, No. 5, 2020, pp. 979-994, esp. pp. 985-986. See also Marzal, T., "Making sense of the use of proportionality in the Bunderverfassunsgericht's PSPP decision", *Revue des Affaires Européennes*, No. 2, 2020, pp. 441-452, p. 445.

<sup>&</sup>lt;sup>46</sup> Judgment of 13 June 1958, *Meroni* v High Authority, 9/56, EU:C:1958:7.

<sup>&</sup>lt;sup>47</sup> Directive 2001/37/EC of the European Parliament and of the Council of 5 June 2001 on the approximation of the laws, regulations and administrative provisions of the Member States concerning the manufacture, presentation and sale of tobacco products (OJ L 194, 18.7.2001, p. 26).

protection involves "political, economic and social choices"<sup>48</sup> which a judicial body cannot call into question. The Court also referred to such wide margin of assessment in the areas of environmental protection<sup>49</sup>, consumer protection<sup>50</sup> and the common transport policy.<sup>51</sup>

The degree of complexity of a given area will usually also trigger limited judicial review. For example, in a case concerning Directive 94/19/EC<sup>52</sup> (on deposit-guarantee schemes), the Court recognised that "the Community legislature was seeking to regulate an economically complex situation".53 On medical matters<sup>54</sup> and environmental protection, the EU legislature equally has a broad discretion in "the assessment of highly complex scientific and technical facts in order to determine the nature and scope of the measures that it adopts".<sup>55</sup> That complexity is further illustrated in relation to the precautionary principle. Thus, the uncertainty of the effectiveness of oral tobacco products as an aid to the cessation of smoking and the risk of a gateway effect are justifiable grounds to consider banning them proportionate.<sup>56</sup> In certain areas, we can find a combination of both these political and technical aspects regulating the scope of discretion. Monetary policy provides a good illustration. The Court observed that policymaking in that area involves not only "technical choices" but also "complex assessments", emphasising that "questions of monetary policy are usually of a controversial nature".57

These choices, whether political or technical, do not fall within the jurisdiction of the CJEU. Faced with such discretionary power, judicial review must be limited "to verifying whether there has been a manifest error of assessment or a misuse of powers, or whether the legislature has manifestly exceeded the limits of its discretion".<sup>58</sup> According to that standard, a measure is invalid only if manifestly inappropriate in relation to the objective pursued.<sup>59</sup>

<sup>&</sup>lt;sup>48</sup> Judgments of 10 December 2002, *British American Tobacco (Investments) and Imperial Tobacco*, C-491/01, EU:C:2002:741, para. 123; and of 14 December 2004, *Arnold André*, C-434/02, EU:C:2004:800, para. 46.

<sup>&</sup>lt;sup>49</sup> Judgment of 8 July 2010, Afton Chemical, C-343/09, EU:C:2010:419, para. 46.

<sup>&</sup>lt;sup>50</sup> Judgment of 17 December 2015, *Neptune Distribution*, C-157/14, EU:C:2015:823, para. 76.

<sup>&</sup>lt;sup>51</sup> Judgment of 12 March 2002, *Omega Air and Others*, C-27/00 and C-122/00, EU:C:2002:161, para. 63. See also judgments of 10 January 2006, *IATA and ELFAA*, C-344/04, EU:C:2006:10, para. 80; and of 2 September 2021, *Irish Ferries*, C-570/19, EU:C:2021:664, para. 151.

<sup>&</sup>lt;sup>52</sup> Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes (OJ 135, 31.5.1994, p. 5).

<sup>&</sup>lt;sup>53</sup> Judgment of 13 May 1997, Germany v Parliament and Council, C-233/94, EU:C:1997:231, para 55.

<sup>&</sup>lt;sup>54</sup> Judgments of 22 May 2014, *Glatzel*, C-356/12, EU:C:2014:350, paras. 52 and 64; and of 5 July 2017, *Fries*, C-190/16, EU:C:2017:513, para. 59.

<sup>&</sup>lt;sup>55</sup> Judgment of 13 March 2019, *Poland* v *Parliament and Council*, C-128/17, EU:C:2019:194, para. 95.

<sup>&</sup>lt;sup>56</sup> Judgment of 22 November 2018, Swedish Match, C-151/17, EU:C:2018:938, para. 47.

<sup>&</sup>lt;sup>57</sup> Gauweiler and Others, op. cit., para. 75 and Weiss and Others, op. cit., para. 91.

<sup>&</sup>lt;sup>58</sup> See *Glatzel*, op. cit., para. 52.

<sup>&</sup>lt;sup>59</sup> Poland v Parliament and Council, C-626/18, op. cit., para. 95.

That wide margin of assessment is recognised to the legislature in the different stages of the legislative process. Thus, it covers not only the "definition of the objectives to be pursued... and choice of the appropriate means of action"<sup>60</sup>, "but also, to some extent, to the finding of the basic facts".<sup>61</sup> The EU judge is thus not allowed to "substitute [his] assessment of scientific and technical facts for that of the legislature on which the Treaty has placed that task".<sup>62</sup>

In addition, the Court will take into account the evolving nature of the available data. When "the [EU] legislature has to assess the future effects of legislation to be enacted although those effects cannot be accurately foreseen, its assessment is open to criticism only if it appears manifestly incorrect in the light of the information available to it at the time of the adoption of the legislation".<sup>63</sup> The validity of an EU measure "cannot depend on retrospective assessments of its efficacy".<sup>64</sup>

The methodological approach followed in the Gauweiler and Weiss judgments reveals no novelty or even originality in this respect. In these judgments, the Court made clear, first, that "the principle of proportionality requires that acts of the EU institutions should be suitable for attaining the legitimate objectives pursued by the legislation at issue and should not go beyond what is necessary to achieve those objectives".65 However, "since the ESCB is required, when it prepares and implements an open market operations programme [such as the PSPP], to make choices of a technical nature and to undertake complex forecasts and assessments, it must be allowed, in that context, a broad discretion".66 Moreover, in Weiss, the Court added that the assessment of the PSPP must be made based on the elements available "at the date of adoption of [the disputed decision]"67, thus applying the principle that I have just mentioned. In other words, the ECB decisions establishing the OMT programme and the PSPP concerning purchase of public sector assets on secondary markets touch on an inherently political and complex area, which justifies limiting the Court's review of proportionality to manifest errors of assessment or misuse of powers. Following a careful examination of the monetary and financial conditions of the euro area, as highlighted in the ESCB's macroeconomic analyses, the Court decided that none of the decisions at issue went manifestly beyond what was necessary to attain the ECB's objective of price stability.

<sup>&</sup>lt;sup>60</sup> Judgment of 15 April 1997, *Bakers of Nailsea*, C-27/95, EU:C:1997:188, para. 32.

<sup>&</sup>lt;sup>61</sup> Poland v Parliament and Council, C-626/18, op. cit., para. 97.

Poland v Parliament and Council, C-128/17, op. cit., para. 95; and judgment of 21 June 2018, Poland v Parliament and Council, C-5/16, EU:C:2018:483, para. 150.
Judgment of 7 September 2006, Spain v Council, C 310/04, EU:C:2008:521, para.

<sup>&</sup>lt;sup>63</sup> Judgment of 7 September 2006, Spain v Council, C-310/04, EU:C:2006:521, para. 120.

<sup>&</sup>lt;sup>64</sup> Judgment of 17 October 2013, *Schaible*, C-101/12, EU:C:2013:661, para. 50.

<sup>&</sup>lt;sup>65</sup> See *Weiss and Others*, op. cit., para. 72.

<sup>&</sup>lt;sup>66</sup> ibid., para. 73, quoting para. 68 of *Gauweiler and Others*, op. cit.

<sup>&</sup>lt;sup>67</sup> Weiss and Others, op. cit., para. 75. See also Gauweiler and Others, op. cit., paras. 72, 74 and 80.

Here, I should insist that in that limited judicial review of proportionality, there is *no room* for an ultimate "balancing exercise" in which the Court weighs the benefits for price stability against the negative effects on economic and social policy. Balancing these competing factors requires a complex policy assessment, which lies at the very heart of the ECB's powers under EU primary law and which the Court is simply not entitled to call into question. That approach is *fully consistent with the methodology applied by the Court* when reviewing the legality of EU action in the other areas to which I referred. Against that background, I cannot agree with the *Bundesverfassungsgericht* in its decision of 5 May 2020 might be valid under German constitutional law, but cannot be reconciled with the methodology carefully developed by the CJEU over the years concerning judicial review of proportionality as a general principle of EU law.

I cannot insist enough, moreover, that it is for the Court only, which has an exclusive competence to declare EU acts invalid, to determine the scope of that competence. If a court in a Member State could declare unilaterally that an EU measure violates the principle of proportionality, following its own assessment of the objectives pursued by that measure weighed against other public interests, there would be no guarantee that the public interests of the EU as a whole would be taken into account. On the contrary, the risk would be very high that the national court would take into account only the interests of the Member State to which it belongs, or what it believes is in the interest of all or part of that Member State's population. Such a unilateral course of action would not only show disrespect towards the other Member States and their peoples that continue to honour the Treaties on a reciprocal basis<sup>69</sup>, but would also be plainly incompatible with the statement made by the Court in its Opinion 2/13 that "[i]n order to ensure that the specific characteristics and the autonomy of th[e EU] legal order are preserved, the Treaties have established a judicial system intended to ensure consistency and uniformity in the interpretation of EU law".70

As the judgment in the *Berlusconi and Fininvest* case<sup>71</sup> confirms, these structural principles apply to measures falling within the scope of the economic and of the monetary union with the same force. That case concerned prudential supervision of the acquisition of a qualifying holding

<sup>&</sup>lt;sup>68</sup> BVerfG, 5 May 2020, op. cit., para 138.

<sup>&</sup>lt;sup>69</sup> Lenaerts, K., "No Member State is More Equal than Others", Verfassungsblog, 8 October 2020, https://verfassungsblog.de/no-member-state-is-more-equal-thanothers/

<sup>&</sup>lt;sup>70</sup> Opinion 2/13 (Accession of the European Union to the ECHR) of 18 December 2014, EU:C:2014:2454, para. 174 (emphasis added).

<sup>&</sup>lt;sup>71</sup> Judgment of 19 December 2018, *Berlusconi and Fininvest*, C-219/17, EU:C:2018:1023.
in a credit institution in Italy under various EU instruments.<sup>72</sup> The Italian Council of State had doubts, in essence, as to whether national courts had jurisdiction to review the legality of preparatory acts adopted by the competent Italian supervisory authorities, including the Banca d'Italia, in a procedure leading up to a decision of the ECB. The Court ruled that there was no such jurisdiction. It emphasised that intervention by those national authorities formed part of a procedure in which the latter only assume preparatory functions and in which the ECB retains exclusive competence to decide whether to authorise the proposed acquisition or not. In that context, no risk could be taken in terms of judicial review at national level that might cast doubt on the validity of the decision that the ECB ultimately adopted. Such judicial review would undermine the effectiveness of the decision-making process in the context of the Banking Union's single supervisory mechanism and compromise "the Court's exclusive jurisdiction to rule on the legality of ... [the EU institution's] final decision... in particular where [that] institution's decision follows the analysis and the proposal of those [national] authorities".73

#### 2.2 Fundamental rights as a limit to limited judicial review

Respect for fundamental rights of course limits the margin of assessment that EU institutions or bodies enjoy when they adopt an EU act. It would clearly take us too far to examine that issue exhaustively in this speech, but a few illustrations are certainly worth mentioning.

The *first illustration* that I want to mention is the *Digital Rights Ireland* case<sup>74</sup>, which arose from requests for a preliminary ruling by the *Verfassungsgerichtshof* (Constitutional Court) in Austria and the High Court of Ireland. In that judgment, the Court invalidated Directive 2006/24/EC<sup>75</sup> (on data retention). The Directive obliged telephone and internet providers to retain bulk metadata that made it possible, in particular, to know the identity of the person with whom the user had communicated and the means by which that communication had been made, as well as to identify the time and the place of the communication. The Court, without denying the existence of a margin of assessment for the EU legislature, decided that that directive imposed a disproportionate limitation on the rights to

<sup>&</sup>lt;sup>72</sup> In particular, Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338) and Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

<sup>&</sup>lt;sup>73</sup> Berlusconi and Fininvest, op. cit., paras 49 and 50.

<sup>&</sup>lt;sup>74</sup> Judgment of 8 April 2014, Digital Rights Ireland and Others, C-293/12 and C-594/12, EU:C:2014:238.

<sup>&</sup>lt;sup>75</sup> Directive 2006/24/EC of the European Parliament and of the Council, of 15 March 2006, on the retention of data generated or processed in connection with the provision of publicly available communications services or of public communications networks and amending Directive 2002/58/EC (OJ L 105, 13.4.2006, p. 54).

privacy and to the protection of personal data in that it failed, in particular, to limit the retention of data to what was strictly necessary to the protection of public interests and also to set out either substantive or procedural criteria determining the circumstances under which national authorities could have access to the data.<sup>76</sup> It noted in that context "the important role played by the protection of personal data in the light of the fundamental right to respect for private life", which implies a reduced discretion of the EU legislature.<sup>77</sup> The Court confirmed that analysis in *Tele 2 Sverige*<sup>78</sup>, a case which raised, in essence, the same issues but concerned Member State legislation. That judgment offers a first illustration of the fact that the Court applies the proportionality requirement of Article 52(1) of the Charter of Fundamental Rights of the EU and by the Member States consistently.

That said, other cases illustrate that the EU legislature keeps a wide margin of assessment to adopt measures involving limitations of a fundamental right in so far as that limitation is commensurate to the importance of the public interests pursued. The judgment in Philip Morris Brands delivered on 4 May 2016 offers an illustration in the area of public health.<sup>79</sup> In the main proceedings, tobacco producers challenged the validity of a number of provisions of Directive 2014/40/EU<sup>80</sup> (concerning tobacco products). One of them precluded cigarette producers from including, on the labelling of unit packets and on outside packaging, elements and features such as to promote a tobacco product or encourage its consumption. The referring court (the High Court of Justice of England and Wales) asked the Court to examine the validity of that prohibition in the light of the freedom of expression guaranteed in Article 11 of the Charter and the principle of proportionality. The Court admitted that that prohibition constitutes an interference with a business's freedom of expression and information. It nevertheless regarded that interference as justified by the need to protect human health. In its examination of proportionality, the Court observed that "discretion enjoyed by the EU legislature, in determining the balance to be struck [between various fundamental rights and legitimate general interest objectives], varies for each of the goals justifying restrictions on that freedom and depends on the nature of the activities in question".81 Considering scientific evidence of the harmful effects of tobacco consumption and exposure to tobacco smoke, the degree of human health protection sought by the provision at issue "outweighed" the commercial interests put forward by the tobacco producers.<sup>82</sup> Referring to the high level

<sup>&</sup>lt;sup>76</sup> Digital Rights Ireland and Others, op. cit., paras 56-65.

<sup>&</sup>lt;sup>77</sup> ibid., para 48. See also, to that effect, judgment of 9 November 2010, Volker und Markus Schecke and Eifert, C-92/09 and C-93/09, EU:C:2010:662, para. 77.

<sup>&</sup>lt;sup>78</sup> Judgment of 21 December 2016, *Tele2 Sverige and Watson and Others*, C-203/15 and C-698/15, EU:C:2016:970.

<sup>&</sup>lt;sup>79</sup> Judgment of 4 May 2016, *Philip Morris Brands and Others*, C-547/14, EU:C:2016:325.

<sup>&</sup>lt;sup>80</sup> Directive 2014/40/EU of the European Parliament and of the Council of 3 April 2014 on the approximation of the laws, regulations and administrative provisions of the Member States concerning the manufacture, presentation and sale of tobacco and related products and repealing Directive 2001/37/EC (OJ L 127, 29.4.2014, p. 1).

<sup>&</sup>lt;sup>81</sup> Philip Morris Brands and Others, op. cit., para. 155.

<sup>&</sup>lt;sup>82</sup> ibid., para. 156.

of human health protection which not only the Treaties but also the Charter itself require in the definition and implementation of all EU policies and activities, the Court expressly rejected the applicants' claim that the objectives pursued by the provision at issue could be achieved by less restrictive measures, such as adding supplementary health warnings. The Court therefore concluded that the provision at issue breached neither Article 11 of the Charter nor the principle of proportionality.

The second illustration concerns decisions which the Commission adopts to sanction undertakings that infringe EU competition rules contained in Articles 101 and 102 TFEU.<sup>83</sup> For a long time, some judgments of the General Court referred to the Commission's "wide margin of assessment" when reviewing the legality of such decisions, even when they did not involve complex assessments of a technical or economic nature. Those judgments therefore suggested that only manifest errors of fact committed by the Commission should justify annulling the decision at issue. In the famous KME and Chalkor cases<sup>84</sup>, the Court of Justice, on appeal, unambiguously "invalidated" such limited judicial review, at least in so far as it applied outside complex economic assessments made by the Commission. Inspired by the Menarini judgment of the European Court of Human Rights<sup>85</sup>, the Court decided that the right which undertakings have to seek annulment of Commission decisions adversely affecting them should satisfy the requirements of an effective remedy before an independent and impartial tribunal within the meaning of Article 47 of the Charter. In principle, therefore, judicial review exercised in that context should allow the General Court to identify - within the limits of the action brought before it - all errors of law or of fact in the Commission's decision, and to review the appropriateness and proportionality of the fine that the Commission has imposed when requested to do so.86

### 2.3 "Process-oriented" review as a counterpart to limited review of substantive choices

The picture would not be complete without emphasising that limited review of proportionality is counterbalanced in the case-law by a "process-oriented review".<sup>87</sup> The Court has made clear on numerous occasions that the EU legislature must take into consideration "all the relevant factors and

<sup>&</sup>lt;sup>83</sup> Such decisions are adopted on the basis of Article 23 of Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty (OJ L 1, 4.1.2003, p. 1).

<sup>&</sup>lt;sup>84</sup> Judgments of 8 December 2011, KME Germany and Others v Commission, C-389/10 P. EU:C:2011:816, and Chalkor v Commission, C-386/10 P. EU:C:2011:815.

<sup>&</sup>lt;sup>85</sup> European Court of Human Rights, A. Menarini Diagnostics S.R.L. v. Italy, n° 43509/08, 27 September 2011.

Article 31 of Regulation 1/2003 provides: "The Court of Justice shall have unlimited jurisdiction to review decisions whereby the Commission has fixed a fine or periodic penalty payment. It may cancel, reduce or increase the fine or periodic penalty payment imposed."

<sup>&</sup>lt;sup>87</sup> Lenaerts, K., "The European Court of Justice and Process-Oriented Review", *Yearbook of European Law*, Vol. 31, No. 1, 2012, pp. 3-16, p. 4.

circumstances of the situation [which its] act was intended to regulate".<sup>88</sup> Therefore, it must "at the very least be able to produce and set out clearly and unequivocally the basic facts which had to be taken into account as the basis of the contested measures... and on which the exercise of [its] discretion depended".<sup>89</sup> That is what I described as "procedural proportionality".<sup>90</sup>

In some instances, that "process-oriented review" has led the Court to conclude that an EU measure is vitiated by a manifest error of assessment.<sup>91</sup> An illustration is the *Spain* v *Council* case, in which that Member State challenged the reform of a "support scheme for cotton" in the common agricultural policy. In its examination of the plea taken from a breach of the proportionality principle, the Court observed "that certain labour costs were not included and were thus not taken into consideration in the comparative study of the foreseeable profitability of cotton growing under the new support scheme which was used as the basis of the determination of the amount of the specific aid for cotton". The fact that those costs could be calculated and were likely to have an impact on the profitability of cotton production in the Spanish regions concerned, contributed to the Court's conclusion that the principle of proportionality had been infringed.<sup>92</sup>

However, once all the scientific studies and other relevant data have been sufficiently taken into account, the likelihood of finding that the measure is manifestly inappropriate is small. In the *Vodafone* case<sup>93</sup>, for example, the Court had to rule on the validity of Regulation (EC) No 717/2007<sup>94</sup> (on roaming on public mobile telephone networks within the EU). One of the issues raised by the referring court concerned the fact that the Regulation, which aimed to reduce roaming costs for consumers, imposed not only a ceiling for wholesale charges per minute, but also for retail charges. The Court observed that the Commission had carried out a comprehensive impact assessment, including alternatives and their economic impact, and took that in-depth market analysis into account to conclude that the provisions of the regulation under scrutiny did not infringe the proportionality principle.<sup>95</sup>

Once again, the *Weiss* judgment does not depart from that methodology. In its analysis of proportionality of the PSPP, the Court underlined that, when an EU institution enjoys broad discretion, "a review of compliance with

<sup>&</sup>lt;sup>88</sup> Poland v Parliament and Council, C-626/18, op. cit., para. 99 and judgment of 8 December 2020, Hungary v Parliament and Council, C-620/18, EU:C:2020:1001, para. 116.

<sup>&</sup>lt;sup>89</sup> See, for example, *Spain* v *Council*, op. cit., para. 123.

<sup>&</sup>lt;sup>90</sup> Lenaerts, K., "The European Court of Justice and Process-Oriented Review", op. cit., p. 7.

<sup>&</sup>lt;sup>91</sup> See, for example, Spain v Council, op. cit., paras 124 and 126.

<sup>&</sup>lt;sup>92</sup> ibid., para. 135.

<sup>&</sup>lt;sup>93</sup> Judgment of 8 June 2010, Vodafone and Others, C-58/08, EU:C:2010:321.

<sup>&</sup>lt;sup>94</sup> Regulation (EC) No 717/2007 of the European Parliament and of the Council of 27 June 2007 on roaming on public mobile telephone networks within the Community and amending Directive 2002/21/EC (OJ L 171, 29.6.2007, p. 32).

<sup>&</sup>lt;sup>95</sup> Vodafone, op. cit., paras 55-71.

certain procedural safeguards... is of fundamental importance".<sup>96</sup> It then observed that the ECB had indeed referred to the practice of other central banks and to various studies to substantiate its view that the massive acquisition of sovereign bonds on secondary markets would contribute to achieving the objective of an inflation rate below, but close to, 2%.<sup>97</sup>

## 3 The proportionality principle applied to Member State measures

As I explained at the beginning of my speech, the Member States are also required to respect proportionality when they act within the scope of EU law. As I will now illustrate, there is no discrepancy in the Court's case-law on either the scope of that principle or the way in which it is implemented depending on whether EU or Member State action is at issue.

Historically, the first cases in which the Court applied a proportionality test to measures adopted by the Member States concerned restrictions to *fundamental freedoms of the internal market*. It would be impossible of course to examine the abundant case-law on that issue in this keynote speech. I should emphasise nonetheless that many judgments illustrate the Court's willingness to reconcile judicial review of proportionality – and indeed the effectiveness of the fundamental freedoms guaranteed by the Treaties – with the recognition of a sufficient margin for the Member States to pursue legitimate public interests and thus carry out their own public policies in so far as they do not enter into conflict with EU secondary law.

A clear example is the Alpine Investments<sup>98</sup> case, one of the Court's landmark judgments concerning the freedom to provide services. In that case, a Dutch company challenged the prohibition in the Netherlands of the practice of cold calling (the making of telephone calls to individuals without their prior consent in writing) in order to offer them various financial services, including speculation on the commodities futures market. That practice had led to numerous "unfortunate investments". In summary, the Court concluded that that prohibition entailed a restriction on the freedom to provide services outside the Netherlands and accepted that safeguarding the reputation of the Netherlands' financial markets and protecting the investing public were imperative reasons of public interest capable of justifying such a restriction. In the last part of its analysis, however, the Court had to address Alpine Investments' argument that these objectives could equally be achieved by less restrictive measures. Alpine Investments referred, first, to the measure in force in another Member State (the United Kingdom), requiring broking firms to tape-record unsolicited telephone calls made by them, which, it argued, would be sufficient to protect consumers effectively. Second, it argued that the general prohibition on cold calling imposed an unnecessary burden on broking firms that have

<sup>&</sup>lt;sup>96</sup> Weiss and Others, op. cit., para. 30.

<sup>97</sup> ibid., para. 77.

<sup>&</sup>lt;sup>98</sup> Judgment of 10 May 1995, Alpine Investments, C-384/93, EU:C:1995:126.

never been the subject of complaints by consumers, suggesting that consumer protection could be effectively achieved by a prohibition targeting "problematic" broking firms. The Court rejected each of those alternative measures. It put forward a number of characteristics of the prohibition at issue (in particular the fact that it did not apply to customers who have given their written agreement to further calls) and concluded that that prohibition did not appear disproportionate to the objective that it pursued.

The underlying rationale is that proportionality cannot be used, in such a context, to substitute autonomous choices of the Member States made in areas in which they retain regulatory competence, in order to achieve a certain level of protection of a legitimate public interest. It only preserves the effectiveness of fundamental freedoms by requiring the Member States, in essence, to ensure that there is a *reasonable correlation* between any restriction placed on those freedoms and that legitimate public interest.

That margin is however without prejudice to other aspects of the principle of proportionality where Member State action entails a limitation of a natural person's fundamental rights or freedoms guaranteed under EU law.

A first aspect relates to the requirement of an individual assessment of that person's situation. Thus, in *Tjebbes*, the guestion referred to the Court concerned the conditions under which a Member State can deprive a person of her citizenship of that Member State, and hence of her EU citizenship rights, when that person is not a national of another Member State, without violating the status of that person as an EU citizen and that person's fundamental right to private and family life (protected by Article 7 of the Charter). In the main proceedings, Ms Tiebbes challenged a ministerial decision rejecting her request for a passport. That decision was based on a provision of the Law on Netherlands Nationality, which automatically entailed the loss of Netherlands nationality when certain conditions are met, without an individual assessment of the situation of the person concerned. In its answer, the Court, applying the proportionality principle, required the competent authorities to carry out "an individual assessment of the situation of the person concerned... in order to determine whether the consequences of... the loss of his citizenship of the Union might... disproportionately affect the normal development of his family and professional life".99

Another aspect concerns situations in which an EU legislative or regulatory act does not itself strike a balance between the interests and fundamental right(s) or principle(s) at issue and which calls for implementing measures at Member State level. In such a situation, it is for the latter "to *reconcile* the requirements of the protection of those various rights and principles at issue, striking a fair balance between them".<sup>100</sup> That requirement of a "fair

<sup>&</sup>lt;sup>99</sup> Judgment of 12 March 2019, *Tjebbes and Others*, C-221/17, EU:C:2019:189, para. 44.

<sup>&</sup>lt;sup>100</sup> Judgment of 17 December 2020, *Centraal Israëlitisch Consistorie van België and Others*, C-336/19, EU:C:2020:1031, para. 65.

balance" therefore applies in the same way as it does to the EU institutions when they decide to strike that balance themselves.<sup>101</sup>

The Grand Chamber judgment in Centraal Israëlitisch Consistorie van België and Others, delivered on 17 December 2020<sup>102</sup>, perfectly illustrates that point. In that case, the Constitutional Court of Belgium raised doubts as to the validity of a provision of Council Regulation (EC) No 1099/2009.103 In principle, that Regulation does not require the stunning of animals before their killing for "slaughter prescribed by religious rites", provided that such ritual slaughter takes place in a slaughterhouse. That exception to the principle of prior stunning sought to protect the freedom of religion guaranteed in Article 10 of the Charter. However, a separate provision of the Regulation allowed the Member States to "ensur[e] more extensive protection of animals at the time of killing". Making use of that possibility, the Flemish Region adopted a decree requiring, in the case of ritual slaughter, stunning which is reversible and cannot cause death. Religious organisations challenged the compatibility of that decree and, by extension, of the flexibility clause in the Regulation on which it was based, with, inter alia, freedom of religion. In its answer to the request for a preliminary ruling. the Court made it clear that that flexibility clause had to be interpreted, and applied by Member States, in a manner consistent with that freedom, as auaranteed in Article 10(1) of the Charter. Although the national decree at issue introduced a limitation on that freedom, the Court decided that that limitation did not violate Article 10(1) of the Charter. The Court emphasised in particular, first, that that limitation, which concerned only one aspect of ritual slaughter, did not prohibit ritual slaughter as such and therefore respected the essence of that freedom. Second, it referred to scientific consensus that prior stunning is the optimal means of reducing the animal's suffering at the time of killing. Those elements led the Court to conclude that the decree at issue in the main proceedings did not exceed the discretion which EU law confers on Member States to reconcile freedom of religion with animal welfare, the latter being a requirement imposed on the EU and its Member States in Article 13 TFEU.

#### 4 Conclusion

In this keynote speech, I have clarified the scope (and limits) of the proportionality principle in the EU legal order. Its many expressions and functions justify its classification among the *matrix principles* of that legal order.

A first lesson is that proportionality in EU law specifically concerns the way in which a competence is exercised and has therefore nothing to do with the very existence of that competence. Moreover, it appears from the

<sup>&</sup>lt;sup>101</sup> See, for example, the landmark judgment of 12 June 2003, *Schmidberger*, C-112/00, EU:C:2003:333, para. 77.

<sup>&</sup>lt;sup>102</sup> Centraal Israëlitisch Consistorie van België and Others, op. cit.

<sup>&</sup>lt;sup>103</sup> Council Regulation (EC) No 1099/2009 of 24 September 2009 on the protection of animals at the time of killing (OJ L 303, 18.11.2009, p. 1).

case-law I have examined that the "burden" which that principle creates for public bodies does not differ depending on whether the action at issue involves the EU or the Member States acting within the scope of EU law. In essence, proportionality offers in all cases the guarantee of a reasonable correlation between the measures envisaged or adopted and the objectives of the public interest pursued. That *conceptual coherence* is without prejudice to *variations* in the *application* of proportionality as a result of the specific aspects and circumstances of a given case, such as the reliability of the data that were taken into consideration, whether the action at issue entailed a limitation of fundamental rights or freedoms, or the fact that alternative measures offering the same degree of protection of the legitimate public interest pursued were obviously available.

The Court plays an essential role in ensuring that the proportionality principle is upheld across the EU legal order. Judicial review of proportionality cannot be unlimited, in order to maintain institutional balance and preserve the autonomy of the Member States to carry out policies in fields where they retain regulatory competence. A considerable number of the illustrations that I have used however demonstrate that that review is far from being an "empty shell". Judicial review of proportionality contributes not only to the effectiveness of EU law, including fundamental freedoms and fundamental rights, but also to the legitimacy of EU action and thus to the confidence that it inspires in EU citizens.

# Symposium on proportionality



## Legal Symposium on proportionality

#### **By Chiara Zilioli\***

A very substantial part of this book contains legal reflections and discussions on the principle of proportionality: almost a third of the ECB Legal Conference 2021 has been devoted to a Symposium dedicated to the study of and discussion on this principle. And this is not the first time a discussion on this topic has been organised at the ECB. Indeed, in the context of the 2021 Strategy Review, the ECB hosted a roundtable discussion between the Governing Council and a group of legal academics, some of whom have also contributed to this volume. Why is there such great interest in the proportionality principle at the ECB?

The increasing importance of legal discourse is a major recent development in central banking. Proportionality is one of those concepts that were previously thought to belong only to a specialised legal vocabulary but are now widely used and frame general debates on the past and future of the ECB. Discussions on proportionality are ubiquitous and inform many aspects of our policymaking.

In addition, recent developments in the jurisprudence of the Court of Justice of the European Union (CJEU) and of the national courts of various Member States have increased the attention paid to the principle of proportionality. When looking at the reasoning employed by these courts, it emerges that there are important differences both in the scope of the judicial assessments of proportionality and in the ways in which they are carried out in different legal frameworks.

The Symposium, which was organised in the framework of the ECB Legal Conference 2021 and the contributions to which are published in this book, continues the endeavour to shed light on the principle of proportionality and aims at further broadening the exchange and deepening the reflection. The keynote speech of the President of the Court of Justice, Koen Lenaerts, which introduced the Symposium, is a milestone in legal doctrine, and in its scholarly clarity, on the topic of proportionality in EU law.

#### 1 The proportionality principle

The proportionality principle is one of the general principles of EU law. It is enshrined in Article 5(4) of the Treaty on European Union, which states that "the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties". This is a principle that matters

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enormously to the ECB as an EU institution, as it posits how the law should be interpreted when applied to concrete cases. It can be seen as a bridge, through which the text of the law leaves the world of ideas and enters the world of facts to affect our daily lives. However, the exact interpretation of this principle has been the subject of considerable discussion. The meaning, nature, scope and use (by the legislator, the administration, and as an instrument of judicial control) of the principle of proportionality have been the subject of various interpretations as discussed in the doctrine of several countries. These issues have also been the subject of different pronouncements both of the CJEU and of the national courts of various Member States.

Two of the more recent judgments of the CJEU on the matter – *Gauweiler*<sup>104</sup> and *Weiss*<sup>105</sup> – have been very significant for our institution, as they concerned ECB monetary policy measures: Outright Monetary Transactions and the public sector purchase programme (PSSP) respectively. In both judgments, the Court referred to its previous case-law on the principle of proportionality and held that the principle requires, and here I quote, that "acts of the EU institutions should be suitable for attaining the legitimate objectives pursued by the legislation at issue and should not go beyond what is necessary to achieve those objectives". Of course, the principle and its interpretation predates the ECB and has the support of a long tradition of CJEU case-law.

In summary, the roundtable discussion and developments in the jurisprudence indicate that there are different interpretations, or, perhaps better, that there are differences in the meaning and use of the proportionality principle in different legal systems, including its application in the legislative, administrative and judicial functions. The next chapters, which contain the contributions of six distinguished panellists, shed new light on these issues.

#### 2 The Symposium on proportionality

The Symposium focuses, first, on the different meanings of the principle of proportionality in the EU legal order, both in the light of the various approaches followed by the CJEU, depending on the specific issue under consideration, and in the light of the jurisprudence of selected Member States. The three first chapters are devoted to this discussion.

**Dieter Grimm**, Professor emeritus at the Humboldt University Berlin and former German Federal Constitutional Court judge, focuses on proportionality from the perspective of German constitutional law, explaining its origins and some of the challenges posed by the application of the principle, including in the context of the COVID-19 pandemic.

<sup>&</sup>lt;sup>104</sup> Judgment of the Court of 16 June 2015, *Gauweiler and Others*, C-62/14, EU:C:2015:400.

<sup>&</sup>lt;sup>105</sup> Judgment of the Court of 11 December 2018, *Weiss and Others*, C-493/17, EU:C:2018:1000.

**Diana Urania Galetta**, Professor of Administrative Law at the University of Milan and Director of its Interdisciplinary Research Centre on Public Administration, speaks about the origin, development and dissemination of the EU law principle of proportionality across (and even beyond) Europe, considering the lessons that can be learnt from the CJEU, in particular, in the light of the *Weiss* judgment on the PSPP.

**Tomi Tuominen**, Lecturer in Law at the University of Lapland (Finland), addresses a very important question: if proportionality as a legal doctrine originates from the protection of individuals' rights, how can it be applied in the context of economic governance when no individual rights are at stake? Is a separate proportionality test required for cases relating to economic governance?

Thereafter the Symposium broadens the scope of the analysis. First, it investigates a possible proportionality taxonomy by focusing both on the jurisprudence of the CJEU and on the legislative activity of the Council. Then, a comparative analysis complements the European experience with a study of the way in which in third countries judicial activism and judicial restraint characterise the relationship between constitutional courts and democratically elected bodies. Finally, the way in which the EU legislator ensures respect for proportionality in the context of legislative activity is discussed.

Vasiliki Kosta, Assistant Professor of European Law at Leiden University, raises questions regarding the role that the principle of proportionality plays in EU law, and proposes a taxonomy based on the interest that the principle serves: it might support the review of interference with rights (rights proportionality), with Member States' powers (subsidiarity proportionality), or the review of unnecessary burdens imposed by legislation (burdens proportionality). At the same time, she explores some of the reasons why EU law might not be sufficiently clear on proportionality.

Iddo Porat, Associate Professor of Law at the College of Law and Business, Israel, brings an important perspective to the discussion, focusing on the origins and global spread of proportionality and the different forms it has taken in different parts of the world. The implications of the principle for judicial activism and the rule of law are an important focus of his presentation.

**Thérèse Blanchet**, Director General of the Legal Service of the Council of the European Union, who has been closely associated with several intergovernmental conferences and Treaty revisions (in particular the Amsterdam Treaty, the Constitutional Treaty and the Lisbon Treaty) and their implementation, presents some observations on the relevance of the principle of proportionality for the legislative activity of the Council.

I am convinced that the high level and the complementarity of the scholarly reflections on the principle of proportionality, its scope, its application and its control, which have been collected in this book, will make it an essential tool and a starting point for further work in this field.

## Proportionality in German constitutional law

**By Dieter Grimm\*** 

#### 1 The constitutionalisation of proportionality

The principle of proportionality originated towards the end of the 19th century in German administrative law. In their effort to strengthen the rule of law, the administrative courts developed it to limit the discretion of the police when it interfered with the liberty and property of citizens. Police measures were regarded as legal only if they were suitable to achieve their purpose and if less intrusive means to achieve the purpose equally well were not available. In a few cases, a third element was added, the appropriateness or reasonableness of the measure. In this understanding, it soon became an integral part of administrative law. German lawyers were familiar with it long before the Basic Law (*Grundgesetz*) was adopted.

Under the Basic Law, which considerably strengthened the role of fundamental rights in Germany, the German Constitutional Court elevated the principle of proportionality to the constitutional level, although it had not found expression in the text of the constitution, and enhanced its meaning beyond the role it had played in administrative law. However, unlike other important innovations in the field of fundamental rights<sup>106</sup>, one cannot name a single judgment that introduced the proportionality test. Instead, it crept in and took shape on a case-by-case basis, until it achieved the form that is now routinely practised.

The consequence of this constitutionalisation was that not only administrative but also legislative acts were submitted to a proportionality test. The consequences were far-reaching. The space for political action shrank beyond the limits drawn by the text of the Basic Law, while the space for judicial decision-making increased correspondingly. However, it would be rash to assume that enhancing judicial power was the motive for giving the principle a constitutional status. Rather, one has to distinguish between intent and effect. The intent was strengthening fundamental rights; the side effect the growing importance of the Constitutional Court.

The Court applies the principle of proportionality whenever a fundamental freedom is limited by law or pursuant to a law. It thus complements the written limitation clauses that the Basic Law attaches to the various rights.

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<sup>&</sup>lt;sup>106</sup> For an overview see Grimm, Dieter (2015), "The role of fundamental rights after sixty-five years of constitutional jurisprudence in Germany", 13 I-CON, pp. 9-29.

Since some limitation clauses are not very restrictive, even if important rights such as the right to life and health are at stake, it can be said that proportionality, as a limit on limitations of fundamental rights now carries the main burden of protecting fundamental rights. If laws are found to be unconstitutional in Germany, it is mostly on the ground of disregard of proportionality requirements.

#### 2 Field and mode of application

The proportionality principle basically operates with the three prongs already developed in administrative law. However, one preliminary prong was added by the jurisprudence of the Constitutional Court and the third prong, also called proportionality in the strict sense (the balancing prong), has considerably increased in importance, compared to its rare use in early administrative law. Today, the majority of laws that do not withstand the proportionality assessment fail on the final step of the test, whereas the preceding steps single out some clearer cases of violation.

The preliminary step concerns the purpose of the law that limits a fundamental right. Only a legitimate purpose can justify a limitation of fundamental rights. Every purpose that is not outlawed by the constitution counts as legitimate. Within the boundaries of the constitution, the legislature may pursue every purpose it deems worth being pursued. It does not have to be an important purpose. Questions of importance play a role when it comes to the final step of balancing. Asking them already in connection with the law's purpose would be premature. It would not do justice to cases where the law pursues a less important purpose but limits a right only minimally. Laws that fail on this preliminary step are extremely small in number.

The step is nevertheless indispensable because without an exact determination of the law's purpose it would be impossible to proceed to the following stages. These stages concern a means-end relationship. The means that the legislature chooses must be suitable to achieve the purpose of the law. In the vast majority of cases, this will not present a problem. The number of laws that fail on this step is also very small. In addition, the means chosen must be necessary to achieve the purpose of the law. This requirement is met if no less intrusive means that would similarly achieve the purpose are available. It is sufficient that the law contributes to achieving the purpose; a full effect is not required.

Whether the law is suitable to achieve its purpose and whether means exist that are less intrusive, but equally effective, are empirical and not legal questions. Sometimes, these questions can be answered by the court on the basis of general knowledge or experience, while at other times external expertise is needed. Quite often, there is insufficient information about the effects of a law or the information provided is controversial. Under such circumstances, the legislature relies on prognostics to assess the effect of the measure chosen. In the area of facts or probabilities, courts have no superior insight. Therefore, the opinion of the legislature holds, at least for

the time being, provided that it has made reasonable attempts to explore the options. But the court may oblige the legislature to observe the development and repair the law if the expected effect does not materialise or has unforeseen negative effects on fundamental rights.

The last step, proportionality in the strict sense, differs from the preceding ones in that the fundamental right that is limited by the law comes in. The suitability and necessity steps remain within the orbit of the impugned law. They concern the relationship between the purpose that the law pursues and the means that it employs in order to achieve the purpose. By contrast, the last prong exceeds a mere means-end relationship. It requires an assessment of losses and gains, losses for the fundamental right that is limited by the law and gains for the legal good in whose interest the right is limited, often itself a fundamental right. On the basis of this assessment, a balancing of the losses and gains is undertaken.

It is of fundamental importance to understanding the proportionality test that only those consequences of the impugned law that affect the legal goods involved, i.e. the right that is limited and the right or other legal good that profits from the limitation, are taken into account. Balancing is not about the consequences of the law for extra-legal goods, be they political, economic, religious or whatever other purposes the legislature may pursue. Such consequences may be of importance for the legislative, but not for the judicial evaluation. Policy choices that have been found to pursue a legitimate purpose are not questioned at the balancing stage.

Whether the principle of proportionality also applies if equality rights are affected is contested. Originally, the Constitutional Court limited the applicability of the equal protection clause in Article 3, section 1 of the Basic Law to cases of arbitrary differentiation. Later on, it began to use proportionality considerations, when it ruled that the equal protection clause is violated if two groups of people are treated differently although there are no differences of such a nature or importance between them that could justify the different treatment. In later decisions, the Court even talked of a "smooth" (*stufenlos*) yardstick that orients itself to the principle of proportionality.<sup>107</sup>

Collisions of fundamental rights constitute a special case. Since no hierarchy among the various fundamental rights is acknowledged, the legislature has to strike a reasonable balance between the colliding rights. This is particularly the case if the legislature is constitutionally obliged to protect fundamental rights against menaces stemming from private actors (the so-called duty to protect<sup>108</sup>). Private actors themselves act under the protection of fundamental rights so that fulfilling the duty to protect one right requires restrictions of another right. Under these circumstances, the legislature must not go too far in limiting a right on the one hand, and not do too little to protect the menaced right on the other. This points in the

<sup>&</sup>lt;sup>107</sup> BVerfGE 129, 49 at 69 (2011).

<sup>&</sup>lt;sup>108</sup> See Grimm, Dieter (2005), "The Protective Function of the State", in Nolte, Georg (ed.), *European and US Constitutionalism*, Cambridge University Press, pp. 137-155.

direction of the final prong of the proportionality test, whereas the necessity step is of no help in a three-pole constellation.

Only one fundamental right is not subject to balancing, namely human dignity, guaranteed in Article 1, section 1 of the Basic Law. In Germany, dignity is regarded as an absolute right. This means that it may not be limited. Rather, every limitation constitutes a violation, whereas all other fundamental rights allow limitations, albeit only under the condition of proportionality. In the event of a collision between dignity and another fundamental right, dignity always prevails. This entails the need to draw the scope of Article 1, section 1 of the Basic Law rather narrowly. Hence, there are not many cases in which dignity applies directly, but very many where dignity comes in indirectly as an element in the interpretation of another right.

Outside the area of fundamental rights, proportionality does not apply. The only exception that has been made so far concerns bans on political parties that attempt to overthrow the free and democratic order (Article 21, section 2 of the Basic Law). Here, the Court started to apply the principle in its judgment of 2017 on the National Democratic Party.<sup>109</sup> It is no longer regarded as sufficient that a party seeks to undermine or abolish the free and democratic order as stipulated in the Basic Law. The party must, in addition, pose a serious and present threat to that order. Otherwise, the ban would be regarded as disproportionate.

In other subject matters outside the Bill of Rights, the principle of proportionality is not applied, especially not regarding the division of competencies among the Bund and the Länder. In this respect proportionality in Germany and in Europe differs. According to Article 5(4) of the Treaty on European Union, the principle has to be observed in every exercise of a competence of the European Union (EU) and by all its organs and institutions. This makes handling the European proportionality principle more difficult than handling the German one. While fundamental rights furnish a relatively clear point of reference for applying the principle, a similar point is lacking outside the field of fundamental rights, at least when there is no longer a means-end relationship, but proportionality in the narrower sense is at stake.<sup>110</sup>

Applying the proportionality principle has become a routine operation. Law students learn it in the early semesters. The legislature applies the principle and balances when it drafts a law. Administrative agencies apply it and balance when their activity encroaches upon a fundamental right. Administrative courts apply it and balance when they check administrative acts that have a limiting effect on fundamental rights. Civil law courts apply it if their judgments affect fundamental rights. The Constitutional Court applies it and balances when it reviews a law as to its compatibility with

<sup>&</sup>lt;sup>109</sup> BVerfGE 144, 20 (2017).

<sup>&</sup>lt;sup>110</sup> See Kosta, Vasiliki (2021), "The Principle of Proportionality in EU Law", in this volume, p. 94.

fundamental rights or when it examines administrative acts or decisions of lower courts that restrict a fundamental right.

Criticism of the results in individual cases occurs often, while fundamental criticism is extremely rare. The worldwide reception of proportionality, either in more recent constitutions or through the jurisprudence of constitutional or supreme courts, signals that it is generally regarded as helpful in solving collisions between various fundamental rights or between fundamental rights and other legally protected goods. If the principle of proportionality is criticised, it is because of the balancing stage. Some critics think that this is not a legal, but a political operation, and hence not the business of courts as, in their view, policy decisions are reserved for the political branches of government. Others fear that there is no way of balancing rationally, so that the results are not foreseeable and thus cannot claim legal validity.

The criticism is particularly vivid in the United States, where other techniques to protect fundamental rights are in use. However, it has not prevented the worldwide expansion of the principle of proportionality, not only in civil law systems but also in common law countries. Yet, the various jurisdictions may develop their own variants of proportionality. Consequently the European courts and some other courts hesitate to apply the last prong, but some consider elements that one would expect here at the necessity or minimal impairment stage.<sup>111</sup>

Of course, no court or organ of another country or of the EU is obliged to apply proportionality in the German way. But it follows a certain logic, and reducing it to the suitability and necessity prong would severely curtail its impact, because fundamental rights in whose interest the proportionality principle was developed, re-enter the test only at the last step, the balancing stage. Even gross encroachments on important fundamental rights would escape constitutional scrutiny.<sup>112</sup>

The criticism of proportionality is in my view not well founded, although the way in which it is handled may occasionally deserve criticism. Courts are sometimes inclined to juxtapose big values that appear behind a legal conflict, such as liberty versus health, to choose a topical example. However, this is not the way in which legal questions present themselves. Laws, such as those enacted in the fight against the pandemic, it must be emphasised, neither abolish liberty nor produce health. They limit a certain liberty in a certain aspect and to a certain degree in order to enhance public

<sup>&</sup>lt;sup>111</sup> Canada is an example, see Grimm, Dieter (2007), "Proportionality in Canadian and German Jurisprudence", 57 *University of Toronto Law Journal*, pp. 383-397.

<sup>&</sup>lt;sup>112</sup> The following example may illustrate this. Imagine that a law which allows a policeman to shoot a perpetrator to death if this the only remaining means to save an innocent life (a legal provision that many countries have) were extended from the protection of life to the protection of property. Here, the right to life of the perpetrator on the one hand, and property interests on the other are at stake. Let's assume that the law is reviewed as to its proportionality, but without the balancing stage, the requirements of a legitimate purpose, protecting property, of suitability to achieve this end and of necessity (which is inbuilt in the text of the law) would be met. Without balancing, the law would be constitutional. Property prevails over life.

health in a certain aspect and to a certain degree. Balancing concerns these concrete effects.

In order to enjoy the benefits of proportionality, but avoid its risks, it is therefore of utmost importance that the two scales of the balance are filled accurately before the balancing itself starts. One scale is filled with the fundamental right that is limited. It must be determined as precisely as possible which aspect of the right is affected by the law (for example, the core or the periphery) and how intensively it is affected. The other scale is filled with the legal good in whose interest the right is limited. Again, the question is how important this good is and what exactly it gains through the limitation of the right. If so prepared, the balancing remains within the realm of the law, legal gains and legal losses are compared, and it can be performed rationally and with foreseeable results.

It should be added that in Germany the principle of proportionality applies twice. It applies first with regard to the law, i.e. in abstract terms. It applies secondly with regard to the application of the law in a concrete case or controversy. Hence, the principle is not yet sufficiently observed if the law that limits a fundamental right is found to be proportional. The constitution extends its influence also to the application of the law. The concrete measure taken by the administration in implementing the law and, if challenged, approved by the ordinary courts, has to be proportional as well. If the law is already flawed, the act of application has no basis in the law and is therefore unlawful. If the law is correct, the act of application may nevertheless constitute an independent violation of proportionality.

#### 3 Proportionality in the pandemic

The current pandemic has brought the importance of proportionality to everybody's attention. No political statement, no news on the pandemic fails to mention proportionality. But the pandemic has also brought the limits of proportionality to the fore. Mostly, the principle applies in bipolar cases. There is a specific danger for a legally protected good, which the legislature wants to cope with. In order to do that, it sees the necessity of restricting a fundamental right, mostly a right of someone from whom the danger emanates. Determining the losses and gains for the conflicting legal goods is normally rather easy and so is balancing.

The pandemic differs from this constellation in its enormous complexity. The threat posed by the COVID-19 virus is not territorially limited. It affects the life and health of a whole population. Life and health are among the most important goods protected by fundamental rights. The state is under a positive constitutional duty to take the necessary steps to protect them. The primary task is to prevent infections. The secondary task is to keep the health system effective for those who have nevertheless been infected. The most important purpose of state measures is therefore, at least as long as not enough people have been vaccinated, to avoid contact. This means that, on the one hand, all spheres of private and social life are affected and may be subject to restrictions. On the other hand, there are fields where restrictions would be counterproductive (health institutions, food supply etc. must keep going) or too costly, not only in terms of money, but also in terms of human risks (school is suspended, family visits are prohibited). The fight against the virus requires a set of various measures that are interconnected. If restrictions are loosened in one area, they have to be tightened in others. Equal treatment becomes a problem. In multipolar constellation of the magnitude of this crisis, rational balancing threatens to exceed legal capacities.

This is not to say that the courts should refrain from checking measures taken at political level. Constitutional courts can ask whether such measures are based on the available knowledge. They can scrutinise the overall concept as to its plausibility and examine whether any of the measures are clearly incompatible with the proportionality principle. But they should apply it with particular care. If there is a case for judicial self-restraint it is this. Still, the Federal Constitutional Court may have been all too cautious when reviewing the "*Bundesnotbremse*" in its recent judgment of October 2021.<sup>113</sup>

<sup>&</sup>lt;sup>113</sup> Bundesverfassungsgericht, Judgment of November 19, 2021 – 1 BvR 781/21 and 6 others.

The EU law principle of proportionality and judicial review: its origin, development, dissemination and the lessons to be learnt from the Court of Justice of the European Union

By Diana-Urania Galetta\*

#### The development of general principles of European Union law and its consequences: introductory remarks

If it is questionable that the reference to "any rule of law" contained in the second paragraph of Article 263 of the Treaty on the Functioning of the European Union (TFEU)<sup>114</sup> can be taken as one of the bases for the development of the general principles of European Union (EU) law, there can on the contrary be no doubt that the second paragraph of Article 340 TFEU, which mentions "the general principles common to the laws of the Member States", is an essential point of reference in this respect. The latter provision has remained essentially unchanged since the Treaty of Rome<sup>115</sup>, and has been recently restated in Article 41(3) of the Charter of Fundamental Rights of the European Union in the context of the right to good administration. The well-known 1957 judgment in *Algera* is indeed clear evidence that the CJEU has followed from the outset the approach described in Article 340 TFEU far beyond the specific hypothesis referred to therein (the non-contractual liability of the EU).<sup>116</sup>

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<sup>&</sup>lt;sup>114</sup> The Court of Justice of the European Union (CJEU) shall have jurisdiction "on grounds of lack of competence, infringement of an essential procedural requirement, infringement of the Treaties or of any rule of law relating to their application", Article 263 TFEU, second paragraph.

<sup>&</sup>lt;sup>115</sup> See Article 215(2) of the 1958 Treaty establishing the European Economic Community (EEC).

<sup>&</sup>lt;sup>116</sup> Joined Cases 7/56, 3/57-7/57, Algera and Others v Assemblée commune, EU:C:1957:7. See more extensively in the Opinion of Advocate General Lagrange, EU:C:1957:6.

According to the doctrinal opinion I agree with, only the CJEU is entitled to declare the existence of a principle as a general principle of EU law.<sup>117</sup> This fact has relevant implications as to the respective ranks held by these principles within the system of sources of EU law. To cut a long story short<sup>118</sup>, the Treaties do not yet contain a provision similar to that set out in Article 38 of the Statute of the International Court of Justice (according to which case-law is one of the sources of international law, albeit of a secondary rank). In order to clarify the position of case-law in the hierarchy of sources of EU law, one has to take into account the ways in which case-law can be overridden. As only the Member States can in fact, in their capacity as "Lords of the Treaties", amend primary law in order to cJEU's case-law is ranked below primary law.

The ranking of the general principles of EU law above EU secondary law has two important practical consequences. First, the non-compliance of a provision of EU secondary law with a general principle of EU law is one of the most important reasons for the annulment of EU secondary law by the CJEU. Second, such principles are binding on Member States in the same way as primary law, as they are used by the CJEU to interpret the provisions of primary law. The CJEU has, in fact, repeatedly stated that the general principles of EU law must also be applied by Member State authorities when they implement EU law in their own national legal orders.<sup>119</sup>

As a consequence of all of the above, over time the CJEU has become a very powerful vehicle of diffusion of general law principles across the Member States<sup>120</sup>, and the principle of proportionality is one of the most peculiar and interesting examples of this phenomenon.<sup>121</sup>

<sup>&</sup>lt;sup>117</sup> See, for a detailed explanation, Ziller (2014), p. 334.

<sup>&</sup>lt;sup>118</sup> See further in Galetta (2018), para 4.

<sup>&</sup>lt;sup>119</sup> The Court of Justice expressly made it clear as early as in C-230/78 *Eridania*, EU:C:1979:216, that "general principles of Community law... are binding on all authorities entrusted with the implementation of Community provisions". See also C-258/78, *Nungesser*, EU:C:1982:211.

<sup>&</sup>lt;sup>120</sup> See Schwarze (2010), passim; Schwarze (2012), p. 117.

<sup>&</sup>lt;sup>121</sup> See Diana-Urania Galetta, "General Principles of EU Law as Evidence of the Development of a Common European Legal Thinking: the Example of the Proportionality Principle (from the Italian Perspective)", in Blanke, H.-J., Cruz Villalón, P., Klein, T., Ziller, J. (eds.), *Common European Legal Thinking: Essays in Honour of Albrecht Weber*, Springer, pp. 221-242.

#### 1 Origins and development of the principle of proportionality in EU law

### 1.1 Its origins: the German principle of proportionality and its three-step review

Turning to the specific analysis of the principle of proportionality in EU law, I would like to begin by pointing out that the CJEU, in its earliest references to this principle in its case-law of the 1950s and 1960s, clearly borrowed it from German law<sup>122</sup>: judgments like *Fédération Charbonnière* of 1956, *Società acciaierie San Michele* of 1962 and *Schmitz* of 1964 are, to me, clear indications of that!<sup>123</sup>

It is therefore useful to briefly refer, first of all, to the German principle of proportionality, which, as a *terminus tecnicus* of legal language, was used for the first time as early as 1802.<sup>124</sup> And the famous descriptive formula offered by Fritz Fleiner<sup>125</sup>, according to which the police should not shoot sparrows with cannons<sup>126</sup>, dates back more than a century.<sup>127</sup>

To this day, in German law the principle of proportionality is still closely linked to fundamental rights<sup>128</sup>, given its genesis in the context of police law (Polizeirecht).<sup>129</sup> The famous 1882 Kreuzberg judgment of the Prussian Higher Administrative Court (preußisches Oberverwaltungsgerichts) was a milestone in its development, making it clear that the pursuit of the common good cannot imply the total sacrifice of the individual and of his legal position (in this case the right to private property).<sup>130</sup> This judgment was

<sup>&</sup>lt;sup>122</sup> There is no contradiction, though, with the position of Craig (2017), p. 145 et seq., who simply contests the idea that proportionality in law is a modern creation, originating in German jurisprudence, by trying to cast historical light on the role played by the concept of proportionality in UK law (dating back to the 16th century doctrine on the legal control of discretion).

<sup>&</sup>lt;sup>123</sup> C-8/55, Fédération *Charbonnière*, EU:C:1956:11; Joined Cases 5-11, 13-15/62, Società acciaierie San Michele, EU:C:1962:46; C-18/63, Schmitz, EU:C:1964:15.

<sup>&</sup>lt;sup>124</sup> See von Berg (1802), p. 67.

<sup>&</sup>lt;sup>125</sup> A pupil of Otto Mayer and himself one of the founding fathers of German administrative law. See Giacometti (1938), p. 462.

<sup>&</sup>lt;sup>126</sup> More precisely, Fleiner (1912), p. 354 stated that "The office of the police is to adopt the 'necessary institutions' to maintain public security and order. The limitation of individual freedom must never exceed what is absolutely necessary. The police should not shoot at sparrows with cannons".

<sup>&</sup>lt;sup>127</sup> Otto Mayer himself expressed this same view: Mayer (1924), p. 223. Many other German-speaking authors have also done so. For a detailed discussion of the meaning of the principle of proportionality in German academic literature, see D'Avoine (1994), p. 48.

<sup>&</sup>lt;sup>128</sup> As to the scope of application of the principle of proportionality, see the fundamental study of Von Krauss (1955), p. 94.

<sup>&</sup>lt;sup>129</sup> See, most recently, Brenz (2018).

<sup>&</sup>lt;sup>130</sup> Judgment of 14 June1882, in *Entscheidungen des preußisches Oberverwaltungsgerichts* (PrOVG), no. 9, p. 353.

followed, shortly afterwards, by two subsequent judgments<sup>131</sup>, on the basis of which the reasoning on proportionality became settled case-law.<sup>132</sup> The case-law since then has led to a progressive clarification of concepts and the principle has meanwhile become an essential point of reference not only in the context of police law but for the entirety of German public law.<sup>133</sup>

As to its concrete content, the German principle of proportionality results from the combination of suitability (*Geeignetheit*), necessity (*Erforderlichkeit*) and proportionality in the strict sense (*Verhältnismäßigkeit im engeren Sinne*)<sup>134</sup> which, since the well-known *Apothekenurteil* of 1958<sup>135</sup>, have been brought together into the principle of proportionality in the broad sense.

According to settled case-law, a means is considered as suitable to attain the goal "if with its help the desired result can be achieved".<sup>136</sup> The prediction must be justified and reasonable but the ex ante assessment implies the possibility of an error. As a rule, it is not even expected that the objective will be fully achieved.<sup>137</sup>

As to the necessity, this parameter is often summarised by the expression "imposition of milder means".<sup>138</sup> That is to say, among several means, all of which are theoretically suitable for achieving the objective, the means chosen must be that which implies the least negative consequences for other rights/interests.<sup>139</sup> The clarification must, however, be made that a means can be considered to have the same effectiveness as another only if it allows the achievement of the objective with the same "intensity" as

<sup>&</sup>lt;sup>131</sup> See the judgments of 10 April 1886 and 3 July 1886, in PrOVG 13, p. 424 and p. 426. In both cases, the Prussian High Court had to assess whether the measures taken by the police did not exceed the intensity required by the objective pursued.

 <sup>&</sup>lt;sup>132</sup> See, inter alia, the judgments of 4 November 1889, in PrOVG 18, p. 336; 18 December 1896, in PrOVG 31, p. 409; 2 July 1990, in PrOVG 37, p. 401; 20 September 1900, in PrOVG 38, p. 291; 21 September 1903, in PrOVG 44, p. 342; 13 May 1904, in PrOVG 45, p. 416; 19 December 1907, in PrOVG 51, p. 248; 24 May 1912, in PrOVG 61, p. 255; 15 March 1923, in PrOVG, 78, p. 431; 10 September 1924, in PrOVG 79, p. 297; 23 March 1933, in PrOVG, 90, p. 293.

<sup>&</sup>lt;sup>133</sup> See, inter alia, Stern (1993), p. 165; Ress (1985), p. 11.

<sup>&</sup>lt;sup>134</sup> See, inter alia, von Krauss (1955); Hirschberg (1981); Dechsling (1989).

<sup>&</sup>lt;sup>135</sup> BVerfG, judgment of 11 June 1958, in BVerfGE 7, p. 377.

<sup>&</sup>lt;sup>136</sup> "Wenn mit seiner Hilfe der gewünschte Erfolg gefördert werden kann". BVerfG judgment of 16 March 1971, in BVerfGE 30, p. 292, para. 70. The translation is mine. See also BVerfG judgment of 24 February 1971, BVerfGE 30, p. 173; BVerfG judgment of 2 October 1973, BVerfGE 36, p. 47; BVerfG judgment of 20 June 1984, BVerfGE 67, p. 157. Among the most recent ones, see BVerfG (VI Senat) of 16 December 2016, in BVerwG 8 C 6.15, para. 43, available at https://dejure.org

<sup>&</sup>lt;sup>137</sup> See BVerfG judgment of 22 May 1963, in BVerfGE 16, p. 147.

<sup>&</sup>lt;sup>138</sup> "Gebot des mildesten Mittels". Synonyms for "Erforderlichkeit" in German literature include: Notwendigkeit; Grundsatz des schonendsten Mittels; Grundsatz des geringstmöglichen Eingriffs; Grundsatz des geringsten Mittels. See on this point Jakobs (1985), p. 102.

<sup>&</sup>lt;sup>139</sup> As is an ongoing element of the case-law of the German Federal Constitutional Court. See, inter alia, the BVerfG judgment of 9 March 1971, in BVerfGE 30, p. 250; the BVerfG judgment of 18 December 1968, in BVerfGE 25, p. 1.; the BVerfG judgment of 10 May 1972, in BVerfGE 33, p. 171; and, most recently, the BVerwG, judgment of 6 February 2019, DE:BVerwG:2019:060219U1A3.18.0, para. 88.

would that other, and this question can obviously be answered only with regard to the specific case at hand.<sup>140</sup> German case-law also denies that the necessity requirement is fulfilled if an ex post examination shows that the chosen means appears to be too restrictive in comparison with others which were already available ex ante.<sup>141</sup>

Finally, proportionality in the strict sense is about comparing the goal and the means and weighing them to ascertain their respective importance. This evaluation is quite complex and is strictly connected with the idea of always having to preserve the essential core of fundamental rights (das *Wesen der Grundrechte* - Article 19 *Grundgesetz*) and, as to its judicial review, has raised debate among German scholars ever since.<sup>142</sup>

## 1.2 The development of the principle of proportionality in EU law

As noted above, the CJEU has referred to the principle of proportionality already from the outset and has gradually established it as an essential tool for judicial review, applied to almost all areas of EU law<sup>143</sup>. This is the case to the point that it is, at present, the general principle "most frequently invoked before and examined by the Court".<sup>144</sup>

As for its development, the principle of proportionality, even if only insofar as the requirement of necessity is concerned, was directly included in the Maastricht Treaty of 1992, in Article 3b (later to become Article 5 of the Treaty establishing the European Community), which referred, however, to the sole activity of the Community institutions.

Later on, with the Treaty of Amsterdam of 1997, a protocol on the application of the principles of subsidiarity and proportionality was adopted, whose first provision basically restated that of Article 3b, with the addition, however, that "[e]ach institution shall ensure constant respect for the principle(s)".<sup>145</sup>

<sup>&</sup>lt;sup>140</sup> In order to clarify this point, it suffices to refer, by way of example, to the judgment of the VGH München (in BayVBI, 1984, p. 432), in which it is stated that the assessment of whether the mere imposition of "operating conditions" can be considered as an equally suitable alternative means to the prohibition of the exercise of an activity (Auflagen statt Verbot) is a question that cannot be resolved in the abstract, but must instead be assessed, on a case-by-case basis, with reference to the specific case under consideration.

<sup>&</sup>lt;sup>141</sup> See on this point, 1973, p. 574.

<sup>&</sup>lt;sup>142</sup> In fact, proportionality in the strict sense became a fully established judicial review criterion only as a consequence of the negative experience during the era of the totalitarian National Socialist State. See on this point Coing (1996), p. 65.

<sup>&</sup>lt;sup>143</sup> Most recently Paul Craig expressly underlined that in EU law the principle of proportionality is "a general head of judicial review that applies across the entire EU legal terrain". See Craig (2021), p. 7 (para. 2).

<sup>&</sup>lt;sup>144</sup> Von Danwitz (2012), p. 367.

<sup>&</sup>lt;sup>145</sup> Protocol on the application of the principles of subsidiarity and proportionality, Article 1.

This protocol was later incorporated, with some modifications, into the Treaty of Lisbon (Protocol No 2) and Article 5 of the Treaty establishing the European Community has been replaced by Article 5 of the Treaty on European Union.<sup>146</sup>

Finally, the principle of proportionality has also been included in Article 52(1) of the Charter of Fundamental Rights of the European Union as a reference principle in relation to limitations on the rights and freedoms recognised by the Charter for "purposes of general interest recognised by the Union" or for the "need to protect the rights and freedoms of others".<sup>147</sup>

It should be noted that the fact that the principle of proportionality is expressly referred to in provisions of secondary EU law does not change its higher ranking, as a general law principle, with respect to the rules of secondary EU law. The moving of general principles from one material source to another, in fact, changes neither their inherent nature as general principles of EU law nor their position of hierarchical superiority with respect to the rules of secondary EU law.

With regard to the case-law on the principle of proportionality, it is applied as a judicial review tool both to the activities of EU institutions, bodies, offices and agencies<sup>148</sup>, and of public authorities of Member States when they are fulfilling their obligations under EU law.<sup>149</sup>

As to its application to judicial review of acts/decisions adopted by Member State authorities, the relevant case-law can basically be grouped within three broad categories.

The first of these categories includes judicial review of Member States' regulatory or administrative measures which have the effect of restricting fundamental freedoms or rights laid down in the Treaties or in EU secondary legislation.<sup>150</sup> This category also includes judgments on the proportionality of measures adopted by Member States in derogation from

<sup>&</sup>lt;sup>146</sup> Article 5(4) of the Treaty on European Union (TEU) provides as follows: "Under the principle of proportionality, the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties". It also states: "The institutions of the Union shall apply the principle of proportionality as laid down in the Protocol on the application of the principles of subsidiarity and proportionality".

<sup>&</sup>lt;sup>147</sup> The analogy with Article 19 of the German *Grundgesetz* on the *Wesensgehaltgarantie* is clear!

<sup>&</sup>lt;sup>148</sup> "In areas as diverse as the Common Agricultural Policy, Transport Policy, the Area of Freedom, Security and Justice, Structural Funds, Monetary Policy, Economic Policy, Anti-Dumping, and inter-institutional controls". Craig (2021), p. 7 (para. 2). See further in Craig (2018), Chapters 19-20.

<sup>&</sup>lt;sup>149</sup> This means, according to the CJEU case-law on Article 51 of the Charter of Fundamental Rights of the European Union, that it applies whenever Member States act within the scope of EU law. Case C-5/88, *Wachauf*, EU:C:1989:32118; Case C-260/89, ERT, EU:C:1991:254; and Case C-309/96, *Annibaldi*, EU:C:1997:631.

<sup>&</sup>lt;sup>150</sup> In this respect, the CJEU has consistently ruled from the outset that, even when there is a legitimate need to restrict freedoms or rights under the Treaty or secondary legislation in order to achieve goals of public interest, such restrictions must still pass the proportionality test. The first application of the test in this context was in the famous ruling in *Cassis de Dijon*, C-120/78, EU:C:1979:4.

the obligations provided for by individual directives, when the directives themselves provide (for specific reasons expressly mentioned) for the possibility of derogation. In this case, EU judges do not limit themselves to verifying that the derogations are appropriate and necessary; they also check their proportionality in the strict sense, to ensure they are not such as to completely jeopardise the attainment of the objectives laid down by the directive in question.<sup>151</sup>

The second category of judgments is very broad and includes (regulatory or administrative) measures taken by Member States in breach of EU competition rules or the free movement of goods and services, which are again subjected to a thorough proportionality test.<sup>152</sup>

Finally, there are of course all those judgments relating to references for preliminary rulings and in which the application of the principle of proportionality is called into question with regard to national acts implementing EU law.<sup>153</sup> In this regard, the CJEU has repeatedly stated that the principle of proportionality must also be applied as a criterion for the interpretation of national rules by Member State public authorities when they implement EU law in their national legal systems.<sup>154</sup> And it is precisely this case-law that has been at the root of the "spill-over effect" in relation to the principle of proportionality: that is, its use by national courts in cases that have no direct relevance to EU law (see paragraph 3).

### 1.3 From the German model to a proportionality review characteristic of EU law (and the reasons for that)

Michel Fromont expressed the influential opinion, more than two decades ago, that the most important divergence between the German and EU models of judicial review of proportionality lies in the fact that that the EU courts disregard the rigidly applied three-phase proportionality test proposed and theorised in German legal doctrine.<sup>155</sup>

<sup>&</sup>lt;sup>151</sup> See, for example, Case C-76/08, *Commission* v *Republic of Malta*, EU:C:2009:535, para. 57.

<sup>&</sup>lt;sup>152</sup> In particular, aids (in any form whatsoever) granted to national undertakings are relevant in this context (see, inter alia, Case C-730/79, *Philip Morris*, EU:C:1980:209, para. 17); measures favouring cartels and associations between national undertakings, and abuses of dominant positions (see, inter alia, Case C-258/78, *Nungesser*, EU:C:1982:211, para. 77; Case 61/80, *Coöperatieve Stremsel*, EU:C:1981:75, para. 18); as well as all measures that introduce de facto restrictions with regard to the possibility to participate in tenders in a Member State (see, inter alia, Case C-213/07, *Michaniki*, EU:C:2008:731; Case C-376/08, *Serrantoni*, EU:C:2009:808). See Koch (2003), p. 546.

<sup>&</sup>lt;sup>153</sup> See, inter alia, Case C-45/08, Spector Photo Group, EU:C:2009:806; Case C-170/08, *Nijemeisland*, EU:C:2009:369.

<sup>&</sup>lt;sup>154</sup> See, most recently, Case C-627/19 PPU - Openbaar Ministerie (Public Prosecutor, Brussels), EU:C:2019:1079. See also the very well-known Mascolo judgment: Joined Cases C-22/13, C-61/13 to C-63/13 and C-418/13, Mascolo and Others, EU:C:2014:2401.

<sup>&</sup>lt;sup>155</sup> See Fromont (1995), p. 156. See also, in the same vein, Koch (2003), p. 198.

For a while, I had in fact embraced this conclusion.<sup>156</sup> However, after more than three decades of constant monitoring of EU case law in this regard, I have come a different conclusion. As I see things now, the divergence Fromont referred to in 1995 is much more apparent than a real one, as it is basically the consequence of a different style of drafting judgments: while German judges draft extensive and detailed reasoned judgments, EU judges stick to a more bare and essential style, which brings out only the essential points of their legal reasoning. For example, if in a judgment there is no explicit reference to suitability as the first step of the proportionality review, this does not mean that a suitability review was not carried out by the CJEU judges.<sup>157</sup> For the same reason, it may sometimes appear that the proportionality review carried out by the EU courts is performed by altering the sequence of application of the three elements of the proportionality test.<sup>158</sup>

More generally, the CJEU's overly concise manner of presenting its legal reasoning often gives rise to doubts as to the existence of logical leaps in the reasoning concerning the proportionality review. The well-known proverb "brevity is the soul of wit"<sup>159</sup> does not work well when applied to the proportionality review! However, in view of the CJEU's constantly growing backlog of work<sup>160</sup>, it is not foreseeable that this aspect can be improved. On the contrary, everything points in the opposite direction: shorter judgments and, therefore, necessarily less reasoned ones.

However, this difference in drafting judgments by EU judges is also a consequence of the great deal of space devoted to explaining the facts and the legal context, as EU courts must necessarily consider the (currently 27) different Member State national legal systems, which have to be combined with the relevant EU law in order to identify the legal background for each case.

Beyond these perhaps only formal differences, there is nonetheless also a more substantial reason, which very much explains the development of what I see as a peculiar judicial review of the form of proportionality that is characteristic of EU law (and which differs from the German one).

This difference concerns the approach to the system of judicial protection. The protection afforded by the German courts is subjectively oriented<sup>161</sup> and takes into account, above all, the intensity with which the measure adopted has affected the legal sphere of the plaintiff. This is obviously linked also to the nature of the judgment and is closely connected to the

<sup>&</sup>lt;sup>156</sup> See Galetta (2005), p. 541.

<sup>&</sup>lt;sup>157</sup> See, for example, Case C-126/91, Yves Rocher, EU:C:1993:19. More recently Joined Cases C-96 and 97/03, *Tempelman*, EU:C:2005:145, para. 47.

<sup>&</sup>lt;sup>158</sup> See Case C-357/88, *Hopermann*, EU:C:1990:172. See on this point Kischel (2000), p. 391.

<sup>&</sup>lt;sup>159</sup> That is, that a short and concise formulation may ultimately be more comprehensible than a long one.

<sup>&</sup>lt;sup>160</sup> See in this respect Craig (2018), p. 264.

<sup>&</sup>lt;sup>161</sup> This has recently been recalled by Kahl (2011), p. 42.

powers conferred on the courts by national procedural law (*Verwaltungsgerichtsordnung* - VwGO).

The EU courts offer, instead, rather an objective type of judicial protection, which essentially takes into account the interests concretely at stake<sup>162</sup>, without giving decisive weight to the extent of the harm suffered by the individual. Thus, the EU proportionality test focuses on a comparative assessment of the interests actually at stake, thus bringing the test closer to the "balance of costs and benefits" typical of the principle of proportionality as applied in France in the case-law of the Conseil d'État<sup>163</sup> and the aim of which is essentially to make an overall and comparative assessment of advantages and disadvantages produced by the measure adopted, according to a multi-polar concept of the interests at stake.<sup>164</sup>

This also explains, in my opinion, another issue that is often complained about in legal literature<sup>165</sup>: the difficulty of identifying an a priori and stable rule as to the actual effectiveness of the review carried out by the EU courts through the application of the principle of proportionality. In fact, on the one hand, and despite the incredible amount of case-law in which possible infringement of the principle is invoked, there are few cases in which EU judges have actually declared legislative or administrative measures taken by EU authorities to be unlawful on account of breach of the principle of proportionality.<sup>166</sup> On the other hand, the EU judges seem to take a rather different attitude to the review of acts adopted by Member State authorities, where, as a matter of fact, the proportionality review is usually more intense and strict.<sup>167</sup>

Nevertheless, the differences in intensity in judicial review of proportionality only appear to depend on whether the measure to be reviewed is adopted by an EU or by a Member State authority. This is not, in my opinion, the central issue in EU judges' reasoning when reviewing proportionality.<sup>168</sup> The differences that exist seem to me instead to be related to the different weight placed upon the interests actually at stake. The stance adopted is also influenced by whether an EU judge is being asked to review measures that aim at contributing to "the process of European integration undertaken

<sup>&</sup>lt;sup>162</sup> See Emiliou (1996), p. 171.

<sup>&</sup>lt;sup>163</sup> See the judgment of the Conseil d'Etat of 2 October 2006, SCI Les Fournels, no. 281506, which expressly states that «une opération ne peut légalement être déclarée d'utilité publique que si les atteintes à la propriété privée, le coût financier et, éventuellement, les inconvénients d'ordre social ou l'atteinte à d'autres intérêts publics qu'elle comporte ne sont pas excessifs eu égard à l'intérêt qu'elle présente».

<sup>&</sup>lt;sup>184</sup> In this sense see, among many others, Case 45/85, *Verband der Sachversicherer*, EU:C:1987:34, para. 61.

<sup>&</sup>lt;sup>165</sup> See for detailed references von Danwitz (2012), op. cit., p. 374.

<sup>&</sup>lt;sup>166</sup> Nevertheless see for example the well-known judgment in Joined Cases C-293/12 and C-594/12, *Digital Rights Ireland Ltd*, declaring invalid Directive 2006/24/EC (of 15 March 2006, on the retention of data generated or processed in connection with the provision of publicly available electronic communications services or of public communications networks), on the ground that by adopting Directive 2006/24 the EU legislature "has exceeded the limits imposed by compliance with the principle of proportionality" (para. 69).

<sup>&</sup>lt;sup>167</sup> In this vein, see also von Danwitz (2012), p. 378.

<sup>&</sup>lt;sup>168</sup> See also Zilioli (2019), p. 257 et seq.

with the establishment of the European Communities<sup>"169</sup> regardless of whether these measures are undertaken by an EU or by a Member State authority<sup>170</sup>; or whether, on the contrary, the measure to be reviewed under the principle of proportionality is adopted in derogation from fundamental freedoms or fundamental rights guaranteed by the EU Treaties. In such cases, the principle of proportionality is of course reviewed more rigorously. The CJEU imposes strict requirements in respect of the need for a national measure restricting fundamental freedoms<sup>171</sup>, as guaranteeing respect for such fundamental freedoms is the very reason for the existence of the EU itself!<sup>172</sup>

Nevertheless, after the entry into force of the Lisbon Treaty, the CJEU imposed similarly strict requirements and applied similar rigour in respect of the proportionality test with regard to measures adopted by EU authorities in derogation from fundamental rights and freedoms recognised by the Charter of Fundamental Rights of the European Union.<sup>173</sup>

Finally, there is another important element which is rarely taken into account by those who criticise the CJEU's jurisprudence but which must be considered when assessing its case-law on the principle of proportionality. This is the procedure in the context of which the review of proportionality is carried out, which differs markedly as between judicial review of proportionality in the context of an infringement procedure under Article 258 TFEU and such review carried out in the context of a preliminary reference procedure under Article 267. According to the "division of labour between the ECJ and National Courts"<sup>174</sup>, in respect of a preliminary reference procedure the CJEU will limit itself, in principle, to providing the national court only with the benchmarks for its decision. It is still for the national compatibility with the principle of proportionality of the national measures contested by the plaintiffs.<sup>175</sup>

<sup>&</sup>lt;sup>169</sup> See the preamble of the TEU.

<sup>&</sup>lt;sup>170</sup> See Case 29/77, *Roquette*, EU:C:1977:164, para. 19 and 20; Joined Cases C-296/93 and C-307/93, *French Republic and Ireland v Commission*, EU:C:1996:65.

<sup>&</sup>lt;sup>171</sup> See, for example, Case C-65/05, *Commission* v *Hellenic Republic*, EU:C:2006:673. In the same vein, see von Danwitz (2012), p. 378.

<sup>&</sup>lt;sup>172</sup> See Papadopoulou (1996), p. 252; Von Danwitz (2003), p. 400.

<sup>&</sup>lt;sup>173</sup> See Joined Cases C-293/12 and C-594/12, *Digital Rights Ireland Ltd*, where the protection of the fundamental rights to privacy and to the protection of personal data were at stake.

<sup>&</sup>lt;sup>174</sup> See von Danwitz 2012, p. 379.

<sup>&</sup>lt;sup>175</sup> See, among the most recent cases, Case C-555/19, EU:C:2021:89, where the CJEU reached the conclusion that "Article 56 TFEU must be interpreted as not precluding such national legislation, provided that it is suitable for securing the attainment of the objective of protecting media pluralism at regional and local level which it pursues and does not go beyond what is necessary to attain that objective, which it is for the referring court to ascertain". See also Joined Cases C-34-36/95, *De* Agostini, EU:C:1997:344, para. 52; Joined Cases C-96/03 et C-97/03, *Tempelman*, EU:C:2005:145, para. 49; Case C-182/08, *Glaxo Wellcome*, EU:C:2009:559, para. 102.

So, to conclude, if there can be no doubt that the CJEU drew heavily upon the principle of proportionality under German law<sup>176</sup> at first, it is equally certain, at this point, that its approach to the review of the proportionality has, for various reasons, developed in such a way as to diverge from that carried out by the German courts. Over a timeframe of now more than six decades, the CJEU has in fact developed a form of judicial review of proportionality all of its own, which is specifically adapted to the characteristics of the EU<sup>177</sup> and of EU law.<sup>178</sup>

## 2 The dissemination of the EU principle of proportionality across (and even beyond) Europe

#### 2.1 The so-called "spill-over effect" and Italian public law

The phenomenon described in academic literature as a "spill-over effect"<sup>179</sup> refers to those Member States that, starting from a situation in which the principle of proportionality was unknown as such in their national legal tradition, have started to refer to the EU principle of proportionality extensively, even in respect of cases without any direct EU law dimension.<sup>180</sup>

A typical example of this phenomenon can be seen in Italian public law, starting from the early 1990s. A test of proportionality was progressively incorporated in the jurisprudence of the Italian administrative courts in the context of domestic cases with no direct EU law dimension<sup>181</sup>, alongside the traditional test of reasonableness (*ragionevolezza*).

The test of reasonableness, which is used to the present day both by the Constitutional Court and by the administrative courts, is in fact extremely volatile, thus creating shortfalls in terms of legal protection.<sup>182</sup> For this reason, the EU principle of proportionality was introduced alongside the test of reasonableness. Nonetheless, the overall outcome of over 30 years

<sup>&</sup>lt;sup>176</sup> Galetta (1998), p. 6. See also von Danwitz (2012), p. 367.

<sup>&</sup>lt;sup>177</sup> From this point of view, as I have already underlined, it also differs from the one carried out by the Strasbourg Court. See Galetta (1999), p. 743 et seq.

<sup>&</sup>lt;sup>178</sup> There is, therefore, really no sense in complaining about this! In this regard see my critical remarks as to the attitude of the German Federal Constitutional Court in Weiss, when it preposterously criticised the CJEU for not applying the German principle of proportionality! Galetta and Ziller (2021), p. 633, para. 3.3.

<sup>&</sup>lt;sup>179</sup> See for example Groussot, X. (2006), *General Principles of Community Law*, Europa Law Publishing.

<sup>&</sup>lt;sup>180</sup> See Galetta (1998a), Principio di proporzionalità e sindacato giurisdizionale nel diritto amministrativo, Giuffrè, Milano, 1998, pp. XVII-273, p. 5.

<sup>&</sup>lt;sup>181</sup> See Regional Administrative Court of Lombardy (TAR Lombardia), sec. III, 02.04.1997, n. 354; sec. III, 16.04.1998, n. 752. See for further references: Galetta (1998a) *Principio di proporzionalità e sindacato giurisdizionale nel diritto amministrativo*, Giuffrè, Milano, 1998, pp. XVII-273, p. 231; Galetta, (2017), p.165.

<sup>&</sup>lt;sup>182</sup> See, for details, Galetta (1998b), p. 299.

of making reference to the EU principle of proportionality for domestic judicial review is made up of lights and shadows.<sup>183</sup> There have been some highlights, however, such as the brilliant judgment no. 20/2019<sup>184</sup> of the Italian Constitutional Court, where it was cleverly used to balance competing fundamental principles including transparency and the right to privacy.

#### 2.2 The principle of proportionality in British common law

Another very relevant case of spill-over of the EU principle of proportionality concerns a (now ex) EU Member State: the United Kingdom.

The British case is very interesting, as the EU principle of proportionality made its own way into the case-law of the British domestic courts only very slowly.<sup>185</sup> If, in fact, as early as the beginning of the 1980s Lord Diplock (an authoritative judge of the House of Lords) had underlined all the potential of this principle<sup>186</sup>, the British judges have nonetheless refused during decades to refer to it: branding it as useless<sup>187</sup> and/or excessively invasive<sup>188</sup> and sticking to the very national "Wednesbury test".

However, the situation has radically changed, in particular since the adoption of the Human Rights Act 1998<sup>189</sup>, which transposed the European Convention on Human Rights (ECHR) into British national law. Therefore, in more recent years the British courts have often used the principle of proportionality instead of the Wednesbury test also with regard to purely domestic case-law. This represents a conscious decision, made on the assumption that "greater intensity of review is available under the proportionality approach ... than is the case where the review is conducted on the traditional Wednesbury grounds".<sup>190</sup> The significance of this stance

<sup>&</sup>lt;sup>183</sup> See Galetta, (2017), "Il principio di proporzionalità", in Sandulli, M.A. (ed.), Codice dell'azione amministrativa, Milano, para 3, p.149.

<sup>&</sup>lt;sup>184</sup> Constitutional Court, judgment 23 January 2019, no. 20, available at https://www. cortecostituzionale.it

<sup>&</sup>lt;sup>185</sup> Birkinshaw (2014), para. 8.02. See also Craig (1999), p. 95; Jowell and Birkinshaw (1996), p. 282; Hoffmann (1999), p. 114.

<sup>&</sup>lt;sup>186</sup> Which he summarised using the following very effective formula: "The principle of proportionality prohibits the use of a steam hammer to crack a nut if a nutcracker would do it". See the well-known House of Lords judgment *R*. v *Goldsmith* (1983), Weekly Law Reports, p. 155. This was followed by the equally well-known judgment (also of the House of Lords) *Council of Civil Services Unions v Minister for the Civil Service*, ([1985] AC 374, [1985] ICR 14), often cited as the "*GCHQ* Case", concerning the relationship between the Wednesbury test and the principle of proportionality.

<sup>&</sup>lt;sup>187</sup> Thus, for example, Lord Hoffmann (1999), defined it as "an analytical error" (p. 109) and dismissed it with the lapidary statement: "I see little future for proportionality in this country as a freestanding principle" (p. 114).

J. Millet stated that the principle of proportionality was a new and dangerous doctrine in his commentary on the Allied Dunbar judgment in The Times. Allied Dunbar (Frank Weisinger) Ltd. v Frank Weisinger, in The Times of 17.11.1987, p. 44. In contrast to this, see Jowell and Lester (1988), p. 61; Craig (1999), p. 85.

<sup>&</sup>lt;sup>189</sup> Available at http://www.legislation.gov.uk/ukpga/1998/42/contents

<sup>&</sup>lt;sup>190</sup> Judgment of the House of Lords of 21.03.2002, *Regina* v *Shayler*, para. 75, available at http://www.publications.parliament.uk

is underlined by the fact that on the basis of an analysis of the case-law following the adoption of the Human Rights Act, it was argued that there has been a genuine transformation of British law; and that "proportionality is now a mandatory tool for judicial review when rights are at stake".<sup>191</sup>

However, the contrast/confrontation between the Wednesbury reasonableness test and the proportionality test as tools of judicial review is far from over.<sup>192</sup> Indeed, it seems to have been reinvigorated by Brexit, which, at least according to some commentators, is considered as an opportunity to undertake what has been identified as a "decontamination of English law".<sup>193</sup>

#### 2.3 The principle of proportionality beyond the EU's borders

The principle of proportionality has more recently extended its influence well beyond the borders of the EU. Exportation of the principle of proportionality across the Atlantic has been facilitated by the circumstance that in applying general principles of law the CJEU has followed patterns developed by the Supreme Courts of continental European countries (starting with the French Conseil d'État) over the course of about a century. The principles thus derived resemble, to some extent, the natural justice principles applied by British courts, mainly by the House of Lords, in the same period and which have obviously been imported from common law jurisdictions overseas.

In fact, there happens to be an intense (and very interesting) debate among overseas scholars (in Australia, Canada and New Zealand<sup>194</sup>), on whether the principle of proportionality should become a general principle, to be applied to judicial review of regulatory and administrative decisions taken by public authorities, which would take the place of the largely unsatisfactory Wednesbury test of reasonableness of British tradition<sup>195</sup> and also "curb judicial intrusion into administrative discretion".<sup>196</sup>

<sup>&</sup>lt;sup>191</sup> See Cohn (2010), p. 622.

<sup>&</sup>lt;sup>192</sup> See Craig (2010), p. 265.; Hickman (2010), p. 303; King (2010), p. 327; Jowell (2015), p. 41. On the concepts of reasonableness and proportionality, see also, more recently, Alexy (2017), p. 13.

<sup>&</sup>lt;sup>193</sup> See Bathurst (2017), p. 2, who notes that "Speaking in Sydney last year, Lord Goldsmith, former Attorney General of England and Wales, embraced the Brexit result as an opportunity to set about 'the decontamination of English law'".

<sup>&</sup>lt;sup>194</sup> See in particular the articles published in the special issue of the New Zealand Law Review 2010, no. 2 (2010), p. 229.

<sup>&</sup>lt;sup>195</sup> See Boughey (2015), p. 59.

<sup>&</sup>lt;sup>196</sup> See Boughey (2017), p. 597. More generally, for a summary of the debate at international level, see Klatt and Meister (2012), p. 159. See also, most recently, Craig (2021), p. 1, who harshly contests a paper published by Endicott in 2020 where he denies that proportionality could ever be a general ground of judicial review.

# The CJEU and judicial review of proportionality vis-à-vis legislative and administrative discretion: some conclusive remarks (also in the light of the *Weiss* judgment on the "PSPP saga")

If one accepts the assumption that the functions of making the laws, administering them and adjudicating upon them are (and need to remain) institutionally separated, then the problem affecting the judicial review of proportionality essentially concerns the boundaries to judicial review vis-à-vis legislative and administrative discretion that it may or may not shift.

In this respect, while the judicial review of proportionality in the context of EU law remains the classical three step test borrowed from German law, it is carried out in such a way as not to overstep the boundaries of judicial review and respect legislative and administrative discretion.<sup>197</sup>

From this perspective, when revising the proportionality of legislative and/or administrative choices made in contexts where there is broad legislative and/or administrative discretion – either because it is about making policy choices or because it is about making complex choices of a technical nature (or possibly both!) – the CJEU will check whether the legislator or administrative authorities have done their preparatory work properly<sup>198</sup> by requiring that they explain why the contested measure was introduced and why it was suitable and necessary to attain the stipulated goals. The CJEU will also take into account the impact on opposing interest(s) and check that the measure adopted was not excessive (proportionality in the strict sense), while being mindful of the discretion inherent in the choice made by the decision-maker<sup>199</sup>, which can be questioned only in the event of a "manifest error of appreciation", especially in contexts where the choices to be made required "complex assessments and evaluations".<sup>200</sup>

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<sup>&</sup>lt;sup>197</sup> See further in Widdershoven (2019), p. 39. Craig (2021), p. 15, states as follows: "The fact that the review is low intensity ensures that the separation of powers is not transgressed."

<sup>&</sup>lt;sup>198</sup> See Lenaerts (2012), p. 13, who identifies such proportionality review as a "Processoriented Review".

<sup>&</sup>lt;sup>199</sup> See Craig (2021), p. 15.

<sup>&</sup>lt;sup>200</sup> See, for example, Case C-58/08, Vodafone, EU:C:2010:321, para. 68 passim.

This appears clearly, for example, in the CJEU's well-known *Weiss* judgment of December 2018<sup>201</sup> concerning the "PSPP saga".<sup>202</sup> This judgment is a perfect example of what I mean when I refer to the type of judicial review of proportionality characteristic of the EU (which diverges from the German approach<sup>203</sup>).

In Weiss, the CJEU had to answer to a request for a preliminary ruling from the German Federal Constitutional Court concerning Decision (EU) 2015/774 of the European Central Bank.<sup>204</sup> In this specific context the CJEU underlined, first of all, that "the ESCB must be allowed a broad discretion since, when it prepares and implements an open market operations programme, it is required to make choices of a technical nature and to undertake complex forecasts and assessments", so that "the Court is required to ascertain, in its review of the proportionality of the measures entailed by such a programme in relation to monetary policy objectives, whether the ESCB made a *manifest error of assessment* in that regard".<sup>205</sup>

This does not mean that the CJEU did not carry out a proper proportionality review!<sup>206</sup> As a matter of fact, the CJEU's proportionality review consisted here precisely in verifying that all three steps of the proportionality test were duly carried out by the ESCB, with the following results:

1) as to the suitability test, the CJEU concluded that "in view of the information before the Court, it does not appear that the ESCB's economic analysis - according to which the PSPP was appropriate, in the monetary and financial conditions of the euro area, for contributing to achieving the

<sup>&</sup>lt;sup>201</sup> Case C-493/17, *Weiss*, EU:C:2018:1000.

<sup>&</sup>lt;sup>202</sup> This expression refers to the judgments related to the series of appeals brought in 2015 and 2016 by numerous German savers as well as practising lawyers and Members of Parliament, including the now famous Member of the Federal Parliament [Bundestag] Peter Gauweiler, before the German Federal Constitutional Court (BVerfG). The appellants asked the BVerfG to declare unlawful the decisions of the ECB establishing and implementing, from 2015 onwards, the Public Sector Purchase Programme (PSPP) for the purchase of government bonds on secondary markets by the European System of Central Banks (ESCB) in order to meet the liquidity needs of euro area economies. The appeals concerned "various decisions of the ECB, the participation of the German Central Bank (Bundesbank) in the implementation of those decisions or its alleged failure to act with regard to those decisions and the alleged failure of the Federal Government and the [Bundestag] to act in respect of that participation and those decisions." See the CJEU's summary in *Weiss*, C-493/17, paras. 13-14.

<sup>&</sup>lt;sup>203</sup> See Galetta (2020), para. 2.

<sup>&</sup>lt;sup>204</sup> Decision (EU) 2015/774 of the European Central Bank of 4 March 2015 on a secondary markets public sector asset purchase programme (OJ L 121, 14.5.2015, p. 20).

<sup>&</sup>lt;sup>205</sup> Case C-493/17, *Weiss*, para. 24. The emphasis in italics is mine.

<sup>&</sup>lt;sup>206</sup> As was instead claimed by the German Federal Constitutional Court in a decision (BVerfG, Second Senate of 5 May 2020, 2 BvR 859/15), which I have described as a "clumsy and poorly disguised attempt to lecture the CJEU on what this principle is and how it should be applied". See Galetta and Ziller (2021), p. 85. This decision of the German Federal Constitutional Court is in fact one of the most debated judgments of recent years. See, for example, the papers published in "*Rivista Italiana di Diritto Pubblico Comunitario*", 2020/4, and in "European Public Law", Vol 27/1 (2021), as well as the various contributions published in CERIDAP and available at https://ceridap. eu/?s=weiss&post\_type=post

objective of maintaining price stability - is vitiated by a manifest error of assessment".<sup>207</sup>

2) As to the necessity test ("whether the PSPP does not go manifestly beyond what is necessary to achieve that objective"<sup>208</sup>) the CJEU concluded that "the way that programme is set up also helps to guarantee that its effects are limited to what is necessary to achieve the objective concerned"<sup>209</sup>, also because "the PSPP has, from the start, been intended to apply only during the period necessary for attaining the objective sought and is therefore temporary in nature".<sup>210</sup>

3) As to proportionality in the strict sense, the CJEU underlined that "as the Advocate General has stated in point 148 of his Opinion, the ESCB weighed up the various interests involved so as effectively to prevent disadvantages which are manifestly disproportionate to the PSPP's objective from arising on implementation of the programme".<sup>211</sup>

However, verifying that the ESCB had carried out the three step proportionality test properly did not mean that the CJEU substituted its own "I know better"<sup>212</sup> assessments for those of the deciding authority, which (unlike the judge) possessed the specific technical knowledge needed to make the relevant decision! Accordingly, in my opinion, the conclusion reached by the CJEU in the *Weiss* judgment is a sort of perfect synopsis of what (administrative) discretion means in practical terms in cases as complex as the one the PSPP tried to deal with: "the fact that that reasoned analysis is disputed does not, in itself, suffice to establish a manifest error of assessment on the part of the ESCB, since, given that questions of monetary policy are usually of a controversial nature and in view of the ESCB's broad discretion, nothing more can be required of the ESCB apart from that it use its economic expertise and the necessary technical means at its disposal to carry out that analysis with all care and accuracy".<sup>213</sup>

I thus very much agree with those who think that what is really at stake when one deals with the issue of proportionality review is the structure of judicial review itself. The debate about proportionality review, indeed, "touches the very heart of judicial review in terms of the relationship between the courts, the government and the legislature".<sup>214</sup>

But, as regards the outcomes, I see it rather the other way around. As I see it, the judicial review of proportionality carried out in the CJEU's own way constitutes a fair judicial review. It makes meaningful review of the use of discretionary powers possible in such a way that, while the principle of

<sup>&</sup>lt;sup>207</sup> Case C-493/17, *Weiss*, para. 78.

<sup>&</sup>lt;sup>208</sup> ibid., para. 79.

<sup>&</sup>lt;sup>209</sup> ibid., para. 82.

<sup>&</sup>lt;sup>210</sup> ibid., para. 84.

<sup>&</sup>lt;sup>211</sup> ibid., para. 93.

The peculiar German expression "besser wisserisch" would perhaps fit best here!
Case C-493/17, para. 91. In the same vein see the very well-known *Gauweiler*

judgment of 2015, Case C-62/14, EU:C:2015:400, para. 75. <sup>214</sup> See Johnston (1996), p. 156.
separation of powers is preserved, the unbearable oscillation of judicial review (from higher intensity to very low intensity), which is typical of reasonableness reviews across the board, is reduced.<sup>215</sup>

To conclude, although the CJEU has certainly been inspired by the German model of judicial review of proportionality, it is equally certain now that, during the last six decades, a form of judicial review of proportionality characteristic of the EU has taken shape in the CJEU's case-law.

As to its specificity, it is rather a point of merit that the CJEU did not give in to the temptation to use the principle of proportionality to overstep its mark and enter territory which, even if not "political" in the strict sense, is characterised by broad legislative and administrative discretion.

In fact, to sum up, the CJEU, when reviewing the proportionality of a decision/act will limit itself to assessing that the choice made was within the range of what could legitimately have been decided, within the margin of assessment reserved for the legislator or public administration, and does not seek to put forward what the judge would have preferred this decision to be.<sup>216</sup> This approach is especially relevant in times of crisis and, more generally, in all contexts where there is uncertainty<sup>217</sup> and unpredictability as to the direction in which matters will develop and where, therefore, finding the appropriate balance is indeed a delicate matter and a moving target<sup>218</sup> for all decision-makers.

So, even if it is certainly true that "across Europe, and no doubt across other jurisdictions beyond Europe, we still have much to learn from one another about the scope, application and value of the principle of proportionality"<sup>219</sup>, when we find ourselves within the scope of EU law, we should perhaps stop bothering too much about the origin of the principle of proportionality and start focusing a bit more on its peculiarity and autonomy<sup>220</sup> and on the fact that there are important lessons about proportionality review that all judges should, at this point, learn from the CJEU.

<sup>&</sup>lt;sup>215</sup> I had already expressed this opinion as to the difference between proportionality review and "controllo di ragionevolezza" in Italian (administrative) law in the conclusions of my 1998 book on the principle of proportionality and judicial review. See Galetta (1998), cit. On this point, see a recent contribution by P. Craig (2021), as to the judicial review of reasonableness by the UK courts.

<sup>&</sup>lt;sup>216</sup> In the same vein Craig (2021), p. 8 underlines that there is no evidence that the judicial review of the proportionality "has caused problems, in the sense of courts interfering too greatly in EU policymaking".

<sup>&</sup>lt;sup>217</sup> This was certainly the case as to the very technical question dealt with in *Weiss*, as economists' opinions on the effects of low interest rates are completely contradictory: see further in Galetta, and Ziller (2021), p. 92.

<sup>&</sup>lt;sup>218</sup> See Zilioli (2019), p. 271.

<sup>&</sup>lt;sup>219</sup> See Young and de Búrca (2017), p. 143.

<sup>&</sup>lt;sup>220</sup> That's why we have harshly criticised the reasoning carried out by the judges of the German "Zweiter Senat" in Weiss, who clearly (and wrongly) referred to their German principle of proportionality in an EU law matter! See Galetta and Ziller, J. (2021), para. 3.3.

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By Tomi Tuominen\*

### 1 Introduction

Clashes between national supreme or constitutional courts and the Court of Justice of the European Union (CJEU) ultimately stem from sovereignty, whether they relate to differences with regard to the extent of fundamental rights or the competences of the European Union (EU). Central to this debate, both as a theoretical premise and a locus of actual contestation, is the principle of primacy of EU law. In *Melloni*, for example, the CJEU explained how differences in the level of fundamental rights protection granted by national law and EU law are allowed only to the extent that "the primacy, unity and effectiveness of EU law" is not threatened.<sup>221</sup> Such issues are at the core of the theory of constitutional pluralism, which, as a descriptive theory, has sought to explain the unsettled nature of the sovereignty debate between the EU and the Member States and, according to some views, as a normative theory, has sought to justify this state of affairs.<sup>222</sup>

The exchange of opinions between the CJEU and the German Federal Constitutional Court on the legality of the European Central Bank's (ECB) Outright Monetary Transactions (OMT) programme in the CJEU's *Gauweiler* judgment has been a central topic in the debate on constitutional pluralism.<sup>223</sup> Whilst studying the *Gauweiler* saga<sup>224</sup>, I noticed that the CJEU did not use the term "primacy" (or "supremacy") in its judgment; the German Federal Constitutional Court used it once in its referral and in its final decision the expression "precedence of application of Union law" (*Anwendungsvorrang*) appeared several times.<sup>225</sup> From this observation I deduced the following argument: the principle of primacy of EU law applies to situations in which there is a conflict between EU law and national law

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<sup>&</sup>lt;sup>221</sup> *Melloni*, C-399/11, EU:C:2013:107, para. 60.

<sup>&</sup>lt;sup>222</sup> See Tuominen (2021), pp. 31-38 and 198-225.

<sup>&</sup>lt;sup>223</sup> See e.g. Goldmann (2016), Kelemen (2016), Bobić (2017), Wilkinson (2017) and Tuominen (2018).

 <sup>&</sup>lt;sup>224</sup> BVerfG 2 BvR 2728/13 of 14 January 2014 DE:BVerfG:2014:rs20140114.2bvr272813 (*OMT Reference*); *Gauweiler*, C-62/14, EU:C:2015:400; BVerfG 2 BvR 2728/13 of 21 June 2016 DE:BVerfG:2016:rs20160621.2bvr272813 (*OMT judgment*).

<sup>&</sup>lt;sup>225</sup> 2 BvR 2728/13 *OMT Reference*, paras. 24 and 2 BvR 2728/13 *OMT Judgment*, paras. 115-120, 146 and 162.

concerning a right granted to an individual by law, whereas the term supremacy better encapsulates the nature of the debate between the EU and the Member States on issues of sovereignty.<sup>226</sup> Essential to both the initial observation and the argument deduced from it was that *Gauweiler* did not concern individual rights but rather institutional constitutional law.

A central topic in the literature on *Gauweiler* is the CJEU's proportionality review - or actually the lack of a proper proportionality review. The same is also true with regard to the follow-up case Weiss, where the German Federal Constitutional Court challenged the ECB's Public Sector Asset Purchase Programme (PSPP).<sup>227</sup> With regard to the CJEU's judgment in Gauweiler, commentators noted that the CJEU's proportionality review only contained the first two stages of suitability and necessity but that the third stage of balancing was missing.<sup>228</sup> Furthermore, the review conducted by the CJEU was seen as deferential<sup>229</sup>, which was perhaps necessitated by the independence accorded to the ECB.<sup>230</sup> When it came to Weiss, the CJEU's proportionality review was seemingly more complete as it now also included the third stage of balancing, yet the CJEU's analysis was still seen as deferential as the defining issue seemed to be whether the ECB had fulfilled the duty to state reasons for its actions.<sup>231</sup> Although the third stage of the test contained a balancing of the risks associated with such bond purchasing programmes, the CJEU's proportionality review did not consider the effects of the ECB's monetary policy measures.<sup>232</sup>

After reading such criticism and studying the two judgments, I was left thinking what might explain the CJEU's difficulty to conduct a proper proportionality review in these cases and why the Court's proportionality review received such criticism. My hypothesis is that it is the same issue that I have discussed in two previous articles on the principle of primacy of EU law: the fact that the two cases did not concern rights granted to individuals by law but rather economic governance-related measures by the ECB or in fact the delineation of competences between the EU and the Member States.<sup>233</sup>

<sup>&</sup>lt;sup>226</sup> See Tuominen (2018) and Tuominen (2020).

<sup>&</sup>lt;sup>227</sup> Case C-493/17, *Weiss*, EU:C:2018:1000.

<sup>&</sup>lt;sup>228</sup> Adamski (2015), p. 1475.

<sup>&</sup>lt;sup>229</sup> Tridimas and Xanthoulis (2016), p. 31.

<sup>&</sup>lt;sup>230</sup> Borger (2016), pp. 194-195.

<sup>&</sup>lt;sup>231</sup> Dawson and Bobić (2019), p. 1025.

<sup>&</sup>lt;sup>232</sup> de Boer and Van 'T Klooster (2020), p. 1713.

<sup>&</sup>lt;sup>233</sup> I acknowledge that proportionality review per se is about the use of competences already conferred on the EU by the Member States while the principle of conferral, as defined in Article 5(1) TEU, is about the extent of these competences. However, the result of the CJEU's proportionality review is that something either can or cannot be done by the EU, so in effect the end result is the same. In the two cases discussed here, it was pertinently clear that both the claimants before the German Federal Constitutional Court as well as the German court itself were of the opinion that the ECB did not have the competence for the two bond purchasing programmes. The proportionality review thus offered them a legal instrument through which to channel political and constitutional opposition.

The principle of proportionality and proportionality review have, both historically and within the shorter trajectory of EU law, evolved in the context of individual rights. Furthermore, proportionality's development occurred at the brink of modernity, during the same time when Max Weber put forth his theory on the formal rationality of modern law. Thus, my purpose in this article is to analyse the CJEU's proportionality review in *Gauweiler* and *Weiss* in the light of this hypothesis and the central concepts of Weberian rationality. Although I will utilise some of the concepts or ideas put forth by Weber, I will not engage with Weber's ideas per se, the exact meaning of which, for that matter, still remains debated.<sup>234</sup> Space precludes an analysis and critical assessment of Weber's theory here, but I hope to further develop this theoretical approach somewhere else.

The purpose of this exercise is to examine whether there is more to the CJEU's proportionality review in these two judgments than meets the eye at first. Although the two judgments are amongst some of the most discussed during the past decade – and hence a Symposium on proportionality is organised as part of the ECB Legal Conference 2021 - 1 believe that this exercise still brings to the fore a new perspective on these judgments and can perhaps even contribute to the ongoing discussion on the meaning of proportionality review in EU law.

The article proceeds as follows. Section 2 briefly introduces some of the concepts used by Weber, which are later utilised in analysing the cases (in Sections 6 and 7). Section 3 details how the CJEU's proportionality review functions in the literature. The point here is to establish that historically, theoretically and in practice proportionality has been, and still is, about individual rights. Section 4 contains a detailed description of the CJEU's proportionality review in *Gauweiler* while Section 5 does the same with regard to the *Weiss* judgment. Sections 6 and 7 then compare and briefly analyse the CJEU's proportionality review in the two judgments, while Section 8 concludes the discussion by presenting a few general remarks.

### 2 Weberian concepts

Weber developed a general thesis about the disenchantment and rationalisation of human action that covered various fields of society.<sup>235</sup> Weber outlined four different ways in which social action can be oriented: (i) instrumental rational action is action directed towards means that are expected to produce rationally pursued ends; (ii) value-rational action is action based on a belief in the value of the action itself; (iii) affectual action is action based on emotions and feelings; and (iv) traditional action is action based on ingrained habituation. Acts based on duty, honour or a religious calling, for example, are value-rational, whereas instrumentally rational is action where "the end, the means, and the secondary results are all rationally taken into account and weighed". Furthermore, such

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<sup>&</sup>lt;sup>234</sup> Compare e.g. Trubek (1972), Teubner (1983) and Tuori (2002).

<sup>&</sup>lt;sup>235</sup> See Weber (1978).

instrumental rationality also "involves rational consideration of the alternative means to the end, of the relations of the end to the secondary consequences, and finally of the relative importance of different possible ends". Yet, it is also possible that instrumental rationality is only applied to the choice of means while the ends are set on the basis of values.<sup>236</sup>

Conversely, economic action can also be rational if based on deliberate planning, utilised through techniques specified through scientific knowledge and used to attain chosen ends. The suitable means is selected on the basis of the principle of least effort.<sup>237</sup> Economic action may be characterised as either formally rational or substantively rational. The formal rationality of economic action refers to action that is quantified by calculation, whereas substantively rational economic action refers to economic action shaped by values.<sup>238</sup>

Lastly, when it comes to the law, Weber outlined how law is formally irrational if based on means that cannot be controlled by intellect. This would be the case if laws were drafted or judgments pronounced on the basis of, for example, oracles or sacred revelations. On the other hand, law is substantively irrational if influenced by ethical, emotional or political factors of the case at hand. Conversely, substantively rational norms are such that, instead of norms obtained through logical generalisation of abstract interpretations, legal judgment is based on ethical imperatives, utilitarian rules or political maxims; that is, criteria extrinsic to the legal order. The first three types of systems are not generalisable or predictable. Finally, formally rational law, then, is law that only takes into consideration the "unambiguous general characteristics" of the case at hand. Such general characteristics can refer, on one hand, to facts such as an utterance of specific words or the signing of a form, but they may also, on the other hand, refer to the logical analysis of the meaning of the relevant facts.239

In conclusion, what Weber wrote about rationalisation, law and the economy clearly relates to proportionality review.<sup>240</sup> For example, the means-ends relationship embedded in rationality is a central element of proportionality review, as is explained below. The debate between formalism and anti-formalism (substantive values) also resonates with the critique of proportionality review.<sup>241</sup> Moreover, the role of expert knowledge is central in proportionality review, as it is also in Weber's schemata on rationality.

<sup>&</sup>lt;sup>236</sup> ibid., pp. 24-26.

<sup>&</sup>lt;sup>237</sup> ibid., pp. 63-67.

<sup>&</sup>lt;sup>238</sup> ibid., pp. 85-86.

<sup>&</sup>lt;sup>239</sup> ibid., pp. 656-657.

<sup>&</sup>lt;sup>240</sup> See e.g. Cohen-Eliya and Porat (2010).

<sup>&</sup>lt;sup>241</sup> See e.g. Urbina (2017).

### 3 Proportionality review is about individual rights

The development of proportionality review is usually presented through three distinct historical phases. Proportionality review, or proportionality as a legal principle, first emerged in Germany during the 18th century as new forms of state action needed to be reconciled with individual freedom. Later, 19th century Prussian administrative law recognised that administrative measures needed to be necessary in order to be lawful. Finally, in the 20th century a modern form of proportionality emerged alongside the adoption of the 1949 Basic Law for the Federal Republic of Germany that was specifically created with view to the horrors of the Third Reich.<sup>242</sup> As this timeline shows, proportionality has its origins in administrative law (not private law or constitutional law), and specifically in the guestion of how the state interferes with peoples' rights. Proportionality was created as a doctrine the purpose of which was to protect individuals when written law did not yet contain such clauses. This development occurred at the brink of modernity, during a formalistic period in German administrative law.243

Theoretically speaking, proportionality review is about balancing competing rights or interests. The third stage of the test, balancing, aims to define whether the measure or law under review limits individual liberties too much. Doing this constructs an understanding of the right and the limitation clause. This, then, assumes that it is possible to assess the relative harms and benefits of the act in question. To do so requires defining, for example, the *core* or *outer remit* of the right, or the severity of the breach.<sup>244</sup> According to Aharon Barak, balancing "does not examine the relationship between the goal of the law and the means adopted for its achievement; rather, it examines the relationship between the goal of the law and human rights focusing on the relationship between the benefit gained by the law's realization in comparison to its limit on the rights".<sup>245</sup> Thus, also as a legal theoretical construct, proportionality is about protecting individual rights.

Lastly, in terms of the CJEU's doctrine, proportionality review emerged in EU case-law during the 1970s through internal market cases in which the CJEU had to assess various restrictions on free movement rights and balance them against other public goods.<sup>246</sup> As explained by Paul Craig<sup>247</sup>, the principle was first developed by the CJEU in *Internationale Handelsgesellschaft*, especially in the opinion of Advocate General (AG) Dutheillat de Lamonthe:

"The questions which are submitted to the Court concerning the internal legality of the disputed measures are all linked to one and the same problem, namely whether or not these measures comply with a principle

<sup>&</sup>lt;sup>242</sup> Stone Sweet and Mathews (2019), p. 2.

<sup>&</sup>lt;sup>243</sup> Cohen-Eliya and Porat (2010), p. 266.

<sup>&</sup>lt;sup>244</sup> See Alexy (2005), p. 573.

<sup>&</sup>lt;sup>245</sup> Barak (2010), p. 6.

<sup>&</sup>lt;sup>246</sup> See e.g. Stone Sweet (2004), pp. 109-146.

<sup>&</sup>lt;sup>247</sup> Craig (2012), p. 591.

described as the principle of 'proportionality', under which citizens may only have imposed on them, for the purposes of the public interest, obligations which are strictly necessary for those purposes to be attained."<sup>248</sup>

Since then, proportionality has become a principle that affects not just the (economic) free movement rights but all areas of EU law.<sup>249</sup> This is evident from just a cursory glance at some recent judgments of the Grand Chamber of the CJEU in such contexts as EU citizenship<sup>250</sup>, animal welfare<sup>251</sup>, taxation<sup>252</sup>, environmental protection<sup>253</sup> and copyright.<sup>254</sup>

When the CJEU reviews measures by the EU and conducts a proportionality review, according to Takis Tridimas, what is at stake is finding the appropriate balance between the private and public (EU) interest. In these cases, the CJEU often sets the limit of proportionality according to the *manifestly inappropriate* test, whereas in cases concerning actions of the Member States the applied limit is defined by the *less restrictive alternative* test.<sup>255</sup>

The CJEU has adopted the manifestly inappropriate test for cases concerning decisions of an economic nature, in which it affords broad discretion to the EU institution in question. The leading case in this regard is *Fedesa*, where the CJEU specified that when reviewing a policy decision of economic nature, and thus a decision of discretionary nature, the test to be applied is whether "the measure is manifestly inappropriate having regard to the objective which the competent institution is seeking to pursue".<sup>256</sup> According to Tridimas, this test applies to both the suitability and necessity stages of proportionality review, although the restrictive effects of the measure under review are usually at the centre of attention, in which case the necessity stage is at stake.<sup>257</sup>

The classification of cases as being of an "economic nature" needs further clarification. Indeed, what is described by Tridimas, and also by others<sup>258</sup>, as economic cases are in fact cases that concern individuals' (natural or legal persons) rights relating to economic activity. These cases concern policy areas such as agriculture, fisheries, transport, social policy and human health.<sup>259</sup> However, the economic nature of such cases is different from the cases concerning economic governance measures this article refers to. Although before the German Federal Constitutional Court the claimants

<sup>&</sup>lt;sup>248</sup> Opinion of Advocate General Dutheillet de Lamothe in Internationale Handelsgesellschaft, C-11/70, EU:C:1970:100, p. 1146.

<sup>&</sup>lt;sup>249</sup> See Tridimas (2006), p. 137.

<sup>&</sup>lt;sup>250</sup> See, C-398/19, *Generalstaatsanwaltschaft Berlin* (Extradition vers l'Ukraine), EU:C:2020:1032.

<sup>&</sup>lt;sup>251</sup> See, Centraal Israëlitisch Consistorie van België, C-336/19, EU:C:2020:1031.

<sup>&</sup>lt;sup>252</sup> See, Joined Cases C-245/19 and C-246/19, EU:C:2020:795.

<sup>&</sup>lt;sup>253</sup> See, *Hinkley Point*, C-594/18 P, EU:C:2020:742.

<sup>&</sup>lt;sup>254</sup> See, Recorded Artists Actors Performers Ltd, C-265/19, EU:C:2020:677.

<sup>&</sup>lt;sup>255</sup> Tridimas (2006), pp. 137-138.

<sup>&</sup>lt;sup>256</sup> Fedesa, C-331/88, EU:C:1990:391, para. 14.

<sup>&</sup>lt;sup>257</sup> Tridimas (2006), pp. 142-144.

<sup>&</sup>lt;sup>258</sup> See e.g. Harbo (2010), pp. 171-180.

<sup>&</sup>lt;sup>259</sup> For an overview, see Tridimas (2006), pp. 144-145.

argued that the OMT programme and the PSPP breach their right to democracy, as enshrined by the German constitution, this right was not at issue before the CJEU; before the CJEU the cases were purely about what type of monetary policy measures the ECB can adopt. *Gauweiler* and *Weiss* did not concern a right granted to an individual or an obligation imposed on an individual by EU law. Thus, they differ considerably from the cases through which proportionality originally emerged and the context in which it is usually approached in EU law nowadays.

In summary, historically, theoretically and in practice the principle of proportionality is about individual rights, not about economic governance measures. Although the principle of proportionality is nowadays also applied outside the context of (economic) free movement rights, it is still primarily a means for assessing the legality of the EU's actions in situations when the rights of individuals are at stake.

### 4 The CJEU's proportionality review in *Gauweiler*

Before engaging with the first stage of proportionality review, the CJEU clarifies what its proportionality review is actually about: according to the CJEU, proportionality review is essentially a means-ends analysis; a measure is constitutional "only in so far as the measures that it entails are proportionate to the objectives of that policy" (paragraph 66). The CJEU then further specifies that proportionality review entails an assessment of both suitability and necessity: the measure has to be "appropriate for attaining the legitimate objectives pursued" and it must "not go beyond what is necessary in order to achieve those objectives" (paragraph 67). The content of these two criteria are then further specified by the CJEU through the substance of the case, which necessitates giving broad discretion to the ECB (paragraph 68). However, such discretion is not unbound as the ECB is constrained by the procedural requirement to "examine carefully and impartially" the facts of the case and to justify its choice of means (paragraph 69). The purpose of the obligation to state reasons is, first, to enable concerned parties to understand the reasons behind the measure and, second, to enable the CJEU to conduct its proportionality review in a meaningful manner (paragraph 70).

The CJEU begins the first stage of its proportionality review by explaining the market situation that prevailed during the adoption of the OMT programme: the prices for government bonds were fluctuating and this fluctuation was somewhat irrational and not based on economic facts but rather on speculations on the possible breakup of the euro area (paragraph 72). This meant that the ECB's normal tools for monetary policy (setting interest rates) did not function properly (paragraph 73). According to the CJEU, the ECB's analysis of the market situation was not "vitiated by a manifest error of assessment" (paragraph 74). This was regardless of the fact that "questions of monetary policy are usually of a controversial nature", and thus due to the broad discretion accorded to the ECB "nothing more can be required of the ESCB apart from that it use its economic expertise and the necessary technical means at its disposal to carry out

that analysis with all care and accuracy" (paragraph 75). The purpose of such contextualisation is to provide the necessary base for the assessment of suitability: to assess whether the OMT programme is a suitable means of tackling the economic crisis at hand, we need to first know what is causing the crisis. In other words, for the means and ends to be in a rational relationship with each other, we need some understanding of the societal problem at hand and of the causality related to it.

The CJEU then moves to characterising the OMT programme and thus to assess its suitability to solve the problem. According to the CJEU, in such an irrational market situation the OMT programme is "likely to contribute to reducing those rates by dispelling unjustified fears about the break-up of the euro area and thus to play a part in bringing about a fall in - or even the elimination of — excessive risk premia" (paragraph 76). This passage is rather complicated and it is not immediately obvious what the CJEU is actually saying here. It needs to be remembered that the purpose of the suitability test is to assess whether the chosen means is appropriate (fitting, apt or proper) for achieving the desired ends (objective). The OMT programme is the means, but what exactly are the ends; (i) reducing excessive interest rates and risk premia; or (ii) "dispelling unjustified fears about the break-up of the euro area"? These two are undoubtedly related, but what is the relationship between them, and, furthermore, what is the OMT programme's connection to them? If we think about suitability causally, in a means-ends manner, what is the CJEU saying here?

The CJEU then continues by stating that the ECB was entitled to assume that lowering such excessive risk premia would be conducive towards the ECB's normal monetary policy instruments becoming functional again (paragraph 77). This is due to how government bond prices transmit into the real economy (paragraph 78). Furthermore, the ECB seems to have been correct in its assessment, as the mere announcement of the OMT programme brought about the desired market reaction (paragraph 79). On this basis the CJEU concludes that the ECB "could legitimately take the view that [the OMT programme] is appropriate for the purpose of contributing to the ESCB's objectives and, therefore, to maintaining price stability" (paragraph 80). Maintaining price stability is the ECB's main duty, constitutionalised in Article 127(1) TFEU, but what is the relationship between price stability and the two objectives of reducing interest rates and dispelling fears about the breakup of the euro area?

In the second stage of its proportionality review, the CJEU seeks to establish whether the OMT programme goes "manifestly beyond what is necessary to achieve" the ECB's objectives (paragraph 81). Here, the CJEU first starts with what seems almost *a petitio principii* when it notes that even according to the ECB's own statement about the OMT programme "the purchase of government bonds on secondary markets [through the OMT] is permitted only in so far as it is necessary to achieve the objectives of that programme and that such purchases will cease as soon as those objectives have been achieved" (paragraph 82), as if the ECB's statements as such could define the legality of the programme.

When it comes to the actual analysis of necessity, the fact that the OMT programme was never used (as the case concerned its announcement and not its use) makes the CJEU's task somewhat different than in most other cases. The CJEU first recalls that should the programme be used, this would "be dependent upon an in-depth assessment of the requirements of monetary policy" (paragraph 83). The CJEU then reiterates the ECB's view that according to its economic analysis there has been no need to use the OMT programme so therefore it has remained unused since its announcement (paragraph 84). The CJEU regards this as an expression of how the use of the OMT programme "is strictly subject to the objectives of that programme" (paragraph 85). What the CJEU is apparently trying to establish here, with regard to the necessity test, is that the very fact that it was never used means that it does not constitute a manifest breach. As the CJEU is applying the criteria of a manifest breach (and not the least restrictive means test), due to the discretion given to the ECB, this reasoning seems logical.

The CJEU then further reinforces this view by analysing the different ways in which the scale of the OMT programme is limited (paragraphs 86 to 90). The purpose of this analysis relates to the fact that the programme can subject the Member States to losses<sup>260</sup>, but the scope of these (possible) losses is limited to the same extent as is the scale of the OMT programme. This, too, means that the OMT programme does not manifestly go beyond what is necessary. At this stage the CJEU again refers to the effectiveness of the OMT programme by explaining how a quantitative upper limit for purchases through the OMT programme would reduce its effectiveness (paragraph 88). This is linked to the way in which the markets operate and that they were irrational: the ECB needs to have an unlimited reserve so as to be credible from the perspective of the markets - so that it can do "whatever it takes".<sup>261</sup> The CJEU also brings up the rationality of the OMT programme when it states that the very fact that it would only target select Member States (and not all of them as is the case with normal monetary policy instruments) is not problematic as the target Member States are selected with a view to the objectives of the programme and "not by means of an arbitrary selection" (paragraph 90). In conclusion, the gist of the CJEU's necessity test seems to be that as the OMT programme would have been applied by experts on the basis of an expert assessment and in a rational manner it therefore passes the second stage of the Court's proportionality review.

Finally, the CJEU also dedicates one paragraph to the third stage of proportionality review – balancing – although in this paragraph it does not actually conduct any analysis itself. The CJEU needs to be quoted *in extenso* here: "In the third place, the ESCB weighed up the various interests in play so as to actually prevent disadvantages from arising, when

<sup>&</sup>lt;sup>260</sup> The Member States are *owners* of the ECB, so if a debtor defaults on the ECB it is ultimately the Member States who bear the costs.

<sup>&</sup>lt;sup>261</sup> Speech by Mario Draghi, President of the ECB, at the Global Investment Conference. London, 26 July 2012. The whole sentence reads: "Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough."

the programme in question is implemented, which are manifestly disproportionate to the programme's objectives" (paragraph 91). But what are the various interests in play? The CJEU neither names them nor explains how the ECB weighed them up against each other.

However, it seems that the CJEU discussed this issue after having finished its explicit proportionality review, when answering the third question of the preliminary referral: whether the OMT programme breaches the ban on central bank financing in Article 123 TFEU (paragraphs 93 to 127). This becomes easier to notice after Weiss, since there the CJEU guotes this part of *Gauweiler* in the third step of its proportionality review (paragraph) 94; citing Gauweiler paragraph 125). At this point of the judgment in Gauweiler the CJEU explains how open market operations such as the OMT programme, which the ECB can engage in, inevitably expose it to a risk of losses, and how the ESCB Statute prescribes how these losses are to be shared between the euro area Member States. These are risks "which the Bank may take in order to achieve the objectives of monetary policy" (paragraph 125). Thus, it appears that the balancing exercise in the third stage of proportionality review is conducted between the possible risk of losses incurred by the ECB (that would be shared between the Member States) and the objectives that the ECB is pursuing with the OMT programme.

### 5 The CJEU's proportionality review in *Weiss*

In *Weiss*, the CJEU's approach towards proportionality review is a bit more detailed than in *Gauweiler*, not just because the Court's analysis in the third stage was more complete but also in the way it framed the proportionality review. The title of the section on proportionality is already very specific about what the analysis concerns: "Proportionality in relation to the objectives of monetary policy" (paragraph 70).

When laying out its proportionality review in *Weiss* the CJEU refers solely to *Gauweiler* and how proportionality was framed there. In fact, the content of those three paragraphs from *Gauweiler* (paragraphs 66 to 68) are reproduced in exactly the same way in *Weiss* (paragraphs 71 to 73).

As was the case in *Gauweiler*, here too the CJEU begins its suitability test by describing the market situation prevailing at the time of adoption of the PSPP: prices were declining and there was a risk of deflation (paragraph 74). Here, the CJEU is able to rely on quantifiable data, that is the rate of inflation in the euro area. As inflation was considerably lower than the target level of 2%, the ECB needed to act (paragraph 75). According to the ECB, buying government bonds through the PSPP will boost aggregate spending and thereby bring inflation closer to the target level (paragraph 76). To ascertain that this is what the PSPP actually does – that is, that PSPP purchases are a suitable means for reaching the desired end of an inflation level close to 2% – the ECB referred "to the practices of other central banks and to various studies" according to which such purchases achieve this "by means of facilitating access to financing" (paragraph 77). Again, as in *Gauweiler*, the CJEU concludes that this assessment by the ECB did not appear to have been "vitiated by a manifest error of assessment" (paragraph 78). The PSPP is thus an appropriate means for achieving the desired ends. The CJEU's logic in this first step of its proportionality review seems to be that as the issue could be quantified by numbers and assessed on the basis of scientific studies – i.e. that it was calculable and rational – it can thus assume that it is suitable.

As to the second part of its proportionality review, the CJEU again decides to apply the test of manifest disproportionality (as opposed to the least restrictive means test) (paragraph 79). In justifying the ECB's choice of means, the CJEU (by reference to the statement of the ECB) first notes, again, the economic context of persistently low inflation. Relying on the factual context seems to fit well with the manifestly disproportionate test: there is no comparison between different means, just an assessment of whether the chosen means was reasonable in the given circumstances. However, the CJEU then continues (again by reference to the ECB) that the ECB was unable to counter deflation "by means of the other instruments available to [it] for increasing inflation rates". Furthermore, the Court states that the ECB "had, for several months, already been implementing a programme of large-scale purchases of private sector assets" (paragraph 80).

By doing this the CJEU seems to be veering towards the least restrictive means test. Indeed, the CJEU explicitly states that "it does not appear that the ESCB's objective could have been achieved by any other type of monetary policy measure entailing more limited action on the part of the ESCB" (paragraph 81). Yet, in the very same sentence the CJEU then concludes that "in its underlying principle, the PSPP does not manifestly go beyond what is necessary to achieve that objective" (paragraph 81). It appears, thus, that the CJEU is either conflating two tests or applying the manifestly disproportionate test and, just in case, also including elements resembling the least restrictive means test. From the perspective of doctrinal constructivism this is problematic, as the conflation of the two tests does not create helpful precedents.

Still, the CJEU then continues its necessity test and looks at the ways in which the application of the PSPP is constrained (paragraphs 82 to 92). Here, the CJEU's logic is that by studying the practicalities of how the PSPP functions it can be established whether the PSPP actually goes beyond its stated objectives (i.e. whether its effects are broader than just to increase inflation) and whether it would thus still breach the necessity requirement. In other words, while the first part of the CJEU's necessity test is about whether it goes beyond those stated ends, this second part is about whether it goes beyond those stated ends. Whereas in *Gauweiler* the CJEU emphasised the fact that the OMT programme has not been used, it now emphasises the restricted manner in which the PSPP has been used, for example how it has been regularly revised taking into consideration market conditions (paragraph 88). Furthermore, the CJEU also reiterates the point it made already in *Gauweiler* paragraph 75). However, what is

interesting is that in *Gauweiler* this statement was presented as part of the first stage of proportionality review whereas in *Weiss* it appears as part of the second stage.

Finally, the CJEU then ends its necessity test by yet again restating what appears like the least restrictive means criteria:

"it is not apparent that a government-bonds purchase programme of either more limited volume or shorter duration would have been able to bring about — as effectively and rapidly as the PSPP — changes in inflation comparable to those sought by the ESCB, for the purpose of achieving the primary objective of monetary policy laid down by the authors of the Treaties" (paragraph 92).

As was already stated, the third stage of the CJEU's proportionality review seemed to be more complete this time. The CJEU starts this stage with a reference to the opinion of AG Wathelet (paragraph 93). In his highly learned opinion AG Wathelet cites the debates within the ECB Governing Council upon deciding on the extension of the PSPP. According to the minutes of the Governing Council's monetary policy meeting the governors concluded "that the risk of policy inaction clearly outweighed the risk of action" and furthermore that "the effectiveness of further monetary policy action had to be weighed against its potential costs and side effects" (paragraph 144).<sup>262</sup> According to the CJEU this means that "the ESCB weighed up the various interests involved so as effectively to prevent disadvantages which are manifestly disproportionate to the PSPP's objective from arising on implementation of the programme" (paragraph 93).

The CJEU then cites the paragraph from *Gauweiler* discussing the possibility of losses arising due to open market operations (paragraph 94; citing *Gauweiler* paragraph 125), as discussed above. Here, the CJEU refers to the practicalities related to the application of the PSPP, which it had already assessed in the second half of its necessity test as it sought to establish whether the PSPP goes beyond what is necessary (paragraph 95). The CJEU then discusses further practicalities that limit Member States' liabilities in case of a default by a Member State whose bonds have been purchased by the ECB through the PSPP (paragraphs 96 to 99). These considerations lead the CJEU to conclude that the PSPP does not infringe the principle of proportionality (paragraph 100).

### 6 Comparison

Next, I will briefly point out the main differences between the CJEU's reasoning in the two cases.

AG Wathelet cites the ECB Governing Council's monetary policy meeting on 2 and 3 December 2015, in particular pp. 15-17 of the French language version, available on the Banque de France website.

Regarding suitability, the CJEU's task was easier in *Weiss* as the mere statistical existence of an inflation level considerably lower than that of the stated objective (2%) was enough to meet this criterion. Contrary to this, in *Gauweiler* the CJEU had to accept the ECB's view of irrational markets as the basis of suitability, while at the same time stating that this conclusion by the ECB cannot actually be questioned in a manner that would alter the result of the CJEU's assessment.

In *Weiss* the CJEU actually assessed, although cursorily, whether there could have been any other measures that the ECB could have taken instead of the PSPP. However, as the normal monetary policy instruments were clearly not effective the PSPP also passed the necessity test. What the CJEU did under the heading of necessity in *Gauweiler* seems to resemble balancing, since, instead of assessing alternative measures, the CJEU analysed whether the OMT programme goes beyond what is necessary for achieving the set objectives.

When it came to balancing, the third stage of proportionality review, in *Weiss* the CJEU managed to outline the interests at stake and also identified criteria on the basis of which to weigh these interests and balance them against each other. Conversely, in *Gauweiler* the CJEU did not manage to explicitly spell out the competing interests nor the criteria that it, or the ECB, used in weighing these interests. However, the CJEU did engage with similar issues in other parts of the judgment.

### 7 Brief analysis

How do these observations about the CJEU's proportionality review in *Gauweiler* and *Weiss* come across if observed from the perspective of Weber's schemata on the formal rationality of modern law?

At first sight it appears that the CJEU's proportionality review in the two cases is characterised by formal rationality. In both cases the objective seems to be price stability, either directly or indirectly, which is an objective prescribed by the Treaties. Thus, no external objectives, devised by the judges themselves, seem to have affected the proportionality review. Furthermore, expert knowledge and guantifiable data played a key role in both the suitability and necessity tests. This too attests to the formal and legalistic character of the CJEU's review. Finally, in Gauweiler there was no explicit balancing of interests, to which formalists such as Weber would perhaps assent. In Weiss, although the CJEU did a better job at outlining the different interest at stake, it did not itself carry out any balancing exercise, deferring this task to the ECB's Governing Council instead. While the distinctive concerns could perhaps have been quantified (e.g. the amount of purchases and thus the extent of the possible risks), and would thus be undoubtedly rational, the lack of any explicit balancing of interests is a more formally rational outcome than having to engage in such balancing. Overall, the fact that the ECB was accorded broad discretion

aligns well with Weber's views on how formal rationality of law, bureaucracy and capitalism are connected to one another.<sup>263</sup>

Yet, there are also elements in the CJEU's proportionality review that can be characterised as substantively rational – or at least lacking formal rationality. This is the case with regard to the CJEU's analysis of the suitability of the OMT programme as it remained unclear what the means and the ends are (reducing excessive interest rates and risk premia, dispelling unjustified fears about the break-up of the euro area or securing price stability) and how the OMT programme relates to them. In other words, are the ends already inscribed into the means, in which case both the ends and the means are not set rationally?

And what about the CJEU's capability to withstand extralegal interests? According to Weber, the legitimacy of the legal order is based on its formal rationality, which secures legal certainty and individual rights, and thus is also central to the rule of law. If extralegal interests enter the arena of adjudication legitimacy is lost.<sup>264</sup> On the basis of the analysis of the CJEU's proportionality review in these two cases it is difficult to give a definite conclusion on this point. While the abovementioned conflation between means and ends could be read as an example of anti-formalism and extralegal elements seeping into the CJEU's argumentation, more direct examples of this could perhaps be found in other parts of the two judgments. This is especially the case with regard to those passages where the CJEU addresses the issue of moral hazard and the impetus to follow a market logic.<sup>265</sup>

### 8 Conclusion

In this article I have briefly explored the hypothesis that proportionality review may not function well in economic governance-related cases because it originates from and is geared towards analysing state breaches of individual rights. I did this within the framework of formally rational modern law, as depicted by Max Weber, and by using the CJEU's landmark judgments *Gauweiler* and *Weiss* as material. Although my analysis is very brief and perhaps even superficial, I believe that it established the following points.

First, there is indeed more to the CJEU's proportionality review in *Gauweiler* and *Weiss* than meets the eye at first. Although the judgments are amongst the most commentated, and the CJEU's proportionality review therein has also received considerable attention, the connection between means and ends, as well as the role of expert knowledge and rationality in the CJEU's argumentation, can still be explored further. This takes me to the next point. Second, it appears, at least in my humble opinion, that

<sup>&</sup>lt;sup>263</sup> See Weber (1978), pp. 218-221; and Tuori (2002), pp. 50-51.

<sup>&</sup>lt;sup>264</sup> Weber (1978), pp. 882-886 and chapter 7; and Everson (2007), p. 139.

<sup>&</sup>lt;sup>265</sup> On this aspect of *Gauweiler*, see Tuominen (2019) and Schepel (2017).

Weberian concepts are useful in uncovering what takes place in the CJEU's proportionality review in these two cases – and perhaps also in other cases. Indeed, as pointed out above, it is, for example, not always clear what means and ends the CJEU is assessing, and what their relationship is. Lastly, as an answer to the question that can be derived from the hypothesis presented in the introduction, I posit that proportionality review can work in economic governance cases although at first it might seem that applying it in such a context might be difficult as it emerged and developed further within the context of individual rights. There is of course already ample literature on this issue within the broader body of scholarship on proportionality, for example the debate between procedural (formal) and substantive review, but I maintain that in the context of EU law there is something peculiar to proportionality review. Perhaps it is the fact that such economic governance cases are actually about competence and not about rights?

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# Proportionality and discretion in EU law: in search of clarity

By Vasiliki Kosta\*

### 1 Introduction

In EU law proportionality takes what Porat calls the "classic or standard form"<sup>266</sup> of proportionality as a public law tool. This classic form originates in Germany, the system in which proportionality first appeared as a discrete legal doctrine. While this form is not used in all legal systems, it is the one "most associated with the doctrine, and most often referred to as the benchmark for its ideal type".<sup>267</sup> It finds expression in a structured threestep test: first, "suitability", sometimes also called "appropriateness" or "rationality"<sup>268</sup>, which requires that the action be suitable for achieving a legitimate aim<sup>269</sup>: second, necessity, which requires that there be no other less restrictive (of the protected right or interest) but equally effective means available to achieve the legitimate aim; third, proportionality in the strict sense (*stricto sensu*), which requires that the interference with or harm to the protected right or interest be justified (or outweighed) in the light of the gain resulting from pursuing the legitimate aim. This is sometimes also called the "balancing" stage of the application of the principle of proportionality. Proportionality in the German system, be it in administrative or constitutional law, is a tool that serves the protection of fundamental rights.

In EU law, unlike in German law, the test is not always fully or consistently applied.<sup>270</sup> For example, in internal market law (but also in other fields), the Court of Justice of the European Union (CJEU) typically limits itself to examining only the first two steps of the test (suitability and necessity). Some understand that the CJEU includes the third balancing step in the

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Porat, I. (2018), "Proportionality" in Grote, R., Lachenmann, F. and Wolfrum, R. (eds), Max Planck Encyclopedia of Comparative Constitutional Law, Oxford University

Max Planck Encyclopedia of Comparative Constitutional Law, Oxford University Press, https://oxcon.ouplaw.com/view/10.1093/law-mpeccol/law-mpeccol-e38, SSRN advanced draft version, available at: https://papers.ssrn.com/sol3/papers. cfm?abstract\_id=3792846, p. 1.

<sup>&</sup>lt;sup>267</sup> ibid.

<sup>268</sup> ibid.

<sup>&</sup>lt;sup>269</sup> In some systems this step is split into two steps, making the proportionality test a four-step test: the first concerns the existence of a legitimate aim; the second, the suitability of the action. Whereas in other systems the existence of the legitimate aim precedes the three-step proportionality inquiry.

<sup>&</sup>lt;sup>270</sup> Porat, op. cit.; Van Gerven, W. (1999), "The Effect of Proportionality on the Action of Member States of the European Community: National Viewpoints from Continental Europe", in Ellis, E., *The Principle of Proportionality in the Laws of Europe*, Hart Publishing.

second step. Sometimes, in cases where the CJEU limits itself to two stages of inquiry, it is unclear which step of the test it is engaging in.<sup>271</sup>

Notably, and importantly for the subject of this contribution, the test also changes in the case of discretionary policy choices of the administrative/ political arm of the EU where no fundamental rights are at stake (where judicial review is more intense and the full three-part test is typically applied). This is well known from longstanding CJEU jurisprudence and standard textbook accounts.<sup>272</sup> The conventional understanding is that proportionality is "less intensely"<sup>273</sup> applied in these cases because courts "should not substitute their own judgment with that of the administration"<sup>274</sup> or the legislature.

This contribution will reveal that this area of the law is marked by a certain lack of clarity. One reason for this is that, when proportionality is applied to measures involving discretionary choices, it takes the form of reading other grounds of judicial review into it in such manner that the relationships between them are not always clear. Moreover, the tests are not always consistently applied. Confusion can also arise when a version similar to the three-step test as formalised after the Second World War by the German Constitutional Court<sup>275</sup> is taken outside its original context of fundamental rights protection and is applied in this area. This is so even if the separate steps are tested by means of a low intensity review. To demonstrate this, it is necessary to set out the applicable tests, which I shall do in the following section.

### 2 Proportionality and discretionary choices: judicial review of EU measures

## 2.1 The applicable tests for reviewing the exercise of discretion

As regards the question of the applicable tests, Koen Lenaerts, in his keynote speech at this conference, provided an overview of the proportionality test based on case-law that involves discretionary policy

<sup>&</sup>lt;sup>271</sup> Van Gerven (ibid.) quotes the following formula used by the Court in the older case of *Formançais* v *FORMA*, C-66/82, EU:C:1983:42, para. 8: "in order to establish whether a provision of Community law is consonant with the principle of proportionality, it is necessary to establish, in the first place, *whether the means it employs to achieve its aim correspond to the importance of the aim* and, in the second place, whether they are necessary for its achievement." (Emphasis added.) He points out that the phrasing put here in italics could be relating to either suitability (the first step) or proportionality *stricto sensu* (the third step).

<sup>&</sup>lt;sup>272</sup> See, e.g., Craig P. (2012), *EU Administrative Law*, Oxford University Press, Chapter 19.

<sup>&</sup>lt;sup>273</sup> ibid., p. 592.

<sup>&</sup>lt;sup>274</sup> ibid.

<sup>&</sup>lt;sup>275</sup> Porat, op. cit. (footnotes 266 and 268).

choices (where complex, technical, scientific, economic or political assessments are to be made). It is useful to cite the relevant passages in full:

"[J]udicial review must be limited 'to verifying whether there has been a manifest error of assessment or a misuse of powers, or whether the legislature has manifestly exceeded the limits of its discretion.' [Judgment of 22 May 2014, *Glatzel*, C-356/12, EU:C:2014:350, para. 52][<sup>276</sup>] According to that *standard*, a measure is invalid only if manifestly inappropriate in relation to the objective pursued [Judgment of 8 December 2020, *Poland v Parliament and Council*, C-626/18, EU:C:2020:1000, para. 95]." [Emphasis added.]<sup>277</sup>

"That wide margin of assessment is recognised to the legislature in the different stages of the legislative process. Thus, it covers not only the 'definition of the objectives to be pursued... and choice of the appropriate means of action' [Judgment of 15 April 1997, *Bakers of Nailsea*, C-27/95, EU:C:1997:188, para. 32], 'but also to some extent to the finding of basic facts' [Judgment of 13 March 2019, *Poland v Parliament and Council*, C-128/17, EU:C:2019:194, para. 97]. The EU judge is thus not allowed to 'substitute [his assessment of scientific and technical facts for that of the legislature on which the Treaty has placed that task.' [Judgment of 21 June 2018, *Poland v Parliament and Council*, C-5/16, EU:C:2018:483, para. 150]."

In addition, "the Court will take into account the evolving nature of the available data. When 'the [EU] legislature has to assess the future effects of legislation to be enacted although those effects cannot be accurately foreseen, its assessment is open to criticism only if it appears manifestly incorrect in the light of the information available to it at the time of the adoption of the legislation' [36]. The validity of an EU measure 'cannot depend on retrospective assessments of its efficacy' [37]."<sup>278</sup>

Lenaerts went on to explain that this limited judicial review of proportionality was applied in *Gauweiler* and *Weiss*: as the ECB's decisions in these cases are within a complex and inherently political area this justifies "limiting the Court's review of proportionality to manifest errors of assessment or misuse of powers"<sup>279</sup> (note, however, that Lenearts omits here the formula "manifestly exceeding the bounds of its discretion"). In these cases, Lenaerts explains further, there is no room for the Court to conduct an ultimate "balancing exercise". In the cases at hand, which required a complex policy or technical assessment, or both, this exercise

<sup>&</sup>lt;sup>276</sup> This formula is explicitly cited as part of the principle of proportionality in this paragraph of the *Glatzel* case: "As far as concerns judicial review of the requirements of the principle of proportionality".

<sup>&</sup>lt;sup>277</sup> Lenaerts, K. (2021), "Proportionality as a matrix principle promoting the effectiveness of EU law and the legitimacy of EU action", Keynote speech at ECB Legal Conference 2021, available on the ECB website at: www.ecb.europa.eu/pub/conferences/ html/20211125 4th ECB legal conference.en.html

<sup>&</sup>lt;sup>278</sup> ibid., p. 8.

<sup>&</sup>lt;sup>279</sup> ibid., p. 9.

remained the task of the ECB. In other cases, it may be that it is the task of the administrative, executive or legislative.

We shall now turn to demonstrating how that low-intensity standard of review of proportionality (proportionality being a substantive ground of review) takes the form of reading other grounds of review, which are also sometimes blended (substantive or procedural) into it.

## 2.2 The overlap between the low-intensity standard of proportionality and other grounds of judicial review

#### 2.2.1 Proportionality versus misuse of powers

Misuse of powers is expressly listed in Article 263(2) of the Treaty on the Functioning of the European Union (TFEU) as a distinct ground of judicial review. According to consistent case-law, the applicable test is as follows: a measure is "vitiated by misuse of powers only if it appears on the basis of objective, relevant and consistent evidence to have been taken with the exclusive or main purpose of achieving an end other than that stated or evading a procedure specifically prescribed by the Treaty for dealing with the circumstances of the case".<sup>280</sup> Misuse of powers asks about the motives of the author of the measure. It is thus a subjective test and, therefore, difficult to prove. It differs from the proportionality test in that, as explained by Türk, in proportionality "the institution pursues a proper objective with inappropriate means, whereas in cases of misuse powers the institution pursues an improper objective".<sup>281</sup>

*Spain* v *Council*<sup>282</sup> illustrates the difference between these two grounds of review. In this case, a cotton support scheme was challenged on several grounds, including misuse of powers and proportionality, as separate grounds of alleged illegality. And indeed the CJEU reviewed them separately. It dismissed the "misuse of powers" claim on the following grounds: first, there was no indication that the Council pursued an exclusive or main aim other than that stated in the relevant recitals of the regulation at issue (Regulation No 864/2004).<sup>283</sup> Second, Spain had not shown that the Council "pursued the exclusive or main aim of evading the procedure prescribed for the revision of provisions of primary law".<sup>284</sup> The Regulation at issue was based on paragraph 6 of Protocol No 4 on cotton (annexed to the Act of Accession of the Hellenic Republic)<sup>285</sup>, which conferred on the Council "a wide discretion to decide on the necessary

<sup>&</sup>lt;sup>280</sup> Swedish Match and Others, C-2010/03, EU:C:2004:802, para. 74.

<sup>&</sup>lt;sup>281</sup> Türk, A. (2010), Judicial Review in EU Law, Edward Elgar Publishing, p. 142.

<sup>&</sup>lt;sup>282</sup> Kingdom of Spain v Council of the European Union (Spanish Cotton), C-310/04, EU:C:2006:521.

<sup>&</sup>lt;sup>283</sup> ibid., para. 71.

<sup>&</sup>lt;sup>284</sup> ibid., para. 72.

<sup>&</sup>lt;sup>285</sup> Protocol 4 on cotton (OJ L 291, 19.11.1979, p. 174).

adjustments to the cotton support scheme provided for by the protocol<sup>7286</sup>. Spain had not shown that the Council pursued an aim other than making such adjustments.<sup>287</sup> The Court also noted that the Council intended to comply with the objectives laid down in paragraph 2 of Protocol 4.<sup>288</sup> Importantly, the Court stated that the question of whether those objectives had been achieved was the subject of the (next) plea alleging breach of the principle of proportionality, and there was therefore no need to examine it under this heading.<sup>289</sup>

## 2.2.2 Proportionality versus "manifest error" (of appraisal/of assessment)

To complicate things further, Nehl notes that because of a restrictive interpretation of the "misuse of powers" ground in the Court's case-law, it "has lost its practical relevance in the context of reviewing the exercise of discretion... and largely been replaced by the 'manifest error of appraisal' test (erreur manifeste d'appréciation), although it is not expressly provided for in Article 263(2) TFEU".<sup>290</sup>

"Manifest error" finds its origins in French administrative law. According to Marketou, it was introduced in the early 1960s when "the administrative judges affirmed their power to sanction manifest errors (erreur manifeste) in the factual grounds of public authorities, even in cases of discretionary powers [FN 228]. In this way, the plausibility of factual appreciations became part of the legality of administrative action".<sup>291</sup> Marketou's evolutionary account also gives us an insight into how "manifest error" has been linked to the term "proportionality" in French administrative law, which is thought to have influenced EU law. She explains the influence of scholarship in the 1970s – the works of Francoise Drevfus and Guv Braibant – by describing this method of judicial review (together with others, such as the necessity review for restrictions on individual liberty), in retrospect, as "expressing the idea of proportionality".<sup>292</sup> The courts themselves were not using this term. These authors seem to have used the word "proportionality" in a looser sense (expressing ideas of efficiency and common sense) than in the German legal context, and its use was not tied to the protection of fundamental rights, which is served by the classic three-part test.

<sup>&</sup>lt;sup>286</sup> Spain v Council, op. cit., para. 73.

<sup>&</sup>lt;sup>287</sup> Spain v Council, op. cit., para. 74.

<sup>&</sup>lt;sup>288</sup> "[T]o support the production of cotton in regions of the Community where it is important for the agricultural economy, to permit the producers concerned to earn a fair income, and to stabilise the market by structural improvements at the level of supply and marketing." *Spain* v *Council*, para. 75.

<sup>&</sup>lt;sup>289</sup> ibid., para. 76.

<sup>&</sup>lt;sup>290</sup> Nehl, H. P. (2019), "Judicial Review of Complex Socio-Economic, Technical, and Scientific Assessments in the European Union", in Mendes, J., *EU Executive Discretion and the Limits of Law*, Oxford University Press, p. 164.

<sup>&</sup>lt;sup>291</sup> Marketou, A. I. (2018), Local Meanings of Proportionality – Judicial Review in France, England, Greece, EUI PhD thesis, Florence, 19 September 2018, p. 55.

<sup>&</sup>lt;sup>292</sup> ibid., p. 63.

Nehl further explains that the concept was introduced in French administrative law to provide more effective, yet, importantly, limited judicial control, over what was thus far unfettered administrative discretionary power that resulted from a "division of powers requirement".<sup>293</sup> This background is given as one of the reasons why, in EU law, "more than 30 years of case law has not given rise to more clarity as to its actual scope and content and the way in which the Union courts are prepared to use it".<sup>294</sup>

Despite that lack of clarity, some scholars have attempted to map the field. As regards the intensity of review of manifest error, Craig notes, for example, that even though initially it was applied as a ground of very low-intensity review, more recently it has served as a ground of more intensive judicial control in areas such as risk regulation or competition.<sup>295</sup>

Regarding its scope, Nehl states that "manifest errors" relate to both the finding of complex facts and discretionary acts "that imply a choice between different policies or objectives (discretion proper or pure volition) or the balancing between conflicting interests the administration is empowered to make".<sup>296</sup> In this context, Nehl cites the *Afton Chemical* case.<sup>297</sup> In *Afton Chemical*, however, there is a separate examination of whether a provision in a directive that limited the use of a certain metallic fuel additive (MTT) in fuel as of a certain date was invalid because of a "manifest error of assessment"<sup>298</sup> or because of a "failure to comply with the principle of proportionality and the precautionary principle".<sup>299</sup> In the first examination under the "manifest error" heading the Court cited the following formula, which includes parts of what Lenaerts (see citation above) referred to as a standard of review of proportionality:

"in an area of evolving and complex technology such as that in the case in the main proceedings, the European Union legislature has a *broad discretion, in particular as to the assessment of highly complex scientific and technical facts* in order to *determine the nature and scope of the measures* which it adopts, whereas review by the Community judicature has to be limited to verifying whether the exercise of such powers has been *vitiated by a manifest error of appraisal or a misuse of powers, or whether the legislature has manifestly exceeded the limits of its discretion.* In such a context, the *Community judicature cannot substitute its assessment of scientific and technical facts for that of the legislature* on which the Treaty has placed that task."<sup>300</sup> [Emphases added.]

<sup>&</sup>lt;sup>293</sup> Nehl, op. cit., p. 179.

<sup>&</sup>lt;sup>294</sup> Nehl, op. cit., p. 178.

<sup>&</sup>lt;sup>295</sup> Craig, P., "EU Administrative Law – The Acquis", Note for the European Parliament DG for Internal Policies, Policy Department C: Citizens' Rights and Constitutional Affairs, Legal Affairs, PE 432.745, p. 8. Available at: www.europarl.europa.eu

<sup>&</sup>lt;sup>296</sup> Nehl, op. cit., p. 188.

<sup>&</sup>lt;sup>297</sup> Afton Chemical, C-343/09, EU:C:2010:419.

<sup>&</sup>lt;sup>298</sup> ibid., para. 28 et seq.

<sup>&</sup>lt;sup>299</sup> ibid., para. 70 et seq.

<sup>&</sup>lt;sup>300</sup> ibid., para. 28.

The Court then went on to examine the claims that the imposition of limits for MMT content were the result of a manifest error of assessment of the facts by the Council and Parliament.

In a separate step, it examined proportionality and the precautionary principle. As for the applicable test, the Court first referred to what looks like the classic three-part test:

"[M]easures adopted by Community institutions do not exceed the limits of what is appropriate and necessary in order to attain the objectives legitimately pursued by the legislation in question; when there is a choice between several appropriate measures recourse must be had to the least onerous, and the disadvantages caused must not be disproportionate to the aims pursued."<sup>301</sup>

It then noted that the legislature enjoys a broad discretion in an area that involves political, economic and social choices, and in which it is called upon to undertake complex assessments.<sup>302</sup> Because of that,

"[t]he legality of a measure adopted in that sphere can be affected only if the measure is *manifestly inappropriate* having regard to the objective which the competent institutions are seeking to pursue."<sup>303</sup> [Emphasis added.]

Note that the language of "appropriateness" might be confusing here. When applying the "manifestly inappropriate" standard, the CJEU does not necessarily limit itself to reviewing "appropriateness" as the first step of the three-part proportionality test; it may test whether a measure is "manifestly unnecessary" and "manifestly disproportionate" in the strict sense. Note, however, that it does not always do so.<sup>304</sup> This case then shows that, in some cases involving complex discretionary choices, the CJEU does also look into the third step of the proportionality test, albeit with low intensity, so that it does not substitute its own balance for that of the legislature.<sup>305</sup> The important point here is that the word "manifest" points to low-intensity review and the "manifestly inappropriate" formula seems to be key for such proportionality review.

If, then, in *Afton Chemical*, the manifest error of assessment test was applied to the finding of facts, whereas the proportionality and the precautionary principle were applied to test (with low intensity) the choices

<sup>&</sup>lt;sup>301</sup> ibid., para. 45.

<sup>&</sup>lt;sup>302</sup> ibid., para. 46.

<sup>303</sup> ibid.

<sup>&</sup>lt;sup>304</sup> It is not always clear what exactly the "manifestly inappropriate" standard is testing vis-à-vis the three-step test. Thus, in relation to *Spain v Council*, op. cit., Groussot reads the "manifest inappropriateness" test as relating to the second limb of the proportionality test, namely necessity. Groussot, X. (2007), Case Comment, 44 *CMLRev* (2007), p. 761 at 773-774; but arguably it can also be understood to refer to the first step (suitability).

<sup>&</sup>lt;sup>305</sup> Afton Chemical, op. cit., paras. 56-69, where the precautionary principle was considered in the proportionality *stricto sensu* stage. See also *Philip Morris*.

made by the legislature in mediating between competing interests<sup>306</sup>, how can we understand Nehl's point above that "manifest error" relates not only to the finding of complex facts but also to discretion proper and to the balancing of competing interests? The answer might be found by construing the "manifestly inappropriate" formula as being an emanation of the "manifest error" test. Perhaps this is how Nehl's following statement is to be understood: "the case law has closely connected [proportionality] review to the test of manifest error by sanctioning only 'manifestly inappropriate' measures or policy choices with regard to the objective pursued".<sup>307</sup> The explanation by Lenaerts above that "manifest error" (next to "misuse of powers" and the question of whether "the legislature has manifestly exceeded the limits of its discretion") is a standard based on which "manifest inappropriateness" can be found could then also be read in this light. Note that, while such a reading is possible, it is certainly confusing. This confusion is further exacerbated when the case-law is not consistent on where it places the tests: so, for example, a formula for testing what is termed "proportionality" in Spain v Council<sup>308</sup> was cited under the separate heading "manifest error of assessment", and outside the separate heading "proportionality", in Afton Chemical.309

There is a final question concerning "manifest error". That question concerns the relationship between "manifest error" and the formula "manifestly exceeding the limits of discretion" and, in addition, how that relates to proportionality. Christophe Sobotta seems to suggest that "manifest error of assessment" coincides with "manifestly exceeding the limits of discretion" in his statement that "[s]ubstantive review by the EU judicature only verifies whether the authorities have manifestly exceeded the limits of their discretion (manifest error test)".<sup>310</sup> However, the language used by the CJEU suggests that these are two separate tests (this is evidenced by the use of the word "or"). Furthermore, the wording in the relevant passages of the case-law cited by Sobotta does not indicate such coincidence.<sup>311</sup> One could read this test as meaning that whenever an

<sup>&</sup>lt;sup>306</sup> In the instant case: the uncertain harm to the environment, and the likely harm to the economic operators and the uncertain harm to the consumers. See discussion by Sobotta, C., "Court of Justice of the European Union and scientific knowledge", available at: https://experts-institute.eu/en/expertise-law-and-jurisprudence/court-of-justice-of-the-european-union-and-scientific-knowledge/#\_ftnref4 (last accessed 3 January 2021). For another example of a separate examination of "manifest error" and "breach of the precautionary principle and the principle of proportionality", see *Gowan Comércio Internacional e Serviços v Ministero della Salute*, C-77/09, EU:C:2010:803.

<sup>&</sup>lt;sup>307</sup> Nehl, op. cit., p. 189.

<sup>&</sup>lt;sup>308</sup> Spain v Council, op. cit.

<sup>&</sup>lt;sup>309</sup> Afton Chemical, op. cit., para. 34: "even though such judicial review is of limited scope, it requires that the Community institutions which have adopted the act in question must be able to show before the Court that in adopting the act they actually exercised their discretion, which presupposes the taking into consideration of all the relevant factors and circumstance of the situation the act was intended to regulate". (Spain v Council, para. 122)

<sup>&</sup>lt;sup>310</sup> See Lenaerts' quote at Section 2.1 above, citing *Glatzel*.

<sup>&</sup>lt;sup>311</sup> Industrias Químicas del Vallés v Commission, C-326/05 P, EU:C:2007:443, para. 75; Enviro Tech (Europe), C 425/08, EU:C:2009:635, paras. 47 and 62; Afton Chemical, op. cit., para. 28; Gowan Comércio Internacional e Serviços, C-77/09, EU:C:2010:803, para. 55; Pesce and Others, C-78/16 and C-79/16, EU:C:2016:428, para. 49.

authority commits a manifest error it thereby exceeds the limits of its discretion, but a literal reading shows this test as implying that an authority exceeds the limits of its discretion when adopting a measure that was not envisaged by the legal basis. There is of course a clear difference between the two. First, one needs to know what the outer limits of discretion are before one can assess how that discretion is exercised.

## 2.2.3 "Procedural proportionality" (duty of care, duty to state reasons) versus "manifest error"

Lenaerts explained that "limited review of proportionality [in cases concerning discretion] is counterbalanced in the case-law by a 'process-oriented review'"<sup>312</sup>, which he calls "procedural proportionality".<sup>313</sup> He reproduces the following excerpts from the case-law to explain this:

"[T]he EU legislature must take into consideration 'all the relevant factors and circumstances of the situation [that its] act was intended to regulate'. [Judgment of 8 December 2020, *Poland v Parliament and Council*, C-626/18, EU:C:2020:1000, para. 99 and judgment of 8 December 2020, *Hungary v Parliament and Council*, C-620/18, EU:C:2020:1001, para. 116] Therefore, it must 'at the very least be able to produce and set out clearly and unequivocally the basic facts which had to be taken into account as the basis of the contested measures... and on which the exercise of [its] discretion depended' [Judgment of 7 September 2006, *Spain v Council*, C-310/04, EU:C:2006:521, para. 124]."<sup>314</sup>

These formulas point to the "duty of care" and the "duty to state reasons". The duty to state reasons is enshrined in Article 296 TFEU, and constitutes an essential procedural requirement, applicable to all legal acts. According to settled case-law "[t]he statement of reasons must disclose in a clear and unequivocal fashion the reasoning followed by the institution ... so as to enable the Court ... to review the legality of the measures and allow the persons concerned to ascertain the reasons for the measure so that they can defend their rights and ascertain whether or not the decision is well founded".<sup>315</sup> The scope of the obligation will vary depending on the nature of the measure and the context in which it was adopted.<sup>316</sup>

<sup>&</sup>lt;sup>312</sup> Lenaerts, K. (2021), footnote 277.

<sup>&</sup>lt;sup>313</sup> Lenaerts, K. (2012), "The European Court of Justice and Process-Oriented Review", 31(1) *Yearbook of European Law*, p. 3.

<sup>&</sup>lt;sup>314</sup> Lenaerts, K. (2021), footnote 277.

<sup>&</sup>lt;sup>315</sup> ABN Amro Group NV v European Commission, T-319/11, EU:T:2014:186, para. 131 and case-law cited therein.

<sup>&</sup>lt;sup>316</sup> ibid.

The duty of care emerged as a principle in the early 1990s<sup>317</sup> and the landmark case *Technische Universität München*<sup>318</sup> is typically cited as the reference. In this case, the Court held that, where the EU institutions have a power of appraisal,

"respect for the rights guaranteed by the [EU] legal order in administrative procedures is of even more fundamental importance. Those guarantees include, in particular, *the duty of the competent institution to examine carefully and impartially all the relevant aspects of the individual case*, the right of the person concerned to make his views known and to have an adequately reasoned decision. Only in this way can the Court verify whether the factual and legal elements upon which the exercise of the power of appraisal depends were present"<sup>319</sup> [Emphasis added.]

This formula is different from the one cited above by Lenaerts regarding "procedural proportionality" in the following sense: the competent institutions must not only examine all relevant aspects of a case, but they must do so "carefully and impartially". However, the formula of *Technische Universität München* is expressly cited in both *Gauweiler*<sup>320</sup> and *Weiss*<sup>321</sup>, and Lenaerts cites the relevant passage in *Weiss* to demonstrate that "procedural proportionality" was applied in this case.

Importantly, in *Technische Universität München*, the CJEU did not refer to the principle of proportionality at all. Instead, it held that the obligation of the competent institution to examine carefully and impartially all the relevant aspects of the individual case, the right to be heard and the obligation to provide an adequate statement of reasons were infringed.<sup>322</sup> Moreover, it is only in relation to the duty to state reasons that the Court expressly linked this test to an "error of appraisal" (however not mentioning here the key word "manifest") by holding that due to an insufficient statement of reasons it is "impossible for the person concerned to ascertain whether the decision is vitiated by an error of appraisal".<sup>323</sup>

There is certainly also a link between the duty of care and the "manifest error" test. While, as noted above, review on procedural grounds is supposed to compensate for lack of a more limited substantive review, Nehl rightly notes that the duty of care "has a strong connotation of substantive review and legality of the exercise of discretion, because it necessarily implies that the judges make a value judgment on the relevance of the

<sup>&</sup>lt;sup>317</sup> Hoffman cites the Opinion of AG Van Gerven and the judgment in *Nölle* v *Hauptzollamt Bremen-Freihafen* C-16/90, EU:C:1991:402 as the first instance where the duty of care was explicitly identified as a principle of EU law. See Hoffman, H., "Delegation, Discretion, and Duty of Care" in J. Mendes, J., *EU Executive Discretion and the Limits of Law*, Oxford University Press, p. 220, at 232, footnote 56.

<sup>&</sup>lt;sup>318</sup> Technische Universität München, C-269/90, EU:C:1991:438.

<sup>&</sup>lt;sup>319</sup> ibid., para. 14.

<sup>&</sup>lt;sup>320</sup> Peter Gauweiler and Others v Deutscher Budestag, C-62/14, EU:C:2015:400, paras. 68 and 69.

<sup>&</sup>lt;sup>321</sup> Weiss and Others, C-493/17, EU:C:2018:815, para. 30.

<sup>&</sup>lt;sup>322</sup> Technische Universität München, op. cit., para. 28.

<sup>&</sup>lt;sup>323</sup> ibid., para. 27.

(primary) facts needed for the purposes of the discretionary appraisal".<sup>324</sup> Nehl attributes to this the reason why "Union courts sometimes tend to blend the concepts of manifest error and care"<sup>325</sup>, citing examples such as the *Bilbaina* case where the Court held: "[T]he Commission committed a manifest error of assessment in that... it failed to comply with its obligation to take into consideration all the relevant factors and circumstances."<sup>326</sup> Unlike in *Bilbaina*, these two blended concepts can also be tested under the heading of "proportionality", as evidenced in *Spain* v *Council*.<sup>327</sup>

The question of whether the ground of review invoked is a substantive or a procedural one does, however, have important legal consequences; and the blending of grounds, even though it may to a certain extent be inevitable, may also cause other difficulties than doctrinal clarity. Nehl reminds us that, based on consistent case-law, and as a matter of public policy, EU courts must raise of their own motion formal or procedural pleas in law (but they may not, based on that plea, go beyond the annulment sought in the form of order).<sup>328</sup> However, they may not, in actions for annulment, raise on their own motion grounds of review to test the substantive legality of the contested act. So, a substantive ground of review, such as (substantive) proportionality cannot be raised *ex officio* but can only be considered if it has been expressly invoked by the parties in the application.

### 3 Condensing the low-intensity standard of proportionality into a three-step test, and the problem of protected interest(s)

As we saw above, there is one standard of proportionality when applied to measures involving discretion that can take on a form similar to the classic three-part proportionality test. In *Afton Chemical*, this was expressed by means of the formula "manifestly inappropriate", and then translated into a three-step test, which was, however, tested with low intensity. Low-intensity testing can also take the form of including procedural elements in the test ("procedural proportionality").

The *Gauweiler* and *Weiss* cases are examples where such a three-step formulation of the test was applied. In *Gauweiler*, the duty to state reasons preceded the three-step test. The "manifest error" test and the "duty of care" were applied in the first "suitability" stage, whereas in the second stage the Court tested whether the measure was "manifestly beyond what was necessary to achieve the objectives". In the third stage, the Court

<sup>&</sup>lt;sup>324</sup> Nehl, op. cit., p. 192.

<sup>&</sup>lt;sup>325</sup> ibid., p. 193.

<sup>&</sup>lt;sup>326</sup> ibid., p. 193, footnote 197; Commission v Bilbaína de Alquitranes and Others, C-691/15 P, EU:C:2017:882, para. 35.

<sup>&</sup>lt;sup>327</sup> See quotation in footnote 304.

<sup>&</sup>lt;sup>328</sup> Nehl, op. cit., p. 165, citing *British Airways* v *Commission*, C-122/16, EU:C:2017:861, paras. 88 and 90.

asked whether the measure was "manifestly disproportionate". In *Weiss*, the "manifest error" test was applied in the suitability stage. In the second stage, the Court tested whether the measure "manifestly went beyond what was necessary to achieve the objectives". Here, the Court also invoked "manifest error" and the "duty of care". At the third stage, the question was whether "the ESCB weighed up the various interests involved so as effectively to prevent disadvantages which are manifestly disproportionate to the PSPP's objective from arising on implementation of the programme".<sup>329</sup>

However, both *Gauweiler* and *Weiss* reveal the difficulty of applying the formulation of the classic three-step proportionality test detached from its original context where it serves the protection of a clearly defined fundamental right. The difficulty of applying the test arises even if proportionality takes, to a certain extent, the form of reading other grounds of review into the three steps, and even if the CJEU does not substantively conduct the final balancing itself but defers to the choices made by the author of the measure.

The difficulty does not emerge at the suitability stage, but at the necessity stage and at the proportionality stricto sensu stage. The reason is that suitability differs in its structure<sup>330</sup> from necessity and proportionality stricto sensu – so much so that some authors have even suggested that this test be separated from the term "proportionality", even though they agree that it is a precondition for applying the test.<sup>331</sup> Suitability only requires knowing and assessing the relationship between the means and the ends (reflected in the question "does the measure suit the objective"). However, both necessity and proportionality stricto sensu require identifying and assessing the relationship between the underlying protected interest that proportionality is to serve and the legitimate aim.<sup>332</sup> Therefore, one could say that both stages are concerned with a kind of balancing.<sup>333</sup> In fact, the reason why proportionality tests suitability, necessity and proportionality stricto sensu is because a measure interferes with a protected interest. The necessity stage of the test reveals that when asking whether equally effective means that are less restrictive of the protected interest are available to achieve the legitimate aim. If the answer is in the affirmative, the measure will be classified as going beyond what is necessary. The stricto sensu stage incorporates the balancing between the two interests in the sense that it asks whether the harm (or disadvantage) caused to the

331 ibid.

<sup>&</sup>lt;sup>329</sup> Weiss, op. cit., para. 93.

<sup>&</sup>lt;sup>330</sup> Heusch, A. (2003), Der Grundsatz der Verhältnismäßigkeit im Staatsorganisationsrecht (Schriften zum Öffentlichen Recht (SÖR), Vol. 936, Duncker & Humblot, Berling, p. 39.

<sup>&</sup>lt;sup>332</sup> See Kosta (2019), "The Principle of Proportionality in EU Law – An Interest-based Taxonomy", in Mendes, J. (ed.), *EU Executive Discretion and the Limits of Law*, Oxford University Press, p. 198, at 199 et seq. In the final analysis proportionality understood in its classic form always relates to conflicting interests that need to be balanced.

Heusch, op. cit.

protected interest is outweighed by (the advantage of) achieving the legitimate aim.

When the form of the three-step classic proportionality is maintained, but is in fact detached from its original function, where the protected interest and reference point is (fundamental) rights protection, multiple reference points become available. That may already lead to confusion as it is not always clear what is at stake, which may obscure the role that proportionality plays in a given case<sup>334</sup>, as was arguably the case in *Gauweiler* and *Weiss*. Moreover, when the reference point is formulated as indeterminate "burdens" or "disadvantages", it is difficult to identify these and to weigh them in the abstract.<sup>335</sup> This problem is to a certain extent concealed because the CJEU takes a deferential approach and avoids doing the actual balancing itself - but it is not always fully concealed. Consider, for example, the CJEU's finding in Weiss in the third stage of the proportionality analysis: "the ESCB weighed up the various interests involved so as effectively to prevent disadvantages which are manifestly disproportionate to the PSPP's objective from arising on implementation of the programme".<sup>336</sup> In the explanation that follows, the Court noted that "the ESCB has adopted various measures designed to circumscribe that risk [of losses arising in open market operations] and to take it into account", and went on to explain why that was the case. The point here is that it is also conceivable to think of other disadvantages than those mentioned by the Court. And even those mentioned were not meant to be exhaustive. The problem remains how to identify the relevant disadvantages and who is to do so for the purpose of meeting the test, both in terms of necessity and in terms of proportionality stricto sensu (even if the actual balancing of those disadvantages is not conducted by the Court).

### 4 Conclusion

The form that "proportionality" and "procedural proportionality" take in cases concerning discretion is essentially one that involves taking into account other grounds of judicial review. Those grounds can be substantive: "misuse of powers", "manifest error", "manifestly exceeding the bounds of discretion" (if equalised to "manifest error"); or they can be procedural: "duty of care", "duty to state reasons". Moreover, the precise contours involved, i.e. the scope, content and intensity of application of some of these grounds ("manifest error" and "manifestly exceeding the bounds of discretion"), are uncertain. Additionally, substantive and procedural grounds are also, and perhaps inevitably so, sometimes blended ("manifest error" and "duty of care"), and the same tests can sometimes appear under different headings. Complicated as all of this is, one may wonder what is to be gained by calling these other grounds of

<sup>&</sup>lt;sup>334</sup> Kosta, op. cit.

<sup>&</sup>lt;sup>335</sup> Kosta, op. cit., p. 203 et seq. See in this discussion also cases where the protected interest could be formulated as a fundamental right, even though it is formulated in terms of burdens, p. 208 et seq.

<sup>&</sup>lt;sup>336</sup> Weiss, op. cit., para. 83.
review "proportionality" and not simply what they are. What can be lost is clarity.

The proportionality review of measures involving the exercise of discretion can also take a form similar to that of the classic three-step proportionality test. When it does (outside the (fundamental) rights context), its application can become difficult. The reason for this is that both the necessity stage and proportionality stricto sensu require identification of the protected interest(s) in order to be operational. That is missing when the protected interests are identified as indeterminate disadvantages. Moreover, as the consideration of burdens or disadvantages in the abstract and without a link to a right enters squarely into the realm of policy considerations, which are, conventionally, considered to be the premise of the legislative or executive institutions<sup>337</sup>, the CJEU rightly adopts low-intensity review. It is this low-intensity review that may conceal the identified difficulty, but it does not do so fully. In cases where low-intensity review is indeed the applicable standard of review<sup>338</sup> and the form of review that the Court actually seeks to apply is similar to the test of "reasonableness", as applied, for example, in English law, it may be better, for the sake of clarity, to avoid the three-step formulation of the test, even if each step is tested with deference.

<sup>&</sup>lt;sup>337</sup> Kosta (2019), op. cit., pp. 206-207.

<sup>&</sup>lt;sup>338</sup> As noted above, the intensity of the review may vary even within the category of cases involving discretionary policy choices and can sometimes be more stringent.

## Proportionality in comparative perspective in view of the *PSPP/ Weiss* saga

**By Iddo Porat\*** 

The doctrine of proportionality has become immensely influential all over the world and is arguably the most important and widespread test in constitutional adjudication globally.<sup>339</sup> The purpose of this essay is to present a comparative analysis of proportionality in the context of the recent challenges posed by the PSPP/Weiss saga - an exchange of cases between the Court of Justice of the European Union (CJEU) and the Bundesverfassungsgericht (the German Federal Constitutional Court (GFCC)) - revolving among other things around the interpretation and application of the proportionality test.<sup>340</sup> I will pose and answer three questions. Is there one meaning to proportionality across different jurisdictions? What is the relationship of proportionality to the distinction between a "culture of justification" and a "culture of authority"? What are the ideological connotations of proportionality? I begin by giving background on proportionality and on the PSPP/Weiss saga in Part I and a comparative survey of proportionality in several important jurisdictions in Part II. I then move on to address the first question in Part III and the two other questions in Part IV.

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<sup>&</sup>lt;sup>339</sup> See generally, Barak, A. (2012), *Proportionality: Constitutional Rights and Their Limitations*, Cambridge University Press; Stone Sweet, A. and Mathews, J. (2008), "Proportionality Balancing and Global Constitutionalism", 47 *Columbia Journal of Transnational Law*, p. 72; Cohen-Eliya, M. and Porat, I. (2013), *Proportionality and Constitutional Culture*, Cambridge University Press.

<sup>&</sup>lt;sup>340</sup> Bundesverfassungsgericht [BVerfG] ] July 18, 2017, 146 Entscheidungen Des Bundesverfassungsgerichts [BverfGE] 216 (hereinafter "PSPP I"); Case C-493/17, Weiss, EU:C:2018:1000; Bundesverfassungsgericht [BVerfG], Cases Nos. 2 BvR 859/15 et al., 5 May 2020 (hereinafter "PSPP II" or "PSPP), English translation available at http:// www.bverfg.de/e/rs20200505\_2bvr085915en.html

#### 1 Part I – Background on proportionality and the *PSPP/Weiss* saga

#### 1.1 Proportionality – definition and structure

Proportionality is a term that derives from the word *proportion* and is used both in common language and in legal terminology to refer to a proper relation or balance between two or more items and to the avoidance of exaggeration or excess in one of them.<sup>341</sup> In law proportionality is best known as a public law doctrine for the constitutionality of infringements on human rights. In the most general terms, an act that infringes on human rights would be constitutional according to proportionality only if the infringement is proportionate to the importance of the interests or rights behind the act.

Proportionality in public law has a classic or standard form. This form, which originated in Germany, is not used in all legal systems, or even most of them, but is the one most associated with the doctrine and the one most often referred to as the benchmark for it or its ideal type. According to this standard form, proportionality is divided into three subtests preceded by a legitimate aim test (which in some systems is made part of proportionality itself making a total of four subtests).<sup>342</sup> The first subtest, suitability (also known as rationality or appropriateness), would ask whether the governmental act (a law, regulation or executive decision) that infringes on the right furthers in any way its proclaimed objective. For example, if a law whose objective is to protect state security infringes on the right to equality by subjecting airport passengers to racial profiling, the suitability test would ask whether racial profiling indeed furthers state security in any way. Passing the first test, the second subtest, necessity (also known as minimal impairment or least restrictive means), would ask whether there are any less restrictive means to achieve the sought-after objective. For example, in the above scenario, that would mean asking whether we could find means other than racial profiling that would protect state security as effectively while infringing less on the right to equality. Finally, if there are no less restrictive means that would achieve the objective as effectively, the third subtest, proportionality in the strict sense (also termed proportionality stricto sensu, proportionality as such or balancing), would ask whether the benefit from achieving the objective is not outweighed by the harm caused by the right infringement. In the above example, this would mean asking whether the increase in state security achieved by racial profiling is not outweighed by the harm to the right to equality.<sup>343</sup>

The legitimate objective test, which precedes the three proportionality subtests (also known as proper purpose or legitimate aim test) asks

<sup>&</sup>lt;sup>341</sup> Oxford Dictionary.

<sup>&</sup>lt;sup>342</sup> Barak, op. cit., p. 3.

<sup>&</sup>lt;sup>343</sup> Jackson, V. (2015), "Constitutional Law in an Age of Proportionality", 124 Yale LJ, p. 3094, at pp. 3113-3122.

whether the governmental objective is legitimate in a democracy and, in some jurisdictions such as Canada, also whether it is important and pressing enough to justify infringing a human right.<sup>344</sup>

#### 1.2 Proportionality – origins and spread

It is usually agreed that as a discrete legal doctrine proportionality's first appearance was in late 19th century Prussian and German administrative law.<sup>345</sup> Proportionality in Prussian administrative law developed out of the enlightenment idea of *Rechtsstaat*, requiring authorisation in law for any state restriction on liberty. If the state uses its powers excessively or disproportionately this would also be seen as unauthorised by law, and therefore conflicting with the rule of law. The Prussian Supreme Administrative Court developed and used the doctrine of proportionality throughout late 19th and early 20th century, reviewing the use of the police power of the state to restrict demonstrations, impose building restrictions and censor theatre plays. It already distinguished between the three subtests of proportionality, albeit not as formally and strictly as will be the case later on, and stressed the second subtest of necessity rather than the third, strict proportionality.<sup>346</sup> After the Second World War proportionality was readopted by the GFCC, which clearly formalised it into the three subtests and gradually made it into the most important principle in the application of the rights guaranteed by the Basic Law for the Federal Republic of Germany.<sup>347</sup>

The spread of proportionality from one legal system – Germany – to a multitude of legal systems all over the globe, all in a matter of just a few decades, is an astounding example of constitutional migration and adoption. By now, the trail of proportionality over time and space has been well documented in several studies<sup>348</sup> and although the details vary somewhat from one account to the other, and exact dates for the first introduction of proportionality into a system are sometimes hard to establish, the following development represents the common view. One should note however, that the following account does not distinguish between systems in which proportionality is highly central and systems in which it is introduced only occasionally or inconsistently. Even so, the phenomenon is very impressive in its breadth and scope.

Due to the substantial influence of German jurists on their jurisprudence, proportionality travelled from Germany to the CJEU (1970) and then to the European Court of Human Rights (ECtHR) (1977). European Union (EU) law, as well as German law, had a profound influence on the different

<sup>&</sup>lt;sup>344</sup> See *R v Oakes* [1986] 1 SCR 103 (Can) (hereinafter "Oakes").

<sup>&</sup>lt;sup>345</sup> Stone Sweet and Mathews, op. cit.

<sup>&</sup>lt;sup>346</sup> See Ledford, K. F. (2004), "Formalizing the Rule of Law in Prussia: The Supreme Administrative Law Court, 1876–1914", 37 *Central European History*, p. 203.

<sup>&</sup>lt;sup>347</sup> See Kommers, D. P. (1997), The Constitutional Jurisprudence of the Federal Republic of Germany, 2<sup>nd</sup> edn., Duke University Press, p. 33.

<sup>&</sup>lt;sup>348</sup> See Stone Sweet and Matthews (2008); Barak (2012).

constitutional systems in Western Europe, many of which gradually adopted proportionality. Barak places the dates of the first entry of proportionality into European countries as follows: Austria, 1978; Portugal, 1982; Ireland, 1994; Spain, 1995; Belgium, 2000; The Netherlands, 2000; Switzerland, 2000: United Kingdom, 2001: Greece, 2001: and Turkey, 2001.<sup>349</sup> After the fall of the Eastern Bloc, and as part of the attempts made by the former Eastern Bloc countries to integrate into the EU, practically all Eastern European countries adopted proportionality, including Russia. Sadurski has documented the entry of proportionality into the jurisprudence of, inter alia, Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Lithuania, Poland, Romania, Slovakia, Slovenia and Russia.<sup>350</sup> German law, German legal theory (especially the work of Robert Alexy) as well as the influence of Spanish and Portuguese jurisprudence have all been important factors in the introduction of proportionality into Latin America. including Brazil, Colombia, Peru, Mexico and Chile.<sup>351</sup> Besides Germany and the EU, another important factor for the spread of proportionality has been Canada. Canada, which adopted proportionality in 1986, has been influential in the introduction of proportionality to Australia and New Zealand in the late 1980s and early 1990s, as well as to the United Kingdom, mentioned above, and to India. Canada as well as the EU and Germany have also influenced Israel and South Africa in their introduction of proportionality in the mid-1990s. Finally, several East Asian countries have also introduced proportionality into their public law since the 1990s. including notably Hong Kong and South Korea.

#### 1.3 The PSPP/Weiss saga

The *PSPP* saga was an exchange of cases between the GFCC and the CJEU in which proportionality was the central axis. I will focus on the way proportionality took part in these cases. However, for the purpose of this essay, it is also important to understand the general details and the context of these cases.

The saga began when the GFCC referred a question to the CJEU regarding the legality, under EU law, of a bonds purchase programme of the European Central Bank (ECB).<sup>352</sup> Under the programme, termed the public sector purchase programme (PSPP), the ECB and the national central banks purchased bonds issued by governments of the euro area Member States. The purpose of the plan was to expand the money supply in the euro area member countries and thus stimulate consumption and increase the inflation rate – all in the context of the economic downturn and the crisis of the euro following the 2008-2009 economic crisis. Since its inception the plan had its detractors. One concern was that buying the bonds would be a way for the core Member States, or *northern states* 

<sup>&</sup>lt;sup>349</sup> See Barak, op. cit., pp. 182 and 186-199.

<sup>&</sup>lt;sup>350</sup> Sadurski, W. (2005), Rights Before Courts: A Study of Constitutional Courts in the Postcommunist States of Central and Eastern Europe, Springer, pp. 263-287.

<sup>&</sup>lt;sup>351</sup> Barak, op. cit., p. 201.

<sup>&</sup>lt;sup>352</sup> **PSPP** I.

(countries such as Germany and France) to finance the struggling periphery Member States, or *southern states* (countries such as Greece, Portugal and Spain), at the expense of the living conditions of the citizens of these northern states.<sup>353</sup> The claim was that such a purchase plan would, among other things, affect interest rates in countries as Germany, thus making it more difficult to buy houses. Another concern was that the citizens of Members States did not have enough democratic representation in EU institutions such as the ECB, and thus were not fully autonomous in making crucial decisions affecting their economy and living conditions.

Following these concerns several individuals brought claims to the GFCC against Germany's participation in this plan, arguing that it contravened their rights according to the German Basic Law, that the PSPP decision was void since it exceeded the competences of the ECB under the Treaty on European Union (TEU) and the Treaty on the Functioning of the European Union and that it did not meet the standard of proportionality. In particular the claim was that, rather than only monetary and financial policies, the ECB was pursuing an economic policy, which was outside of its competences.<sup>354</sup> The GFCC stayed the case and referred the matter to the CJEU which decided that the PSPP was within the competence of the ECB and that it met the standard of proportionality. The unique element in the saga came about when the case returned to the GFCC and it ruled that the CJEU decision itself was ultra vires and therefore did not apply in Germany. In effect this was the first time that the GFCC – probably the most influential national constitutional court in the EU – had directly defied a ruling of the CJEU. The locus of the GFCC's criticism was that the CJEU erred in its application of proportionality – it did not properly apply the third, strict proportionality, subtest and it did not balance the economic detrimental effect of the PSPP with its monetary benefits:

"In its Judgment of 11 December 2018, the CJEU held that the Decision of the ECB Governing Council on the PSPP and its subsequent amendments were still within the ambit of the ECB's competences. This view manifestly fails to give consideration to the importance and scope of the principle of proportionality (Article 5(1) second sentence and Article 5(4) TEU), which also applies to the division of competences, and is no longer tenable from a methodological perspective given that it completely disregards the actual effects of the PSPP (see below). Therefore, the Judgment of the CJEU of 11 December 2018 manifestly exceeds the mandate conferred upon it in Article 19(1) second sentence TEU, resulting in a structurally significant shift in the order of competences to the detriment of the Member States. To this extent, the CJEU Judgment itself constitutes an ultra vires act and thus has no binding effect [in Germany]."<sup>355</sup>

The GFCC expressed its criticism of the CJEU's application of proportionality in very strong terms:

<sup>&</sup>lt;sup>353</sup> See e.g. De Cabanes A. and Fontan C., "Why Germany's Far Right Wants Judges to Rule Europe's Monetary Policy", Jacobin 2020, available at https://jacobinmag. com/2020/05/germany-europe-judges-afd-banks

<sup>&</sup>lt;sup>354</sup> See *PSPP* at 55/93.

<sup>&</sup>lt;sup>355</sup> *PSPP* at 61/93.

"As a result, the review of proportionality is rendered meaningless, given that suitability and necessity of the PSPP are not balanced against the economic policy effects – other than the risk of losses – arising from the programme to the detriment of Member States' competences, and that these adverse effects are not weighed against the beneficial effects the programme aims to achieve."

One can detect several assumptions regarding the comparative understanding of proportionality in the PSPP decision. The first is that the proportionality test should be well structured according to the three subtests. The second is that the third subtest is a vital element in the proportionality test. And the third is that it should be applied stringently and without deference otherwise it is rendered "meaningless". I will discuss these assumptions in Part III, under the heading of my first question: "Does proportionality have one meaning?" Another feature of the decision is the application of proportionality to determine competences. This I will discuss under the heading of my second question: "What is the relationship of proportionality to the distinction between a 'culture of justification' and a 'culture of authority'?" Finally, in the PSPP decision the GFCC protects national interests, and democratic self-rule. I will discuss this under the heading of my third question: "What are the ideological connotation of proportionality?" Before addressing these questions, however, I will give a short survey of proportionality in several important jurisdictions, including Germany and the EU.

#### 2 Part II – Proportionality in comparative perspective

In this Part II survey some of the leading jurisdictions in terms of the use of proportionality and highlight the main features of proportionality in each.

#### 2.1 Germany

As described above, Germany can be seen as the birthplace of proportionality and also the place where proportionality has acquired the highest status. The term *proportionality* does not appear in the German Basic Law from 1949 and none of the different limitation clauses in the German Basic Law refer to proportionality. Nevertheless, as early as 1952 the GFCC started applying proportionality as a detailed test that complements the requirements of the limitation clauses without basing this use on any text or authority.<sup>356</sup> The earliest uses were in the context of the right to freedom of profession (Article 12 of the German Basic Law), including in the *Pharmacy* case (1958).<sup>357</sup> The use soon expanded to all other rights and, in 1965, the GFCC also provided a textual basis for

<sup>&</sup>lt;sup>356</sup> Grimm, D. (2007), "Proportionality in Canadian and German Constitutional Jurisprudence", 57 *University of Toronto Law Journal*, p. 383 at 385.

<sup>&</sup>lt;sup>357</sup> Pharmacy case 1 BvR 596/56 (11 June 1958) BVerfGE 7, 377 (Ger).

proportionality in the constitution; it highlighted its centrality and fundamental nature, stating that the principle "follows from the principle of the rule of law (guaranteed in Article 20 of the German Basic Law), even more from the very essence of fundamental rights".<sup>358</sup>

#### 2.2 The Court of Justice of the European Union

The CJEU adopted proportionality in the early 1970s, despite there being no direct mention of it in the Treaty of Rome (1957), by deriving it directly from the principle of the rule of law.<sup>359</sup> The first uses of the doctrine were mainly in the free movement of goods domain focusing on Article 28 of the Treaty of Rome, where its influence has been dramatic.<sup>360</sup> It has quickly evolved into a central concept in the jurisprudence of the CJEU so that by 1989 the Court referred to it as "one of the general principles of Community law".<sup>361</sup> The elements of the three subtests of proportionality can be found in CJEU jurisprudence, albeit not consistently or in a structured way and the Court does not always distinguish between them.<sup>362</sup>

In Article 52 of the Charter of Fundamental Rights of the European Union, which was incorporated into the additional protocol of the Lisbon Treaty (2009), proportionality is included explicitly as part of the general limitation clause. Currently, individual claims, especially pertaining to discrimination, can be brought before either the ECtHR or, under the Charter, before the CJEU, in addition to the local courts, resulting in a complex web of overlapping jurisdictions, and overlapping versions of proportionality.<sup>363</sup> In addition, proportionality is specifically mentioned together with the principle of subsidiarity, as one of the two principles that determine the reach of EU law. Article 5(4) TEU reads: "Under the principle of proportionality, the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties."

#### 2.3 The European Court of Human Rights

The European Convention on Human Rights (ECHR) includes specific limitation clauses for most of the rights it enlists. Influenced by German jurists these were gradually interpreted to include the principle of

<sup>&</sup>lt;sup>358</sup> Wencker 1 BvR 513/65 (15 December 1965) BVerfGE 19, 342 at 348 (Ger).

<sup>&</sup>lt;sup>359</sup> Internationale Handelsgesellschaft, C-11/70, EU:C:1970:114.

<sup>&</sup>lt;sup>360</sup> See Stone Sweet and Mathews, op. cit., p. 147.

<sup>&</sup>lt;sup>361</sup> Schräder v Hauptzollamt Gronau, C-265/87, EU:C:1989:303.

<sup>&</sup>lt;sup>362</sup> Herwig, A. and Serdarevic, A. (2014), "Standard of Review for Necessity and Proportionality Analysis in EU and WTO Law: Why Differences in Standards of Review Are Legitimate", in Gruszczynski, L. and Wener, W. (eds.), *Deference in International Courts and Tribunals: Standard of Review and Margin of Appreciation*, Oxford University Press, p. 209 at 213.

<sup>&</sup>lt;sup>363</sup> See Di Federico, G. (2011), "Fundamental Rights in the EU: Legal Pluralism and Multi-Level Protection after the Lisbon Treaty", in Di Federico, G. (ed.), *The EU Charter of Fundamental Rights: From Declaration to Binding Instrument*, Springer, p. 15.

proportionality.<sup>364</sup> Most limitation clauses include the requirements that limitations of the right be "prescribed by law" and "necessary in a democratic society" for the furtherance of one of a list of objectives listed in the relevant clause (e.g. Article 8.2. for the right to respect for private and family life: Article 9.2. for the freedom of religion: Article 10.2. for the freedom of expression). The phrase "necessary in a democratic society" was interpreted to include a proportionality test as early as 1976<sup>365</sup> and over time a full-fledged proportionality test has been developed. The ECtHR's formulation of the subtests of proportionality review, however, is somewhat different from the classical three subtests of German law and also less consistently applied. Usually, this formulation includes the following subtests: (i) do the measures meet a pressing social need; (ii) are the measures relevant and sufficient to achieve the legitimate aim pursued; and (iii) are the measures proportional to the legitimate aim pursued?366 The second subtest is similar to the suitability subtest in German law and the third subtest to the proportionality in the strict sense one. The first subtest can be interpreted to include the rationality test.367

Probably the most unique and notable trait of the use of proportionality by the ECtHR is the application of the doctrine of margin of appreciation to proportionality, which allows for greater flexibility to defer to local interpretations of the application of that principle.<sup>368</sup>

#### 2.4 Canada

Canada is probably the second most influential system, after Germany, in terms of exporting proportionality and the most influential within the common law world. Proportionality was first introduced in Canada in the seminal *Oakes* case (1986)<sup>369</sup>, in which Justice Dickson interpreted the general limitation clause, Section 1 of the Canadian Charter of Rights and Freedoms, as including a three-step proportionality test. Section 1 of the Charter reads: "The Canadian Charter of Rights and Freedoms guarantees the rights and freedoms set out in it subject only to such reasonable limits prescribed by law as can be demonstrably justified in a free and democratic society". Justice Dickson in *Oakes* did not refer specifically to German or EU law, despite having arrived at the same three subtests as in the classic formulation.<sup>370</sup> The context of *Oakes* – criminal defendants rights – has produced a stringent form of proportionality, requiring governments to show *cogent and persuasive* evidence of meeting the proportionality subtests,

<sup>&</sup>lt;sup>364</sup> Stone Sweet and Mathews, op. cit., p. 147.

<sup>&</sup>lt;sup>365</sup> See Handyside v the United Kingdom (ECtHR) (1976).

<sup>&</sup>lt;sup>366</sup> Smet, S. (2016), *Resolving Conflicts between Human Rights: The Judge's Dilemma*, Routledge, p. 33.

<sup>&</sup>lt;sup>367</sup> Brems, E. and Lavrysen, L. (2015), "Don't Use a Sledgehammer to Crack a Nut: Less Restrictive Means in the Case Law of the European Court of Human Rights", 15 *HRLRev* 139, pp. 139-168.

<sup>&</sup>lt;sup>368</sup> See Arai-Takahashi, Y. (2002), *The Margin of Appreciation Doctrine and the Principle of Proportionality in the Jurisprudence of the ECHR*, Intersentia.

<sup>&</sup>lt;sup>369</sup> See Oakes, op. cit.

<sup>&</sup>lt;sup>370</sup> See Grimm, op. cit., pp. 343-344.

based on the idea that limitations on rights are *exceptions*. This stringency was however reduced in subsequent cases in which it was deemed too confining, especially cases involving freedom of speech.<sup>371</sup> In *Irwin Toy Ltd* v *Quebec* (1989)<sup>372</sup> the Supreme Court of Canada distinguished between a higher level of review when government is pitted against the individual and a lower level of review when different groups in society are pitted one against the other. Canadian jurisprudence emphasises the second subtest of proportionality – least restrictive means – and the Court is more reluctant to repeal laws based on the third subtest – proportionality in the strict sense.<sup>373</sup>

#### 2.5 South Africa

The Interim Constitution of South Africa included a general limitation clause without any reference to proportionality. In its seminal S v Makwanyane and Another case (1995)<sup>374</sup>, dealing with the constitutionality of the death penalty, the newly established Constitutional Court of South Africa interpreted this limitation clause as including "an assessment based on proportionality" and went on to list five considerations for its application: (i) the nature of the right; (ii) the importance of the purpose of the limitation; (iii) the nature and extent of the limitation; (iv) the relation between the limitation and its purpose; and (v) the less restrictive means to achieve the purpose. These considerations were subsequently incorporated almost verbatim into the limitation clause of the permanent constitution as nonexclusive relevant factors for its applications (paragraphs (a) to (e) of Section 36(1) of the Constitution of the Republic of South Africa). This list includes almost all the elements of the classic formulation of proportionality (except for proportionality in the strict sense which is only implied by paragraphs (a) and (c)), albeit not in the same order. The Court however made it clear that it would make a "global judgment on proportionality" and look at these considerations as a whole rather than apply them separately or sequentially, as is usually the case in Germany or Canada. The Court also developed a doctrine according to which it would require stronger and more persuasive justifications the more the infringement touches on core fundamental rights.375

#### 2.6 India

The use of proportionality in India is on the rise, and recent seminal cases have relied heavily on proportionality. Noteworthy is the seminal case *Justice KS Puttaswamy* v *Union of India* (2017) in which Justice Chandrachud writes that "Proportionality is an essential facet of the

<sup>&</sup>lt;sup>371</sup> *R v Edwards Books and Art Ltd* (1986) (Can); *RJR-MacDonald Inc. v Canada* (1995) (Can).

<sup>&</sup>lt;sup>372</sup> Irwin Toy Ltd v Quebec (1989) (Can).

<sup>&</sup>lt;sup>373</sup> See Grimm, op. cit., p. 387.

<sup>&</sup>lt;sup>374</sup> S v Makwanyane and Another (CCT3/94) [1995] ZACC 3 (S Afr).

<sup>&</sup>lt;sup>375</sup> S v Bhulwana, S v Gwadiso (CCT12/95, CCT11/95) [1995] ZACC 11 (S Afr).

guarantee against arbitrary state action" and uses the doctrine to interpret the newly recognised right to privacy.<sup>376</sup> However, the use of proportionality hitherto has not been consistent and many times depends on the justice who delivered the opinion, as the Supreme Court of India issues its decisions in different *benches*. In addition, until recently, proportionality was not used in any ordered and sequential way; judges are free to pick and choose from the different elements of proportionality and have, on different occasions, used different standards of strictness in its application.<sup>377</sup>

#### 2.7 Israel

Proportionality has become the most central doctrine in Israeli constitutional law since its introduction in the *Mizrahi Bank* case (1995).<sup>378</sup> The limitation clauses in the Israeli Basic Laws, human dignity and liberty and freedom of occupation, are based on the Canadian model and were interpreted by the Court in *Mizrahi* as espousing the three-step proportionality analysis, citing Canadian and German case law.<sup>379</sup> Since then, the Supreme Court of Israel has used the doctrine extensively in most of its leading constitutional cases. Israel has adopted a tiered approach to proportionality, applying it more strictly and requiring more evidence from government the more the infringement touches on a core right.<sup>380</sup> While initially concentrating on the second subtest, the Court has shifted the emphasis to the third subtest of proportionality in the strict sense.<sup>381</sup>

#### 2.8 The United Kingdom

The United Kingdom has long resisted the introduction of proportionality into its public law<sup>382</sup> but since the enactment of the Human Rights Act of 1998 (HRA), which incorporated the ECHR into UK law, the courts have referred to ECtHR jurisprudence when applying the HRA and have thus introduced proportionality into UK law.<sup>383</sup> This is in addition to the application of proportionality in the context of the reach of EU law in the United Kingdom. However, a heated debate is still ongoing as to whether proportionality should be seen as a general principle of law that is

<sup>&</sup>lt;sup>376</sup> Justice KS Puttaswamy v Union of India (24 August 2017) Writ Petition (Civil) No. 494 of 2012 (India) at Section S, p. 255.

<sup>&</sup>lt;sup>377</sup> See Chandrachud, A. (2013), "Wednesbury Reformulated: Proportionality and the Supreme Court of India", 13 Oxford University Commonwealth Law Journal, p. 191.

<sup>&</sup>lt;sup>378</sup> United Mizrahi Bank Ltd v Midgal Cooperative Village CA 6821/93 (9 November 1995) 49(4) PD 221 (Isr).

<sup>&</sup>lt;sup>379</sup> ibid.; opinion of Barak paras. 208-210.

<sup>&</sup>lt;sup>380</sup> Ressler v Knesset HCJ 6298/07 (21 February 2012) (Isr).

<sup>&</sup>lt;sup>381</sup> Beit Sourik Village Council v Government of Israel and Commander of the IDF Forces in the West Bank HCJ 2056/04 (30 June 2004) 58(5) PD 807 (Isr).

<sup>&</sup>lt;sup>382</sup> Council of Civil Service Unions v Minister for the Civil Service [1983] UKHL 6 (UK); R v Secretary of State for the Home Department [1991] UKHL 4 (UK).

<sup>&</sup>lt;sup>383</sup> Cohn, M. (2010), "Legal Transplant Chronicles: The Evolution of Unreasonableness and Proportionality Review of the Administration in the United Kingdom" 58 *AmJCompL*, p. 583.

applicable outside the scope of rights jurisprudence under the HRA, or litigation involving EU law, and in particular, whether it should be integrated into judicial review in administrative law and replace the existing Wednesbury reasonableness standard of review. This debate tends to track the pro and anti-judicial activism debate in the United Kingdom, as proportionality is seen to be much more open-ended and less deferential than Wednesbury reasonableness.<sup>384</sup>

The form of proportionality when introduced under the HRA has changed over time. It has taken its own form, not replicating ECtHR formulations of proportionality, and has also drawn on Canadian law. Earlier stages incorporated the Canadian *Oakes* test but without the final, proportionality in the strict sense, subtest.<sup>385</sup> In *Bank Mellat* v *Her Majesty's Treasury* (2013), however, the Court reached a formalised four stage proportionality test, similar to the Canadian and German models.<sup>386</sup>

#### 2.9 Australia

The use of proportionality in Australia has been associated mainly with the freedom of political communication, which, owing to the fact that the Australian Constitution does not have a bill of rights, was found to be implied in the system of representative and responsible government that was established by the Constitution. In the first cases that confirmed this implied right<sup>387</sup> the High Court used the terminology of proportionality; however, it was only in McClov v New South Wales (2015)<sup>388</sup> that the Court clearly adopted the three subtest structure of classical proportionality. The long time it took the Court to systematise proportionality, as well as the strong dissenting opinions in the case and in a subsequent case<sup>389</sup> attest to the ongoing debate over this doctrine in Australia, and, based on its perception as antithetical to the central principles of separation of powers and parliamentary sovereignty, to its uncertain future. In Brown v Tasmania (2017)<sup>390</sup>, the judges of the High Court argued over whether a structured proportionality test (meaning the classical form) should be applied, or whether it is too rigid a test, with the minority holding the latter opinion.<sup>391</sup>

<sup>&</sup>lt;sup>384</sup> Young, A. L. (2014), "Proportionality Is Dead: Long Live Proportionality!", in Huscroft, G., Miller, B. W. and Webber, G. (eds.), *Proportionality and the Rule of Law: Rights, Justification, Reasoning*, Cambridge University Press, p. 43.

<sup>&</sup>lt;sup>385</sup> Varuhas, J. N. E. (2018), "Should the Common Law of Review and the Law under the Human Rights Act 1998 Be 'Synthesised'?" (28 April 2014) UK Constitutional Law Association, available at https://ukconstitutionallaw.org/ (5 March 2018).

<sup>&</sup>lt;sup>386</sup> Bank Mellat v Her Majesty's Treasury [2013] UKSC 39 (UK).

<sup>&</sup>lt;sup>387</sup> Australian Capital Television Pty Limited v Commonwealth [1992] HCA 45 (Austl); Nationwide News Pty Ltd v Wills [1992] HCA 46 (Austl).

<sup>&</sup>lt;sup>388</sup> McCloy v New South Wales [2015] 257 CLR 178 (Austl).

<sup>&</sup>lt;sup>389</sup> Murphy v Electoral Commissioner [2016] HCA 36 (Austl).

<sup>&</sup>lt;sup>390</sup> Brown v Tasmania [2017] HCA 43 (Austl).

<sup>&</sup>lt;sup>391</sup> Chordia, S. (2018), "The Trajectory of Structured Proportionality in Implied Freedom of Political Communication Cases: Brown v Tasmania" (2 November 2017) AUSPUBLAW, available at https://auspublaw.org/2017/11/the-trajectory-of-structuredproportionality/ (5 March 2018).

#### 2.10 The United States

The United States is usually used as an example of a system that is resistant to proportionality and does not follow the global trend of adopting it. This is attributed to several factors, including the text of the Constitution of the United States of America which does not include limitation clauses and frames some rights in absolute terms; the aversion, especially in constitutional law, to the use of foreign law; the political culture that stresses separation of powers, and is thus suspicious of open-ended doctrines of rights; and the emphasis on pluralism rather than a coherent set of values which proportionality can harmonise and maximise.<sup>392</sup>

However, some scholars have argued that the United States has in fact adopted proportionality, at least the basic logic and structure of proportionality, as well as the different elements of proportionality, despite not having used the term explicitly.<sup>393</sup> Such accounts sometimes add the normative claim that it would have been better had the United States explicitly adopted proportionality, both because of its advantages for American constitutional law and because it would allow American constitutional law to communicate with and draw on the vast legal discourse developed in other countries on proportionality.<sup>394</sup>

Those who argue that proportionality exists within American law find the different subtests in different doctrines of American constitutional law: (i) the first subtest, rationality, is found in rational review – the lowest tier among the three tiers of scrutiny in American constitutional law; (ii) the second subtest, least restrictive means, is found, either using the same words or using the *narrow tailoring* test which is part of strict scrutiny review – the highest tier of review; and (iii) the third subtest, proportionality in the strict sense, can be found in the different balancing tests prevalent in American law as well as in intermediate scrutiny – the intermediate tier of review.<sup>395</sup>

3

## Part III – Comparative perspective and the *PSPP/Weiss* saga – one meaning?

What can the above comparative survey teach us in respect of the question as to whether proportionality has one meaning or not and as to the three assumptions surveyed above on which the *PSPP* decision was based? Does it confirm these assumptions or deny them?

<sup>&</sup>lt;sup>392</sup> See Cohen-Eliya and Porat, op. cit., pp. 52-60.

<sup>&</sup>lt;sup>393</sup> See Mathews, J. and Stone Sweet, A. (2011), "All Things in Proportion – American Rights Review and the Problem of Balancing", 60 *Emory LJ* 797; see Jackson, op. cit.

<sup>&</sup>lt;sup>394</sup> See Jackson ibid.

<sup>&</sup>lt;sup>395</sup> ibid.

#### 3.1 Structured or not?

The *PSPP* decision criticised the CJEU judgment, among other things, for its methodological flaws in applying proportionality, alluding to the claim that proportionality should always be applied in a structured way. That is, that proportionality should be applied using the three subtests in proper order and according to their proper definition, as in German jurisprudence. The comparative review above, however, shows considerable variety regarding the structured nature of proportionality and the way in which it is internally shaped.

First, the comparative review shows that countries using proportionality fall along a spectrum between structured and non-structured. On the structured side of the spectrum one can find Germany, as well as Canada and Israel. As the survey shows, all three jurisdictions use all three subtests of the tripartite test, use them in order and define them in a way that accords with the German source. There are, however, countries that fall on the other end of the spectrum regarding the structured nature of proportionality. The survey shows that South Africa, for example, is one of them. Despite being an important jurisdiction regarding the use of proportionality. South Africa does not use proportionality in a structured way. As mentioned above, the South African Constitutional Court has maintained from early on that it would take a "global judgment on proportionality" and look at the different tests of proportionality as a whole rather than apply them separately or sequentially, as is usually the case in Germany, Canada and Israel. In addition, the proportionality subtests themselves, as they appear in the South African Constitution, show a mix of the different three subtests, include other tests that are added to them, and do not appear in the same order as in the German formula.

The above survey also shows that between these two extremes on the spectrum, between structured and non-structured, one can find jurisdictions where proportionality, while not being self-consciously non-structured, is not applied in the same exact and structured manner as in Germany. This category includes India, where the form of proportionality changes from one judge to the other, as well as the ECtHR and the CJEU where, as described above, proportionality has evolved over time in an organic, rather than planned, way and where the courts have not always clearly divided the test into three subtests.

Secondly, the review above also shows that in some jurisdictions there is a debate about whether proportionality should be applied in a structured way or not. Australia, in particular, has seen such a debate in the *Brown* case, mentioned above. There the minority view held that the court should not be confined by a structured application of proportionality and should have the leeway to decide cases according to its general assessment of proportionality. In Australia, such a view is generally associated with a more deferential attitude to judicial review. Some of the debates in the United Kingdom on proportionality also revolve around the structured nature of proportionality.

#### 3.2 Using the third subtest or not?

A second assumption that can be attributed to the German *PSPP* decision is that proportionality should always include the third, strict proportionality, subtest and that this test should be regarded as equal to the two other subtests. Here too the comparative review shows considerable variety and different approaches.

As shown above, different legal systems put emphasis on different subtests, especially distinguishing between the first two subtests and the third one. The first two subtests - necessity and suitability - are regarded as more objective, scientific and formal since they are supposed to involve only empirical questions as to the aptness of means to ends, and as they do not guestion the governmental end or require balancing between that end and other conflicting societal concerns. The third subtest proportionality in the strict sense - however, is thought of as more subjective, value-laden and substantive as it requires judges to balance the extent of harm to rights against the extent of the benefit from achieving the aim, and therefore questions the governmental aim, in the sense that it might impose on the government a duty to achieve a lesser degree of it.<sup>396</sup> Therefore, legal systems that are more sensitive to challenges posed by judicial activism and policy-oriented judgments tend to emphasise the first two subtests. This happens most distinctly, as shown above, in Canadian jurisprudence, in which justices have self-consciously avoided the third, more policy-oriented, subtest; in the United Kingdom, which was late to adopt the third subtest; and in Australia. In Germany and Israel, however, proportionality in the strict sense became the central test, where most of the emphasis of the case lies.

The relationship is further complicated by the fact that it is not always easy to maintain a clear analytical separation between the second and the third subtest. Grimm, for example, has criticised the Canadian Supreme Court for involving balancing and trade-offs in the second subtest as well, thus confusing it with the third subtests.<sup>397</sup> However, there has been analysis that attributes this slippage to the German and the Israeli courts as well and it seems that no court is immune from it.

In addition, in some formulations of proportionality there is no clear separation between the legitimate objective test and the proportionality tests, especially the third subtest of proportionality in the strict sense. Thus, under the Canadian *Oakes* test, and in systems that follow *Oakes*, such as the United Kingdom and Australia, and in different formulations under EU law, the requirement for a legitimate purpose is compounded by the requirement that the purpose should be *pressing* or *substantial*. In this manner the purpose test involves not only the legitimacy of the purpose but also its weight or importance, which connotes balancing.

<sup>&</sup>lt;sup>396</sup> See Barak, op. cit.

<sup>&</sup>lt;sup>397</sup> See Grimm, op. cit.

#### 3.3 Always applying proportionality strictly or not?

Finally, the third assumption that can be read into the German *PSPP* decision is that proportionality should always be applied strictly and in a searching and demanding way. The *PSPP* decision criticises the CJEU for applying the proportionality subtests, and especially the third subtest, in a very loose and deferential way, rendering it in the words of the decision "meaningless".

Regarding this third assumption as well, one can view many counterexamples from a comparative perspective. The way courts differentiate between different levels of strictness of proportionality can vary. One such way is with regard to the onus of proof. As noted above, in Canada in cases pertaining to defendants' rights, where the government is pitted against the individual, the onus of proof to show that the elements of proportionality have been obtained is on the government. However, when individuals and groups are pitted one against the other this rule does not apply. In Israel too, the onus of proof can vary depending on the case. According to one opinion, it will depend on the nature of the case and of the infringement.<sup>398</sup>

Another way of distinguishing between different levels of strictness of proportionality is through the debate on whether the limitation of rights is the rule or the exception. This is a debate on whether proportionality amounts to a cost-benefit balancing where a limitation of rights is commonplace, or whether it is a protective measure for rights, with only some exceptions to this protection. Some advocates of proportionality defend it on these terms and distinguish it from balancing.<sup>399</sup> Others stress that proportionality inevitably means balancing.<sup>400</sup>

Other systems have devised different levels of scrutiny, affecting either the level of proof (sometimes in effect also affecting the onus of proof), the extent and level of detail of evidence and facts required, the margin of appreciation given to government or all of the above. The level of scrutiny changes according to the nature of the right – for example, whether it is related to a financial interest or a core human right – according to the nature of the infringement and according to whether the case has extensive political and policy aspects or remains more strictly within the expertise of the court. Applied to the second subtest of necessity, for example, this distinction means that in a case of lower level scrutiny, the government would be given a range of possible alternative means and would not be required to, strictly speaking, choose only the least restrictive one.

Examples of jurisdictions where the level of scrutiny applied can vary include Canada, Israel, and South Africa. The UK debate about whether

<sup>&</sup>lt;sup>398</sup> Zemach v Minister of Defense HCJ 6055/95 (1999) 53(5) PD 241 (Isr).

<sup>&</sup>lt;sup>399</sup> Greer, S. M. (2006), The European Convention on Human Rights: Achievements, Problems and Prospects, Cambridge University Press.

<sup>&</sup>lt;sup>400</sup> Webber, G. (2010), "Proportionality, Balancing, and the Cult of Constitutional Rights Scholarship", 23 *Canadian Journal of Law and Jurisprudence*, p. 179.

proportionality applies only in relation to rights, and not in administrative law, can be seen as an instance in this debate of the different levels of strictness of proportionality. For those advocating the first view, rights cases would meet a proper strict proportionality review, while administrative law cases would meet only the very deferential Wednesbury reasonableness standard of review. An additional difficulty seems to arise regarding the level of proof or type of analysis when applying proportionality to social and economic rights.<sup>401</sup>

A related but different issue is whether the court, when applying proportionality, should entertain facts and, if so, what level of factual hearing it must entertain. Specifically, this has become important when applying the first subtest of suitability, as the question arises what kind of evidence needs to be produced to show that the means indeed further the end. In several common law jurisdictions, notably the United Kingdom and Australia, there are judicial pronouncements to the effect that no detailed evidence and facts should be presented at this stage. Rather, the court need only reach the conclusion that it is reasonable to assume that the means is adapted to the end. In addition, it has been held that the court must entertain only facts that were present in front of the governmental decision-maker, at the time of the decision. This is so since the judges need only review whether the decision was reasonable at the time it was made.<sup>402</sup> Other jurisdictions, such as Canada, tend to get into a much more detailed factual analysis even at the first subtest<sup>403</sup> and to discuss facts that became known only after the fact.404

#### 3.4 Conclusions

The comparative survey above does not support the claims, to the extent that we assign them to the *PSPP* decision, that proportionality has one proper meaning and that proportionality is always assumed to be, or is by definition, (i) structured, (ii) inclusive of all three subtests on an equal footing, and (iii) applied searchingly and demandingly. The *PSPP* decision may, however, receive a more favourable reading as arguing that in the circumstances of the case – i.e. a review of ECB policy by the CJEU – proportionality should have been applied according to the three principles described above. This view, however, should have been properly supported in the reasoning of the case, and the GFCC should have explained what was it about the circumstances of this case that warranted this attitude, taking into consideration that other attitudes are also possible.

<sup>&</sup>lt;sup>401</sup> Gardbaum, S. (2018), "Positive and Horizontal Rights: Proportionality's Next Frontier or a Bridge Too Far?", in Jackson, V. and Tushnet, M. (eds.), *Proportionality: New Frontiers, New Challenges*, Cambridge University Press.

<sup>&</sup>lt;sup>402</sup> Stone, A. (1999), "The Limits of Constitutional Text and Structure: Standards of Review and the Freedom of Political Communication", 23 *MelbULRev* 668.

<sup>&</sup>lt;sup>403</sup> See e.g. *R* v *Keegstra* [1990] 3 SCR 697 (Can) where the Canadian Supreme Court discussed the effects of hate speech law on the curtailment of hate speech.

<sup>404</sup> Ressler v Knesset HCJ 6298/07 (21 February 2012) (Isr).

The German court should not have, in my view, implied in its decision that there is only one *objective* or *methodologically sound* version of proportionality review and that other applications, such as the one made by the CJEU, render it "meaningless". Rather, it should have engaged directly with the question of why the CJEU should have applied, for example, a searching level of review rather than deferential one, and why the CJEU should not have, as UK courts do in administrative cases or as much of the CJEU and ECtHR jurisprudence does, used a Wednesbury-like reasonableness standard of review in this case.

The GFCC does indeed refer to some of these reasons, for example when it discusses the fact that the ECB is very lightly regulated and there is very little supervision over its decisions, and that therefore the CJEU must step in, in the name of the Member States, as a vigorous regulator and overseer of ECB decisions. This is a cogent argument and one on which a proper discussion could be had. In such a discussion courts would also have to deal with the question whether this was a case of rights or a case of administrative policy, and whether the two should be met with different standards of proportionality. However, much of the reasoning in the *PSPP* decision is framed, as mentioned above, in very strong definitional terms, criticising the CJEU for errors of method and logic, and on the ground of meaninglessness, which seems to miss the point. The answer to the interesting questions posed in the case cannot be found, I would suggest, in the concept of proportionality itself, as the concept is open to several manifestations and variations.

#### 4 Part IV – Two further questions

## 4.1 What is the relationship between proportionality and the distinction between a "culture of justification" and a "culture of authority"?

Another aspect of the *PSPP* decision that can be reviewed in a comparative perspective is its relation to the distinction between the "culture of justification" and the "culture of authority". Moshe Cohen-Eliya and I have argued that the success of proportionality in spreading itself to so many countries should be understood against the background of the rise in many countries of the "culture of justification". The fact that proportionality has not entered US constitutional law, on the other hand, could be understood, among other things, by reference to the "culture of authority" which prevails in US constitutional law.<sup>405</sup>

The distinction between the culture of justification and the culture of authority can be understood as follows: the culture of justification is a

<sup>&</sup>lt;sup>405</sup> Cohen-Eliya, M. and Porat, I. (2011), "Proportionality and the Culture of Justification", *American Journal of Comparative Law* 463; Cohen-Eliya, M. and Porat, I. (2014), "Proportionality and Justification", 64 *Toronto L. J.* 458.

constitutional culture according to which government should provide justification, in substantive terms, to all its actions. The function of the court in such a culture is to require from government, in the name of the citizens, that it provides such justification. Moreover, the function of the court is also to make sure that the government's justification is sound and meets the standards of rationality and human rights protection, otherwise the court sets its actions aside.

The culture of authority, however, views the function of the court differently. Its function is to monitor the scope of governmental action and make sure that in any given sphere of action, the government did not overstep its bounds of authority. The court therefore investigates the nature of the authorisation given to a public body and then looks into particular cases to determine whether a breach of authority has occurred. The court sets aside action taken in breach of bounds of authority.

As mentioned above, Moshe Cohen-Eliya and I argued that the success of proportionality should be attributed partly to the rise of the culture of justification, especially in Europe but which is also spreading elsewhere. The reason is that proportionality is a key element in this culture. It is through proportionality that courts require justification from governments and, furthermore, it is through proportionality that courts assess whether such justification can withstand criticism or will need to be set aside. The reason for this is that proportionality is based on the aptness of means and ends and on the proper balancing of conflicting aims and goals. These are exactly the considerations under which governmental action can be justified in substantive terms and under which courts can supervise such justification. Furthermore, proportionality concentrates on the balance of legitimate reasons and on the guestion of *degree* – of how much the sacrifice of one legitimate goal for another is too much. Such concentration is adept to the culture of justification and to the substantive review of government action.

On the other hand, if what we wish the court to do is to distinguish between legitimate and illegitimate governmental goals, and to monitor the scope and boundaries of legitimate government actions, then proportionality does not seem to be an ideal doctrinal tool. Such analytical operation requires distinctions of kind rather than of degree, whereas proportionality, as mentioned above, is all about distinctions of degree. The determination of the proper scope of authority and whether it has been breached does not involve balancing, but rather classification and characterisation.

The distinction, and its relation to proportionality, reveals another problematic aspect of the *PSPP* decision. This is so since the GFCC used proportionality primarily to determine the proper scope of authority – following a culture of authority paradigm – rather than to find out whether,

within the proper scope of authority, the action was justified.<sup>406</sup> Recall that the main question the court wished to deal with was whether the ECB bonds programme was an economic or a monetary programme, and thus, whether it was within or without the scope of ECB authority. This question is not primarily about balancing conflicting considerations nor is it primarily a guestion of degree or of fitting means and ends. It is about framing and defining what would constitute a legitimate policy goal and then of classifying a particular policy as either falling under that definition or not. It is about authority rather than justification, and it is about whether the ECB could have engaged in a particular calculation at all rather than, once engaged in that calculation, whether it balanced the different considerations properly. Indeed, according to one criticism of the *PSPP* reasoning<sup>407</sup>, by requiring the ECB to balance economic and monetary effects, the PSPP decision in effect demands the ECB to enter the realm of economic policy, which it should not. Consider for example a determination that the bonds policy has economic advantages (rather than only disadvantages) - would this determination be a proper consideration in terms of ECB action if it is not to base its decisions in economic policy? The point is that the flaw the GFCC was looking for was not one that could have been easily determined by balancing costs and benefits, but required the outlining of boundaries and the characterisation of types of actions by the ECB – whether they are economic or monetary (regardless of either economic or monetary actual effects).

#### 4.2 What are the ideological connotations of proportionality?

The final question that I posed in a comparative perspective relates to the ideological connotation of proportionality as manifested in the *PSPP* decision. First, it should be noted that proportionality does not have an ideology per se. Proportionality is a method and a tool. As such, one can put any type of content into it, and it is not associated with any one view more than another. However, over the years proportionality has been associated with a set of ideological beliefs and attitudes as a matter of practice rather than as a matter of definition or structure. This set of beliefs and attitudes associated proportionality with the political and ideological context in which it rose to prominence in the late 1990s and early 2000s – liberal constitutionalism, cosmopolitanism, universal human rights discourse and the vital role of judiciaries and other elite institutions in inculcating and protecting human rights against popular sentiment. Indeed, proportionality was key in spreading these ideas and in allowing a common

<sup>&</sup>lt;sup>406</sup> Compare to a similar argument in Petersen, N. (2020), "Karlsruhe's Lochner Moment? A Rational Choice Perspective on the German Federal Constitutional Court's Relationship to the CJEU After the PSPP Decision", *German Law Journal*, Vol. 21, pp. 995-1005.

<sup>&</sup>lt;sup>407</sup> Maduro, M., "Some Preliminary Remarks on the PSPP Decision of the German Constitutional Court, VerfBlog", 2020/5/06, available at https://verfassungsblog.de/ some-preliminary-remarks-on-the-pspp-decision-of-the-german-constitutional-court/, DOI: 10.17176/20200506-133802-0.

language – a lingua franca – through which they could be promoted and shared among different jurisdictions and among different judges.<sup>408</sup>

What seems to be peculiar about the *PSPP* decision is that it appears to run contrary to the ideological associations that proportionality used to have during the past few decades. This is so since the decision sides with a particularistic, local, state-centred, national interest and national identity view. It is not associated with a universalistic, cosmopolitan, individualist, human rights view as much of the use of proportionality over the last couple of decades did. The *PSPP* decision sides with the interests of the German people to define their future for themselves according to their national interests and needs. It is thus also averse to cosmopolitan politics and to the rule of elites and bureaucracies rather than that of the people through democratic decision-making.

It is true that the decision does express itself in the language of rights. But these rights are the rights to vote and democratic rights protecting self-governance and collective identity rather than universal human rights that are independent of a collective or a nation. This strand in German constitutional politics did not start with the *PSPP* decision but goes back to the Maastricht decision in the 1990s. However, what is peculiar about the *PSPP* decision is that it reasons through proportionality. In that way there seems to be a tension in the use of proportionality, at least vis-à-vis its prior use. While there are of course great differences, this more particularistic and nationalistic use of proportionality bears some resemblance to recent uses of proportionality by backsliding democracies in Eastern Europe such as Hungary and Poland. In such countries, proportionality is also being used for aims that are contrary to those with which proportionality was associated in the 1990s and 2000s.<sup>409</sup>

#### 5 Conclusion

This essay has sought to give a short survey of comparative aspects of proportionality and through them to assess several aspects of the *PSPPI Weiss* saga. The essay criticised the GFCC's *PSPP* decision for overstressing a particular meaning of proportionality as the only proper meaning and showed how, in a comparative perspective, the reasoning could have been framed more intelligibly. It also dealt with two additional comparative perspectives of the saga – the culture of justification and the national and particularistic ideological association of proportionality in the decision. The fascinating and ever evolving jurisprudence of proportionality is bound to provide us with further challenges in the future for which a comparative perspective would still be vital.

<sup>&</sup>lt;sup>408</sup> See Cohen-Eliya and Porat, op. cit.; Porat I. (2021), "Towering Judges and Global Constitutionalism", in Abeyratne, R., and Porat, I. (eds.) *Towering Judges: A Comparative Study of Constitutional Judges*, p. 21.

<sup>&</sup>lt;sup>409</sup> See Cohen-Eliya, M., and Porat, I, "Proportionality in the Age of Populism", *American Journal of Comparative Law* (forthcoming 2022).

# How the Council applies the principle of proportionality when legislating

By Thérèse Blanchet\*

This contribution outlines how the Council of the European Union applies the principle of proportionality when legislating.

The Council usually has to apply the principle of proportionality in its two forms: the "classic" proportionality test and the "strict" proportionality test. The strictness of the test applied to any given draft legislation varies according to the areas at stake or the nature of the provisions at stake:

- in areas in which the EU co-legislator enjoys broad discretion i.e. areas entailing political, economic and social choices, and in which the legislator has to make complex assessments and evaluations – the legislator applies the classic proportionality test referred to in Article 5(4) of the Treaty on the European Union (TEU). In such areas, the review by the Court of Justice of the European Union (CJEU) of the proportionality of the legislative measures at stake is limited to examining whether the measure is manifestly inappropriate having regard to the objective pursued;
- in cases where the EU co-legislator interferes with or restricts fundamental rights, the legislator applies the stricter test set out in Article 52(1) of the Charter of Fundamental Rights of the European Union. In such cases, the Court exercises a stricter or full review.

When assessing compliance with the principle of proportionality, the Council of course bases its approach on the Treaties, their relevant protocols and the case-law of the CJEU. It also uses different accompanying instruments developed over time such as the Better

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#### 1 History and legal context

### 1.1 The principle of proportionality before it was codified in the Treaty

A brief search through the Treaties shows that the principle of proportionality is mentioned only twice: in Article 5 TEU (and the related Protocol 2)<sup>412</sup> and in Article 52 of the Charter.<sup>413</sup> It was not expressly set out in the original Treaties in 1957.

The principle of proportionality can, however, be traced back to Article 40 of the 1957 Treaty establishing the European Economic Community (hereinafter the "EEC Treaty") (now Article 40 of the Treaty on the Functioning of the European Union (TFEU)), which implicitly refers to it. This Article dealt with the common organisation of agricultural markets, which constitutes the core instrument for the common agriculture policy. The common organisation of agricultural markets is very integrated and regulated in detail.

Article 40 of the EEC Treaty stated, as does Article 40 TFEU (paragraph 2), that "the common organisation... may include all measures required to attain the objectives [of the agriculture policy, e.g. price regulation, production and marketing aid, storage arrangements, import or export stabilisation mechanisms]", but adds that it "shall be limited to pursuit of [these] objectives".

Given the level of intrusiveness and detail of this policy, it is not surprising that agriculture became the prime area of development of the case-law of the CJEU on founding issues, including on the proportionality principle.

<sup>&</sup>lt;sup>410</sup> Interinstitutional Agreement of 13 April 2016 between the European Parliament, the Council of the European Union and the European Commission on Better Law-Making (OJ L 123, 12.5.2016, p. 1).

<sup>&</sup>lt;sup>411</sup> Such as, for instance, the Guidelines on methodological steps to be taken to check fundamental rights compatibility at the Council preparatory bodies, endorsed by Coreper on 19 December 2014 (Council document 5377/15). See also the different useful toolkits issued by the European Data Supervision Supervisor (EDPS): the EDPS quick-guide to necessity and proportionality (2020), Assessing the necessity of measures that limit the fundamental right to the protection of personal data: A Toolkit (11 April 2017) and the EDPS Guidelines on assessing the proportionality of measures that limit the fundamental rights to privacy and to the protection of personal data (19 December 2019). See also the Handbook by the EU Fundamental Rights Agency: Applying the Charter of Fundamental Rights of the European Union in law and policymaking at national level - Guidance (2020).

<sup>&</sup>lt;sup>412</sup> Protocol (No 2) on the application of the principles of subsidiarity and proportionality.

<sup>&</sup>lt;sup>413</sup> It is also mentioned in Article 49 of the Charter on the principles of legality and proportionality of criminal offences and penalties.

In *Internationale Handelsgesellschaft*<sup>414</sup>, the national judge asked the Court whether a system of deposits for export licences under the common organisation of the cereal market was proportionate. In its judgment – which became famous for stating that fundamental rights are part of the EU general principles of law<sup>415</sup> – the Court ruled that the deposit system was "both necessary and appropriate" having regard to the objective pursued.

This wording was then used and developed by the CJEU in its successive case-law. It progressively became the well-known sentence that "measures adopted by Community institutions must not exceed what is appropriate and necessary to attain the objective pursued".<sup>416</sup>

### 1.2 Codification of the proportionality principle in the Treaty and present content

Following its progressive framing and anchoring into EU law as part of the general principles of EU law, by the case-law of the CJEU, the principle of proportionality was codified in the 1992 Maastricht Treaty, which added Article 3b to the Treaty establishing the European Community. The third paragraph of Article 3b provided that "any action by the Community shall not go beyond what is necessary to achieve the objectives of [the] Treaty".

At the time, the only accompanying element was a declaration on estimated costs under Commission proposals annexed to the Final Act of the Intergovernmental Conference (Declaration No 18), in which the Commission undertook, by basing itself on consultations and evaluations of Community legislation, to take into account, in its legislative proposals of costs and benefits to the Member States' public authorities and all the parties concerned.

In addition, a text<sup>417</sup> on the application of Article 3b was agreed upon and annexed to the December 1992 Edinburgh European Council Conclusions, which were designed to solve issues raised following the negative

<sup>&</sup>lt;sup>414</sup> Judgment of 17 December 1970, *Internationale Handelsgesellschaft*, 17 December 1970, EU:C:1970:114, para. 12: "a deposit constitutes a method which is both necessary and appropriate to enable the competent authorities to determine in the most effective manner their interventions on the market in cereals".

<sup>&</sup>lt;sup>415</sup> See paragraph 4 of Internationale Handelsgesllschaft, which affirmed - after the 1969 Stauder judgment - that "respect for fundamental rights forms an integral part of the general principles of law protected by the Court of Justice". In paragraph 5 of Stauder, the Court had already referred to "the fundamental human rights enshrined in the general principles of Community law and protected by the Court" (Judgment of 12 November 1969, C-29-69, EU:C:1969:57).

<sup>&</sup>lt;sup>416</sup> Judgment of 15 May 1984, *Denkavit*, C-15/83, EU:C:1984:183, para. 25. See also Judgment of 20 November 1979, *Buitoni*, C-122/78, EU:C:1979:43, para. 16; Judgment of 23 February 1983, *Fromençais*, C-66/82, EU:C:1983:42, para. 8; Judgment of 11 July 1989, *Schräder*, C-265/87, EU:C:1989:303, para. 21; and Judgment of 13 November 1990, *Fedesa*, C-331/88, EU:C:1990:391, para. 13.

<sup>&</sup>lt;sup>417</sup> See Annex 1 to Part A of the Edinburgh European Council Conclusions of 12 December 1992, Overall approach to the application by the Council of the subsidiarity principle and Article 3b of the Treaty on European Union.

referendum in Denmark on the ratification of the Maastricht Treaty. This text outlined the meaning of and the way to apply the three "Article 3b principles" (conferral, subsidiarity and proportionality). It explained the jurisprudential origin of the principle of proportionality and described it as a rule about the intensity of EU action (part I).<sup>418</sup> It also contained guidelines on how to apply the principle (part II)<sup>419</sup> and a set of procedures and practices that the EU institutions should follow to comply with Article 3b (part III).

The 1997 Amsterdam Treaty did not amend Article 3b, but it added a rather detailed Protocol on the application of the principles of subsidiarity and proportionality, which in fact essentially contained the text on Article 3b that had been annexed to the Edinburgh European Council Conclusions.

Regarding the principle of proportionality, that Amsterdam Protocol required a specific justification with regard to compliance with the principle of proportionality to be inserted in legislative acts (paragraph 4). It required that the form of the action be as simple as possible and consistent with satisfactory achievement of the objective of the measure and the need for effective enforcement, and that directives should be preferred to regulations and should not be too detailed (paragraph 6). Regarding the nature and the extent of the action, measures should leave as much scope for national decision as possible – respecting well-established national arrangements and the organisation and working of Member States' legal systems (paragraph 7). The Protocol also built on the Declaration made in the Maastricht Intergovernmental Conference and requests that the Commission consult widely and duly takes into account the need for any financial or administrative burden to be minimised and proportionate to the objective to be achieved (paragraph 8).

In 2000, the Charter of Fundamental Rights – which at the time was only a declaration, but with high authority – added a new and important element to the proportionality edifice for cases of restrictions to fundamental rights. This was also a codification of previous texts and case-law.

Article 52(1) of the Charter – which has not changed – provides that "any limitation on the exercise of the [fundamental] rights … must be provided for by law and respect the essence of those rights … Subject to the principle of proportionality, limitations may be made only if they are necessary and genuinely meet objectives of general interest recognised by the Union or the need to protect the rights".

<sup>&</sup>lt;sup>418</sup> See paragraph 2(iii) of Section I of Annex 1 to Part A of the Edinburgh European Council Conclusions of 12 December 1992: "The principle that the means to be employed by the Community should be proportional to the objective pursued is the subject of a well-established case law of the Court of Justice which, however, has been limited in scope and developed without. the support of a specific article in the Treaty. (The principle of proportionality or intensity)".

<sup>&</sup>lt;sup>419</sup> See, in these guidelines, points (i) to (vii) about proportionality (third paragraph of Article 3b) on burden minimisation, leaving enough scope for national decision, preference for minimum standards and for directives, etc.

This wording stems both from the European Convention on Human Rights – as interpreted by the European Court of Human Rights – and the case-law of the CJEU. The Explanations Relating to the Charter of Fundamental Rights refer to the *Karlsson* judgment (2000)<sup>420</sup> as a source.

With the 2007 Lisbon Treaty, the Charter was upgraded to the status of primary law. Building on the wording of Article 3b, the Treaty also clarified the limits and use of EU competences by transforming Article 3b into Article 5 TEU, which sets out the three principles that govern EU competences: conferral, subsidiarity and proportionality.

These principles help the EU legislator to answer three questions, which the annex to the Edinburgh European Council Conclusions already identified:

- Can the EU act?
- · Should the EU act?
- · How intensively should the EU act?

Only conferral concerns the limits of competences and it is the most "legal" of the three principles. The two other principles concern the use or the exercise of competences: subsidiarity has to do with whether or not to use non-exclusive EU competence, and proportionality has to do with the intensity of the use of the (exclusive or non-exclusive) EU competence. These two principles are very much about the choices to be made by the EU legislator.

Article 5(4) TEU reformulated the third paragraph of Article 3b on proportionality. It provides that "the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties". This wording integrates the references to the content and the form of the action, which were developed in the long Protocol of Amsterdam.

The Lisbon Treaty also replaced the Amsterdam Protocol with a new Protocol No 2. This new Protocol is mostly about the subsidiarity control mechanism for national parliaments.

On the principle of proportionality, the Protocol is shorter. It simply states that "each institution shall ensure constant respect for the [principle of] proportionality" (Article 1); that "draft legislative acts shall be justified with regard to the [principle of] proportionality" and "should contain a detailed statement making it possible to appraise compliance with the [principle of]

<sup>&</sup>lt;sup>420</sup> Judgment of 13 April 2000, *Karlsson*, 13 April 2000, C-292/97, EU:C:2000:202, para. 45: "it is well-established in the case law of the Court that restrictions may be imposed on the exercise of those rights... provided that those restrictions in fact correspond to objectives of general interest pursued by the Community and do not constitute, with regard to the aim pursued, disproportionate and unreasonable interference undermining the very substance of those rights".

proportionality" (Article 5); and that "draft legislative acts shall take account of the need for any burden, whether financial or administrative... to be minimised and commensurate with the objective to be achieved" (Article 5).

In addition, the 2016 Better Law-Making Interinstitutional Agreement<sup>421</sup> covers the necessity for the Commission to provide impact assessments (paragraphs 12 to 18), to conduct public consultations before proposing legislation (paragraph 19) and to justify the type of legal act proposed (that is, whether it should be a directive or a regulation) (paragraph 25).

#### 2 The practice of the Council

Against the background of the incremental developments outlined above, the Council, in its practice as EU co-legislator, uses the following yardsticks to assess compliance with the proportionality principle:

- the classic analysis based on Article 5(4) TEU in areas where the legislator enjoys a broad discretion; and
- the strict and more demanding analysis based on Article 52(1) of the Charter in cases where the legislator restricts fundamental rights.

#### 2.1 The classic analysis

In this scenario, the Member States themselves typically ask whether the measures proposed are proportionate, not too heavy or detailed, and whether they leave them sufficient freedom of choice. This is consistent with the usual concerns they expressed, as authors of the Treaties, in the current Protocol 2 about the need for any burden to be minimised and commensurate with the objective to be achieved. Such concerns are rooted in the abovementioned Amsterdam Protocol and in the annex to the 1992 Edinburgh European Council Conclusions.

In the Council, the analysis will first consist in checking whether this is an area where, to paraphrase the wording used by the CJEU in its settled case-law, the EU legislator enjoys broad discretion, i.e. an area which entails political, economic and social choices requiring the legislator to undertake complex assessments and evaluations.<sup>422</sup>

<sup>421</sup> op. cit.

<sup>&</sup>lt;sup>422</sup> See, for instance, Judgment of 8 June 2010, Vodafone, C-58/08, EU:C:2010:321, para. 52: "in the exercise of the powers conferred on it the Community legislature must be allowed a broad discretion in areas in which its action involves political, economic and social choices and in which it is called upon to undertake complex assessments and evaluations. Thus the criterion to be applied is not whether a measure adopted in such an area was the only or the best possible measure". See also Judgment of 22 November 2018, *Swedish Match*, C-151/17, EU:C:2018:938, para. 36; and Judgment of 8 December 2020, *Poland* v *EP* and *Council (posting of workers*), C-626/18, EU:C:2020:1000, para. 95.

Once it is established that the draft legislation at stake falls within such an area of broad discretion, the following questions are asked:

- · Is the proposed measure appropriate to achieve the objective pursued?
- Are there any less intrusive or less onerous means of achieving that objective?
- · Does the measure exceed what is necessary to achieve the objectives?

In those areas of broad discretion – in accordance with the principle of institutional balance, which is an expression of the principle of separation of powers – the CJEU has consistently taken a deferential approach – limiting its review to examining whether the EU measure is manifestly inappropriate having regard to the objective that the competent EU institutions seek to pursue.<sup>423</sup> The Court limits itself to checking whether the EU legislator has manifestly exceeded the limits of its discretion or whether the exercise of that discretion has been vitiated by a manifest error or misuse of powers.<sup>424</sup> In such areas, the CJEU cannot substitute its assessment of scientific and technical facts for that of the EU legislator, to which the Treaty has assigned that task.

It may be that, on balance, for achieving transversal Treaty objectives<sup>425</sup> such as, for instance, consumer protection, environmental protection or a high level of health, the Council chooses a more heavy or intrusive measure, which may result in negative economic consequences for certain economic operators.

For instance, in the case of roaming, in the interest of consumers, the EU legislator imposed ceilings on per-minute charges.<sup>426</sup> In the case of tobacco, in line with the precautionary principle and to ensure a high level of health protection, the EU legislator prohibited the placing on the market of snus (tobacco for oral use).<sup>427</sup>

When advising the Council, the Legal Service pays particular attention to the decision-making process leading to the adoption of the act. This is because, as set out in its case-law on the limits on the scope of its review, the CJEU conducts a process-oriented review. It examines whether the EU legislator has actually exercised its broad discretion. This is what some call

<sup>423</sup> See ibid.

<sup>&</sup>lt;sup>424</sup> See Spain v Council, C-310/04, EU:C:2006:521, paras. 96 to 99. This case is interesting because it is one in which the Court annulled the contested EU measure for having infringed the proportionality principle.

<sup>&</sup>lt;sup>425</sup> See, in particular, Articles 8 to 13 TFEU, which contain provisions of general application in all EU activities and policies dealing with issues such as equality between men and women, high level of employment, adequate social protection, fight against social exclusion, high level of education, training and protection of human health, combating discrimination, environmental protection, consumer protection, and animal welfare.

<sup>&</sup>lt;sup>426</sup> See *Vodafone*, paras. 60 and 69.

<sup>&</sup>lt;sup>427</sup> See Swedish Match, para. 38, 41.

"procedural proportionality". The fact that the EU legislator has indeed proceeded to assess the proportionality of the measure by assessing the basic facts that it took into account as the basis of that measure should be appropriately reflected and demonstrated in the recitals of the legal act. This enables the CJEU to review the process followed.

In exercising its discretion, the EU legislator must base its approach on objective criteria, and must consider all relevant factors and the circumstances of the situation the act is intended to regulate. The legislator may be required to present to the CJEU, clearly and unequivocally, the essential facts on the basis of which it decided to adopt the act.<sup>428</sup>

To demonstrate that, the EU legislator must be in possession of sufficient factual elements to explain the policy choices it has made. The primary tools for that are all the analyses and studies conducted by the Commission when preparing its legislative proposal. This is normally reflected in the impact assessment, the explanatory memorandum and the draft preamble of the proposed act.

However, there may be situations where there is a limited number of elements or no elements allowing the Council to assess whether less intrusive or less onerous means are available. Sometimes, usually when the Commission submitted a proposal in a rush, there is no impact assessment or not enough information.

In such cases, the Council tries to rely on other sources of information such as previous studies or consultations made by the Commission or studies made by the Research Service of the European Parliament. In accordance with Article 241 TFEU, the Council may also formally request the Commission to provide the necessary information.

There have been some instances where the Council Legal Service has advised that the legislator was not in a position to assess the impact or proportionality of the proposed measure.

#### 2.2 The strict analysis

In cases where the EU legislator intends to restrict fundamental rights, it must proceed with the strict analysis provided for in Article 52(1) of the Charter. This proportionality assessment, while contained in Article 5(4) TEU, must be made in line with a set of additional – stricter – criteria.

In the Council, such analysis is less often requested by Member States. Therefore, it is typically made by the Council Legal Service on its own initiative. Internally, guidelines, and a checklist to help verify compatibility with the Charter, have been issued to help working groups of the Council.<sup>429</sup>

<sup>&</sup>lt;sup>428</sup> See Spain v Council, paras. 121 to 123.

<sup>&</sup>lt;sup>429</sup> See Guidelines on methodological steps to be taken to check fundamental rights compatibility at the Council preparatory bodies, op. cit.

Bodies such as the European Data Protection Supervisor and the Fundamental Rights Agency have also issued useful guidance.

This is all the more important since, in such cases, judicial review is generally strict and, therefore, the scope of discretion of the EU legislator is generally more limited. Under the case-law, this scope of discretion depends on a number of factors, including, in particular, the area concerned, the nature of the fundamental right at issue, the nature and seriousness of the interference and the object pursued by the interference.<sup>430</sup>

The Court ruled in *Schecke* that the institutions are obliged to balance the interests and fundamental rights at stake and that no automatic priority can be given to a particular legitimate objective, however important it may be, over a fundamental right, "even if important economic interests are at stake".<sup>431</sup>

Where interference with fundamental rights is at stake, the analysis of the draft legislative act will consist in asking the following questions:

- · Does the proposed measure limit fundamental rights?
- · Does the limitation respect the essence of the fundamental rights?
- Does it genuinely meet objectives of general interest recognised by the EU?
- · Is the limitation necessary and proportionate?

Depending on the fundamental right at stake, the test will be whether the limitation is strictly necessary.

As shown in recent case-law, this is particularly so for privacy and personal data protection.

The EU legislator should be able to demonstrate that it has explored alternative ways of attaining the objectives pursued that would be less restrictive of the rights of the individuals concerned.

In recent years, a number of EU measures were invalidated or annulled by the CJEU for being in breach of the principle of proportionality. In *Schrems* 

<sup>&</sup>lt;sup>430</sup> Judgment of 8 April 2014, *Digital Rights Ireland*, C-293/12, EU:C:2014:238, paras 46 to 48. Paragraph 47 reads: "With regard to judicial review of compliance with those conditions, where interferences with fundamental rights are at issue, the extent of the EU legislature's discretion may prove to be limited, depending on a number of factors, including, in particular, the area concerned, the nature of the right at issue guaranteed by the Charter, the nature and seriousness of the interference and the object pursued by the interference."

<sup>&</sup>lt;sup>431</sup> Judgment of 9 November 2010, *Schecke*, Joined Cases C-92/09 and C-93/92, EU:C:2010:662, para. 85.

 $\it I$  , the CJEU ruled that the very essence of the fundamental rights was violated.  $^{\rm 432}$ 

In some of these cases, the EU institutions found solutions such as, for example, after the judgment in *Schecke* concerning the publication of the names of the beneficiaries of agricultural funds. In other cases, no solution has yet been found (for example, on data retention<sup>433</sup>, *Schrems II*<sup>434</sup> and *PNR Canada*<sup>435</sup>).

After the judgment in *Schecke*, the Commission submitted a new proposal in which a new purpose was added to justify the publication of the beneficiaries of EU agriculture funds; it did not, however, provide much information or many elements. The Council Legal Service advised the Council to explore less intrusive ways of attaining the same objective. As a result, the Council notably introduced a de minimis measure. The EU legislator balanced the different rights and interests better, explained this at length in several recitals, and adopted a new regulation in December 2013.<sup>436</sup>

The Legal Service prompted a similar analysis in relation to other issues, such as, for instance, access to beneficial ownership of information in the context of the fight against money laundering, which resulted in the adoption of Directive (EU) 2015/849.<sup>437</sup> During the discussions on the Directive, suggestions were made to establish an online public register where the beneficial owners of all companies established in the EU would

<sup>&</sup>lt;sup>432</sup> Judgment of 6 October 2015, *Schrems I*, C-311/18, EU:C:2020:559, para. 94.

<sup>&</sup>lt;sup>433</sup> Following the invalidation in 2014 of the Data Retention Directive by the *Digital Rights Ireland*, judgment (C-293/12), several other judgments were given by the CJEU in the area of retention of, or access to, data for the purpose of investigations in criminal matters, public policy or national security, but the Commission has not submitted a proposal to the EU legislator to regulate that matter. See, for instance, Judgment of 21 December 2016, *Tele 2*, C-203/15 and C-699/15, EU:C:2016:970; Judgment of 2 October 2018, *Ministerio Fiscal*, C-207/16, EU:C:2018:788; Judgment of 6 October 2020, *Quadrature du Net*, C-511/18, C-512/18 and C-520/18, EU:C:2020:791.

<sup>&</sup>lt;sup>434</sup> As, in the 2015 Schrems I judgment, the Safe Harbour with the US was held to be in breach of privacy and personal data protection, the Commission started discussions with the US on the Privacy Shield and adopted a new adequacy decision in 2016. This was however declared invalid again by the CJEU in Judgment of 16 July 2020, Schrems II, C-311/18, EU:C:2020:559.

<sup>&</sup>lt;sup>435</sup> See Opinion 1/15 of the Court of Justice, *PNR Canada*, 26 July 2017, EU:C:2016:656. It states that the draft Agreement on the transfer of Passenger Name Record (PNR) data with Canada was contrary to privacy and personal data protection. New PNR negotiations were launched by the Commission with Canada in June 2018 and are, at the time of writing (December 2021), still ongoing.

<sup>&</sup>lt;sup>436</sup> See, in particular, recitals 73 to 87 of Regulation (EU) No 1306/2013 of the European Parliament and of the Council of 17 December 2013 on the financing, management and monitoring of the common agricultural policy and repealing Council Regulations (EEC) No 352/78, (EC) No 165/94, (EC) No 2799/98, (EC) No 814/2000, (EC) No 1290/2005 and (EC) No 485/2008 (OJ L 347, 20.12.2013, p. 549).

<sup>&</sup>lt;sup>437</sup> Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC (OJ L 141, 5.6.2015, p. 73).

be listed. The final version of the relevant provisions does provide for the setting up of such a register but, as a result of advice from the Legal Services of the Council and of the Commission, the Directive mandates only restricted access to the data, at least in relation to the purpose of fighting money laundering, terrorist financing and other related offences – as opposed to the general access that had been suggested.<sup>438</sup>

#### 2.3 The future of digital euro legislation

On a more prospective note, one of the outstanding areas where the Council will have to consider the proportionality of measures susceptible of limiting fundamental rights is in relation to the digital euro. In accordance with Article 133 TFEU, which empowers the EU legislator to lay down measures necessary for the use of the euro, the introduction of the digital euro will have to be preceded by an act of the EU legislator.

Whilst fully respecting the monetary powers and independence of the ECB, this legislative act will:

- · decide on the very principle of establishing the digital euro;
- grant it legal tender value; and
- deal with the possible interference with fundamental rights that the new form of money could entail, such as the rights to respect for private life, the protection of personal data and right to property.

This will require an examination of the principle of proportionality in accordance with the relevant criteria discussed above and set out in Article 52(1) of the Charter. This provides, inter alia, that any limitation of fundamental rights should be provided for by law.

<sup>&</sup>lt;sup>438</sup> See recital 14 and Article 30 of Directive (EU) 2015/849.

## Part II



## When you need change to preserve continuity: climate emergency and the role of law

By Frank Elderson\*

#### 1 Introduction

Good morning everyone and thank you, Chiara, for the kind introduction.

It is with great pleasure that I would like to welcome you all to this year's ECB legal conference. Our annual legal conferences have always focused on the most pertinent topics in the field, bringing together the most distinguished legal experts and academics. Today's event is no different.

Being a trained lawyer myself, I am well aware of the topicality of the issues that will be discussed here today and tomorrow from a legal point of view. However, their relevance goes far beyond law: these topics clearly have a wider impact on society.

Later, I will introduce the speakers of today's first panel, which will focus on the future of legal pluralism and the dialogue between courts. First, though, I would like to use this opportunity to share my thoughts on a topic close to my heart, where the role of courts has proven crucial and where the dialogue and cooperation among courts is intensifying. This conference deals with continuity and change, so I have decided to focus on the change that is going to be the single defining issue for humankind in this generation: climate change. In particular I am going to talk about a specific aspect of the relationship between climate change and the legal system: climate change litigation. I would like to share some of my thoughts on how climate-related human rights - which I will refer to as climate rights - may be seen as branches stemming from the tree of fundamental rights, and how the community of lawyers has specific responsibilities to uphold these rights. Against this background I would then like to consider the role of courts and highlight their importance in the European context in general and for the ECB in particular.

Frank Elderson, Member of the Executive Board of the ECB and Vice-Chair of the Supervisory Board of the ECB

## 2 From fundamental rights to climate rights and the role of lawyers

The law has always mirrored developments in society. And vice versa, the law has a profound impact on society, in that it governs many of our daily actions and interactions.

A very important historical example is the emergence of human rights after the Second World War, most notably the adoption of the Universal Declaration of Human Rights and, in Europe, the European Convention on Human Rights, both of which are seen as direct responses to the atrocities committed during the war. The European Convention's impact and importance today is thanks in particular to the work of courts – first and foremost the European Court of Human Rights. Alongside other courts, it played a crucial role in developing human rights and fundamental principles such as proportionality, which is another topic you will delve into this afternoon. Human rights and fundamental principles are two concepts that are closely intertwined and it was no coincidence that they gained ground simultaneously after the war. And proportionality and its implications have become so topical that we decided to dedicate a separate panel to the subject this morning.

Coming back to climate change, I would like to echo the words of Mary Robinson, the former United Nations High Commissioner for Human Rights, who defined climate change as the "greatest human rights issue of our time".<sup>439</sup>

I would like to use this opportunity to remind all of you, and the community of lawyers at large, of the central role that lawyers can play in the climate change field. Remember that how the law is interpreted and applied is as important as how it is written, and this is relevant each step of the way – from academic writing to judicial proceedings. Lawyers, as a community, share a huge responsibility towards future generations and the world as a whole.

#### 3 The role of courts

Court proceedings are inevitably going to gain prominence in the climate change field. Individuals and non-governmental organisations have been bringing cases against polluting companies, and increasingly against governments, for quite some time already. Climate-related litigation, which has been defined by the United Nations Environment Programme as "cases that raise material issues of law or fact relating to climate change

<sup>&</sup>lt;sup>439</sup> Robinson, M. (2013), "Video Message to the Panel of Experts on Climate Leadership, on the eve of the Pacific Islands Forum", 2 September.
mitigation, adaptation, or the science of climate change"<sup>440</sup>, is not a new phenomenon.

This year, however, we have seen an increase in the number of impactful judgments in climate-related cases in many different jurisdictions. Maybe in 50 years we will look back at those rulings in the same way we today look at the first seminal judgments on human rights after the war.

The cases I want to briefly mention to you today were categorised and described by the Network for Greening the Financial System in a recently published technical document.<sup>441</sup> These cases are important because they show that the attitude of courts is changing, and there is more willingness on their part to follow the plaintiffs' arguments and to hold governments and companies accountable for not taking sufficient action to combat climate change. The cases are informed by highly accurate scientific evidence on the seriousness of climate-related developments that has been published in recent years, and show an increasing willingness of courts to recognise an individual right to the environment for future generations.

In the *Urgenda* case<sup>442</sup>, the Dutch Supreme Court, citing among other things the European Convention on Human Rights, ordered the Dutch Government to reduce greenhouse gas emissions by at least 25% by the end of 2020 compared with 1990 levels. The case has received widespread attention because of the way it established a link between human rights and what was considered insufficient action to combat climate change.

Similar arguments were brought forward in the Irish Climate Case.<sup>443</sup> In this one, the Irish Supreme Court examined whether the Irish National Mitigation Plan complied with the Irish Climate Act. The Supreme Court found that it did not, as the plan had failed to specify in enough detail how Ireland could transition to a low-carbon, climate-resilient and environmentally sustainable economy by the end of 2050.

Another prominent case earlier this year involved the German Constitutional Court.<sup>444</sup> It decided that the provisions of the German Federal Climate Change Act governing national climate targets and the annual emission amounts allowed until 2030 were incompatible with fundamental rights. In particular, the court found that the targets did not sufficiently specify emission reductions from 2031 onwards and were thus

<sup>&</sup>lt;sup>440</sup> United Nations Environment Programme (2021), "Global Climate Litigation Report: 2020 Status Review", 26 January.

<sup>&</sup>lt;sup>441</sup> Network for Greening the Financial System (2021), "Climate-related litigation: Raising awareness about a growing source of risk", November.

<sup>&</sup>lt;sup>442</sup> Judgment of The Hague District Court of 24 June 2015 in Case C/09/456689 Urgenda Foundation v State of the Netherlands, English translation available at www. climate-laws.org

<sup>&</sup>lt;sup>443</sup> Judgment of the Supreme Court of 31 July 2020 in *Friends of the Irish Environment* v *Government of Ireland & others* [2020] IESC 49.

<sup>&</sup>lt;sup>444</sup> Judgment of the German Constitutional Court of 29 April 2021 in *Neubauer et al.* v *Germany*, English translation available at www.climate-laws.org

disproportionally violating the freedoms of younger generations as protected by the German constitution.

But it is not only cases against governments. Plaintiffs are also increasingly suing corporations. One of the most prominent recent examples was a case against the oil company Shell<sup>445</sup>, in which a Dutch court in the first instance found that Shell had violated its duty of care and had to cut its greenhouse gas emissions in the entire supply chain, throughout its worldwide operations, by 45% by 2030. Another case that has received considerable attention is currently pending before the German courts: a Peruvian farmer is suing the utilities company RWE<sup>446</sup>, alleging that their emissions are partially responsible for the dangerously high water levels in his area.

As for central banks, it is worth mentioning that the first climate case against a central bank is currently pending before courts in Belgium<sup>447</sup>, and the hearing took place last week. We will know in about a month whether this case will be referred to the European Court of Justice.

These cases show that courts are giving more weight and relevance to the protection of the right to a clean environment, and they are finding legal bases for such climate-related claims.

First of all, courts are increasingly relying on the human rights law that has been developed over the last 70 years. For instance, in the *Urgenda* case, the court found a violation of both Article 2 of the European Convention, which protects the right to life, and Article 8, which protects the right to respect for private life. From these core provisions, the Dutch Supreme Court derived an obligation of the State towards the residents of the Netherlands to take adequate measures to reduce greenhouse gas emissions.

Second, courts are also ready to use well-developed concepts of civil and tort law, such as the duty of care, in innovative ways. For example, the first instance decision against Shell largely relied on Shell's duty of care under Dutch law.

Third, the protection of the environment as a global right that transcends borders leads to the assertion of claims with an extraterritorial nature. This is exemplified by the two cases against the companies I mentioned earlier. In the case of Shell, the court of first instance held that Shell is also responsible for emissions from its subsidiaries and supply chain partners around the world. And in the case of RWE, the plaintiff is trying to hold the company responsible for the impact of its actions on an area that is

<sup>&</sup>lt;sup>445</sup> Judgment of The Hague District Court of 26 May 2021 in Case C/09/571932 *Milieudefensie et al.* v *Royal Dutch Shell plc.*, English translation available at www. climate-laws.org

<sup>&</sup>lt;sup>446</sup> *Luciano Lliuya* v *RWE AG*, Case No. 2 O 285/15, on appeal from the Essen Regional Court, English translation available at www.climate-laws.org

<sup>&</sup>lt;sup>447</sup> *Clientearth* v *National Bank of Belgium*, case filed on 1 April 2021, English summary of the action filed available at www.climate-laws.org

thousands of kilometres away, on another continent. As I said, there is no verdict in the RWE case yet, but the fact that such arguments are increasingly being made is proof of the understanding that climate change, just like human rights, has no territorial limits.<sup>448</sup> This means that courts will also have to cooperate internationally, as their decisions will have a cross-border reach.

These cases are also testament to the importance of cooperation and dialogue. For instance, the German Constitutional Court made explicit reference to the arguments developed in the *Urgenda* case and the case before the Irish Supreme Court. This is a good example of how cooperation helps each judge further refine the arguments and apply climate rights to different jurisdictions, applicable laws and factual settings.

### 4 The interaction with EU law

Climate litigation is a worldwide phenomenon. A Columbia Law School database keeping track of relevant cases across the globe currently contains close to 500 entries of lawsuits against governments, corporations and individuals outside the United States. As you may have noticed, all of the cases I have mentioned were decided by courts in the EU. The openness of courts in the EU to this new stream of cases raises two questions. First, how could different emerging judicial practices be reconciled at EU level in the future? And second, what is the likelihood of similar cases being more directly based on EU law?

Earlier this year, when individuals were arguing that the EU's existing targets to reduce domestic greenhouse gas emissions were insufficient, the Court of Justice of the European Union (CJEU) dismissed the action for annulment due to a lack of standing.<sup>449</sup> However, it is very likely that plaintiffs will continue to rely on comparable arguments before national constitutional courts, which may then bring such questions to the attention of the CJEU through a request for a preliminary ruling. This may bring questions into EU law that would otherwise not have been admissible as happened in the OMT case.<sup>450</sup>

Plaintiffs may even challenge the EU institutions directly and argue that the EU itself is not doing enough to address climate change, for example because its greenhouse gas reduction targets are not ambitious enough or because the institutions are not taking sufficiently effective action to comply

<sup>&</sup>lt;sup>448</sup> However, the German Constitutional Court held that there is no need to decide at this point whether duties of protection arising from fundamental rights also place Germany under an obligation vis-à-vis the complainants living in Bangladesh and Nepal to take action against impairments – both potential and actual – caused by global climate change.

<sup>&</sup>lt;sup>449</sup> Judgment of the Court of 25 March 2021, *Armando Carvalho and Others* v *European Parliament and Council of the European Union*, C-565/19 P, EU:C:2021:252.

<sup>&</sup>lt;sup>450</sup> Judgment of the Court of 16 June 2015, *Peter Gauweiler and Others v Deutscher Bundestag*, C-62/14,EU:C:2015:400.

with them. This is not surprising, as one of the key objectives of the EU is to improve the quality of the environment. After all, the European project was born out of the post-war wish for peace, and without peace you cannot enjoy human rights or preserve the environment.

Protecting the environment and tackling climate change are global challenges. Courts in the EU need to be aware that, while they are independent, they have a collective role and responsibility. I would even go so far as to say that they could be seen as having a mandate to preserve fundamental rights – including climate rights. Cooperation among courts is key to marrying their individual independence with their collective responsibilities.

In the European context it is equally necessary to preserve the institutional framework which enables such cooperation. The EU's arrangements for a multi-layered judicial system are a precondition for courts to deliver on this collective responsibility and mandate, and both the CJEU's exclusive power to interpret the Treaty, and the supremacy of EU law over national law, are crucial elements.

### 5 Beyond the courts

But while the EU and its courts can make significant contributions to the fight against climate change and to supporting climate rights, they have their limits.

As I have said many times before, the climate emergency is a global issue that requires urgent responses and a global approach. Fortunately, we are seeing civil society play a very active role by raising awareness of this issue around the globe. As a result, many governments are adopting more ambitious climate laws that aim to curb emissions. And while governments and parliaments have the primary responsibility to act on climate change, central banks and supervisors have also increasingly shown their commitment to contribute within their mandate to addressing the ongoing climate crisis.<sup>451</sup> As you may know, two weeks ago the ECB pledged to contribute, within all our fields of competence and responsibility, to decisive action by policymakers to implement the Paris Agreement and mitigate the consequences of climate change.<sup>452</sup> As examples of concrete measures we will take, we presented a climate change action plan for our monetary policy and have set expectations for the management of climate-related and environmental risks in our banking supervision.

<sup>&</sup>lt;sup>451</sup> Since its foundation in 2017, the Network of Central Banks and Supervisors for Greening the Financial System (NGFS) has grown from eight to over 100 members, encompassing central banks and supervisors from five continents, covering 88% of the global economy and 85% of all global emissions. The work of the NGFS covers all tasks and responsibilities of central banks and supervisors.

<sup>&</sup>lt;sup>452</sup> See the ECB pledge on climate change action.

Climate change has profound implications for price stability, financial stability and the soundness of banks. It therefore falls squarely within our mandate to take the implications of climate change into account in all our tasks and responsibilities, in line with the EU's climate goals and objectives.

### 6 Conclusion

Just as the financial risk implications of climate change place it squarely within the mandates of central banks and supervisors, the fact that climate rights branch off from the tree of fundamental rights places them squarely within the mandates of the courts. I am confident that courts around the world will take inspiration from each other to ensure that climate rights – and I would say environmental rights too – are being served by our legal system in the same way as any other human right. In this context, I trust that everyone will continue working together – and within their mandate – to develop solid legal foundations to address the challenges of climate change.

Let me end by quoting the Greek philosopher Heraclitus, who said that "big results require big ambitions". So all of us here, in both our professional and our private lives, must take action to preserve our planet for future generations.

Thank you very much for your attention.



Panel 1: Dialogue between courts: what is the future for legal pluralism?

### On the dialogue between courts: what is the future for legal pluralism?

**By Frank Elderson** 

### 1 Introduction

European integration has since 1951 been a process of integration through law<sup>453</sup> whereby lawyers, judges and legal scholars have played an essential role in advancing and supporting the development of a common European judicial space.<sup>454</sup> The "new legal order of international law"<sup>455</sup> created by the Treaties has neither replaced nor absorbed the Member States' legal orders, but has "created its own legal system which, on the entry into force of the treaty, became an integral part of the legal systems of the Member States and which their courts are bound to apply".<sup>456</sup> The European Union (EU) and national legal systems have thus to coexist, and in this parallel coexistence resides the inherently "pluralist" character of the new reality. A very distinctive feature of this new complex system is the dédoublement fonctionnel of courts established in and by national legal systems, which are required to ensure the application and enforcement of the EU legal system and its norms. Against this background, the contribution of judges both at national and at EU level has been particularly crucial in creating a well-functioning and fully fledged legal order to support the creation of the Common Market and, more recently, the EU.

### 2 Challenges facing EU law

The task faced by judges coming from different countries, backgrounds and legal cultures of building a common understanding of the European legal order was and remains challenging. To better understand the challenges facing the European legal community it is crucial not to overlook that the main feature of the European legal space is its pluralism. In this respect, the contribution of **Judge Ziemele** provides a good reminder that this plurality of legal systems, expressly enshrined in Article 2 TEU, call for new

<sup>&</sup>lt;sup>453</sup> Cappelletti, M. Seccombe, M. and Weiler, J. H. H. (1986), "Integration Through Law: Europe and the American Federal Experience", in Cappelletti, M., Seccombe, M. and Weiler, J. H. H. (eds.), *Integration Through Law*, Vol. 1, Book 1, Berlin: de Gruyter, pp. 3 and 4.

<sup>&</sup>lt;sup>454</sup> Vauchez, A. and de Witte, B. (eds.), *Lawyering Europe: European Law as a Transnational Social Field*, Modern Studies in European Law, Oxford, Portland: Hart Publishing.

<sup>&</sup>lt;sup>455</sup> Judgment of the Court of 5 February 1963, van Gend & Loos, C-26-62, EU:C:1963:1.

<sup>&</sup>lt;sup>456</sup> Judgment of the Court of 15 July 1964, *Costa* v *E.N.E.L.*, C-6/64, EU:C:1964:66.

paradigms and analyses from lawyers. Merely reproducing the framework and relying on the ideas that have been instrumental to the development of the nation state would lead to stalemate. At the same time, designing a solution at EU level without properly reflecting upon the diversity of legal traditions within the EU would also constitute an inadequate approach.

To overcome these challenges, the development of an in-depth "dialogue of judges" was therefore an important and necessary step.

While the notion of the dialogue of judges, first coined in 1978 by Advocate General Genevois of the Conseil d'État<sup>457</sup>, remains known today, it is often forgotten that in his Opinion the French judge also highlighted a dual pitfall (the government of judges and the war of judges) that could threaten the relationship between EU and national courts.

Against this background, the dialogue of judges was perceived as a pragmatic tool by which to avert the two abovementioned pitfalls while cementing the relationship between national and EU judges. Over the past decades, the intuition of Judge Genevois has to a large extent been vindicated.

It is now well established that this dialogue has important functions that are crucial for European integration.

Contrary to what is often assumed, the EU as an organisation functions in a highly decentralised way. The full implementation of EU law requires the intervention and involvement of the national courts in each Member State. Consequently, national judges effectively act as EU judges of first instance whose tasks include applying EU law in its entirety and protecting the rights that the latter confers on individuals.<sup>458</sup> Together with the CJEU, national courts fulfil the duty conferred upon them of ensuring that, in the interpretation and application of the Treaties, the law is observed.<sup>459</sup> As such, national courts act as an essential tool enabling EU citizens and companies alike to enjoy the rights conferred on them by EU law.

Quite logically, the CJEU has inferred from this unique framework that this essential role of national courts is to be preserved and, that, for instance, Member States are not allowed to confer jurisdiction on an international court to solve disputes that would deprive national courts of their task of implementing EU law.<sup>460</sup>

Relying on national courts is also a key element through which to boost the legitimacy of European integration. The Treaty<sup>461</sup> and the Court<sup>462</sup> have indeed placed emphasis on the need to build a truly European law by

<sup>&</sup>lt;sup>457</sup> Opinion of 6 December 1978, *Ministère de l'Intérieur c/Cohn-Bendit*, Conseil d'Etat.

<sup>&</sup>lt;sup>458</sup> Judgment of 9 March 1978, *Simmenthal*, C-106/77, EU:C:1978:49.

<sup>&</sup>lt;sup>459</sup> Judgment of 16 December 1981, *Foglia* v *Novello*, C-244/80, EU:C:1981:302.

<sup>&</sup>lt;sup>460</sup> Opinion 1/09 of the Court of 8 March 2011, EU:C:2011:123, para 80.

<sup>&</sup>lt;sup>461</sup> Article 6(3) TEU.

<sup>&</sup>lt;sup>462</sup> Judgment of 5 December 2017, *M.A.S. and M.B.*, C-42/17, EU:C:2017:936, para. 53.

relying on the constitutional traditions common to the Member States. In this respect, national courts ought to play a crucial role in ensuring that EU judges are made aware of the constitutional traditions of each Member State.

Lastly the dialogue of judges is a necessity to ensure the equality of both EU Member States and citizens before the law. Referring a case to the CJEU provides an opportunity for the CJEU to ensure that a common interpretation of key concepts under EU law is implemented across the Member States.

A fruitful and efficient dialogue of judges may, however, only take place if a set of underlying conditions for such dialogue to exist are fulfilled.

First, as very well explained by **Professor Maduro**, there is an absolute need to draw a clear line between legal pluralism and the practices of some national courts that openly conflict with EU Treaties. The latter cannot provide the right environment in which to enhance the dialogue of judges in Europe.

Second, and more importantly, national courts and judges should act with impartiality and independently from their respective governments. EU law can indeed sometimes impose obligations upon Member States that are not fully or correctly implemented in domestic law. In such situations Member State courts should allow actions brought against their own governments by individuals or companies alike that rely on rights conferred on them by EU law.

Third, national courts should be fully entitled to make a preliminary reference to the CJEU to actively contribute to judicial dialogue and embrace a truly cross-border perspective in respect of such cases.

In this regard, it is worth mentioning the CJEU's most recent contributions to this debate, in which it has emphasised that national courts of last instance are required under EU law to duly state reasons for non-referral of cases to the CJEU and that the decision as to whether to refer a case should take into account the existence of divergences between the case-law of different national courts.<sup>463</sup>

These are welcome developments which should support the possibility for applicants to use preliminary references (which is the key procedure by which to avoid conflicts between the national and the EU spheres) and hence strengthen judicial dialogue in the EU.

Challenges regarding the future of the dialogue of judges remain nonetheless numerous. Allow me to mention two.

<sup>&</sup>lt;sup>463</sup> Judgment of 6 October 2021, *Consorzio Italian Management*, C-561/19, EU:C:2021:799.

First, the constitutional identity clause<sup>464</sup> remains to this day a key element of the EU legal order. Introduced with the Maastricht Treaty and mostly understood as a justification for divergence from EU law, it has been increasingly relied on by Member States and national courts over the past years.<sup>465</sup> However, if applied widely and unchecked this clause could undoubtedly fragment the EU legal order.

There is, therefore, a balance to be attained between the need to accept and give way to the different national constitutional identities while ensuring that they do not weaken the equal treatment of Member States as provided for under EU law.

Recent attempts by the CJEU to lay down the conditions under which the concept of constitutional identity can be relied on, as well as attempts to define a European constitutional identity, are promising steps which should be pursued. Here again, the contribution of national courts will be particularly relevant and, as recalled by **Daniel Calleja Crespo**, the Treaties technically provide sufficient flexibilities to accommodate the specificities of Member States' national identities.

Second, the application of national law by EU institutions such as the ECB in its function as banking supervisor has in effect led the EU courts to perform a full review of national law. This can prove to be challenging for EU institutions and sometimes increases legal uncertainty. While remaining true to the choice made by the EU legislator to apply national law in such a case, one may envisage different means by which the EU courts could directly take into consideration the views of national judges. Hearing as an expert a judge from a national court or opening the possibility to refer questions of interpretation to national courts are interesting options to be reflected upon. More fundamentally, Advocate General Kokott is right to stress that improving judicial dialogue in Europe would also require an increased sensitivity on the part of the CJEU to areas of conflict (including, inter alia, when it reviews national law).

In a nutshell, the current state of judicial dialogue within the EU is and remains a key component of the EU legal order but also a work currently in progress that should be very well served by the contributions to this roundtable.

<sup>&</sup>lt;sup>464</sup> Article 4(2) TEU.

<sup>&</sup>lt;sup>465</sup> Judgments of 22 December 2010, Sayn-Wittgenstein C-208/09, EU:C:2010:806, paras. 83, 88 and 92; of 12 May 2011, Runevič-Vardyn and Wardyn C-391/09, EU:C:2011:291, paras. 86 and 87; and of 2 June 2016, Bogendorff von Wolffersdorff C-438/14, EU:C:2016:401, para. 73.

## Legal pluralism in context

#### By Ineta Ziemele\*

Good morning and many thanks for the invitation and the thoughtprovoking speeches that preceded my intervention. I have been asked by the organisers to reflect on the notion of legal pluralism for the very reason that, by now, I have been a member of three different courts in Europe, each ensuring the supremacy of a separate legal order. Especially in view of some recent developments, I believe the real question is whether legal pluralism still is, or should be, an organising idea of European societies for the future of the common European legal space. My answer to this inquiry is that legal pluralism is a European reality, and therefore we cannot and should not do away with it; indeed a much better effort needs to be put in place to properly engage with legal pluralism both in thought and in practice so as to actually benefit from it for a common purpose. I will provide some arguments and explanations in this regard, but I can immediately indicate that my experience tells me that legal pluralism as a guiding intellectual framework is still a work in progress. As has already been mentioned, the most likely reason for questioning legal pluralism is the fact that, periodically, we are confronted with political or legal positions that claim to not accept, for example, the primacy of EU law or the binding nature of iudgments of both the Court of Justice of the European Union (CJEU) as well as the European Court of Human Rights (ECtHR). In these situations, it may seem that diversity and unity are irreconcilable. I argue that it is very useful to calmly decipher the arguments advanced in these situations: not only because they are different in each one of them, but also because they provide an opportunity to, in fact, reinforce those common European principles that are being challenged and to review the ideas and concepts at the source of these principles.

### 1 The challenges to the primacy of EU law

The following arguments have been advanced as a challenge to compliance with the judgments of the CJEU or, for that matter, the judgments of the ECtHR: (i) legitimacy of supranational courts to tell sovereign people what the common values are; (ii) overstepping of the courts' competence; and (iii) wrong or insufficient interpretation of applicable legal texts. I believe that during this conference a number of these challenges will come up and be examined and discussed. Evidently, there are other possible challenges, but these three categories cover the field rather exhaustively. One may say that these issues have long been settled through the construction by the Member States and the CJEU of the

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primacy and autonomy of EU law<sup>466</sup> and that the above challenges are therefore purely political, which may indeed be the case. However, leaving aside instances where these challenges are raised in bad faith - an important distinction to be made - one of the reasons for these challenges has to do with the legal pluralism that is intrinsically linked to the ongoing self-constituting processes in our societies.467 For example, from a historical and sociological perspective it is natural that each new generation, since it operates within a changed social context, has a need to guestion that which seems to have been firmly established previously: this is something important to bear in mind. Indeed, it is in this perspective that our generation must consider our decisions with a view to the reality of climate change - something that we leave for the next generations, as rightly pointed out in the introductory reflections of the conference. In this ongoing process the self-constituting of societies' law remains one of the most interesting and complex phenomena of our culture, reflecting the history and identity of separate societies.<sup>468</sup> In Europe, which constructs a new kind of society with a supranational identity, that construction is both reflected and promoted, among others, by the phenomenon of EU law. The construction of a new kind of society through new sets of legal relationships is not a simple matter. None of the challenges in this process should be taken lightly or approached based on the premise that the applicable principles are clear and accordingly do not merit discussion. How we approach legal pluralism today will have repercussions tomorrow.

### 2 A new project (the EU) calls for new concepts

The problem is that within this process of construction of a new kind of society we actually use concepts that crystallised in the 20th century with the purpose of explaining the validity of law in a European type of democracy. Therefore, we explain and conceptualise the European project with concepts that have been created to explain a different project: the nation state. I have been arguing that it is for this reason that the common European legal space needs to have a theory and philosophy proper to its purpose and specific challenges. The theory of constitutional pluralism has emerged as one such proposition.<sup>469</sup> It is in this context that a further conceptualisation of legal pluralism is necessary. For example, in the scholarly works of legal philosophy one finds that legal pluralism refers to the idea "that in any one geographical space defined by the conventional boundaries of a nation state there is more than one law or legal system".<sup>470</sup> With the evident decline of nation states as the only locus of political and

<sup>&</sup>lt;sup>466</sup> Costa v ENEL, Case C-6/64, EU:C:1964:66; and more recently, Opinion 2/13 (Accession of the European Union to the ECHR) of 18 December 2014, EU:C:2014:2454.

<sup>&</sup>lt;sup>467</sup> Allott, P. (2002), *The Health of Nations, Society and Law beyond the State*, Cambridge University Press.

<sup>&</sup>lt;sup>468</sup> On society and law, see Allott, ibid, especially at p. 53.

<sup>&</sup>lt;sup>469</sup> Professor Maduro's intervention at the conference.

<sup>&</sup>lt;sup>470</sup> Davies (2010), *The Oxford Handbook of Empirical Legal Research*, Oxford University Press.

legal power, it seems inevitable that traditional state-centred legal philosophy must be reviewed and reconciled with a new paradium that recognises the plurality of legal systems, all with claims to primacy, and yet is aimed at building a common legal order. So, what is the current response of the EU law? I underline the following: the preamble of the Treaty on European Union (TEU) explains the roots, the contents and the purpose of the common project and thus draws "inspiration from the cultural, religious and humanist inheritance of Europe, from which have developed the universal values of the inviolable and inalienable rights of the human person, freedom, democracy, equality and the rule of law" and desires "to deepen the solidarity between their peoples while respecting their history, their culture and their traditions ... to achieve the strengthening and the convergence of the economies". I think the preamble sums up wonderfully the centuries of history and human thought in Europe, and it includes the tension which, to date, has been central to this European thought. In other words, the perception of our stand for universal values, on the one hand, and, on the other hand, the need for a local sense of belonging or identity. defined with reference to a smaller historically and territorially delimited group. The preamble therefore includes the juxtaposition of the universalist vision of Europeans and the inescapable fact that a human being identifies with a particular group or nation.<sup>471</sup> Today, EU law tries to accommodate this tension and hopes that the principles of primacy of EU law, of loyal cooperation and of mutual respect, and common economic growth and prosperity outweigh the reality of identity tension. This historical tension is supposed to be managed and kept in check by the agreement of all parties concerned to comply with the Treaties in good faith, as laid down in Article 4 TEU. Article 4 TEU thus reflects that local identity is part of the European DNA but, at the same time, limits it using other well-known legal concepts such as good faith compliance with Treaty obligations, interstate cooperation, etc. I suggest that the acknowledgment of the tension, which is unavoidably built in the EU's supranational structure, is important and should not be avoided. It is not helpful to insist on the fact that we have all agreed to respect the primacy of EU law. It is important that all EU Member States truly own this principle. The fact that, within the common European legal space, there is much in common among European societies is good news because that indeed is the basis for building common ownership of the project. I would say, however, that in those instances where there are challenges with regard to the vision of common ownership of the EU project, these have to be addressed with great care and a genuine attempt should be made to understand the causes of disagreement.

### 3 National particularities and the roots of legal pluralism

This shows, for example, in the work of the constitutional courts. Coming from a Member State with a complex political history, I can bring the

<sup>&</sup>lt;sup>471</sup> Fukuyama, F. (2018), *Identity. Contemporary Identity Politics and the Struggle for Recognition*, London: Profile Books, p. 162.

following insider argument. First, in the legal orders of post-socialist or post-totalitarian societies a particular sensitivity against abuse of executive power has led to some distinct legal approaches. Second, on the other hand, societies with such history may have not yet fully developed the necessary civic and democratic practices to resist the corruption of political power. Generally, constitutional courts in societies with dramatic past experiences are particularly attentive, in all aspects relating to the adoption of binding rules, to the compliance of decision-makers with rule of law requirements, i.e. to the legality aspect of the adopted legal act. For example, the Latvian Constitutional Court, as well as the Lithuanian Constitutional Court, I believe, similarly to the German Constitutional Court, go rather deeply into assessing the validity and proportionality, including the possible long-term impact, of adopted laws. Compared with some other constitutional jurisdictions in Europe, one may consider that this methodology interferes with the principle of separation of powers and is rather an innovative approach to the competence of the judiciary. One might even suggest that there is distrust among the branches of power. There are various examples that show the differences in constitutional traditions rooted in the histories of the individual European nations and that is reflected in and projected onto how they view the common European project and the roles of the EU institutions. Moreover, it is extremely important for constitutional courts in the European tradition to ensure the supremacy of the constitution. The old idea of Grundnorm remains a fundamental idea that organises our societies. The supremacy of the constitution is considered a fundamental element in guarding against the abuse of executive power. It may be that, for the purposes of the new ideas that organise the new kind of supranational European society, one needs to engage in reviewing this idea of the supremacy of legal orders. It is certainly the case that better reconciliation of supremacy claims is required.472

Furthermore, several sub-state entities in Europe possess legal traditions, have their own rules and may enjoy separate legal status and rights under national, European and international laws. Such entities may include federal, regional, and indigenous and minority autonomies, and some of them have their own legislatures, executives and judiciaries. You may want to think about the Aland Islands, you may want to think about the Sami people, etc. The legal pluralism picture is not complete unless and until these entities, their identities and their institutions are taken into account. To sum up, the reality of the common European legal space is such that the plurality of legal systems, subsystems and regimes makes up what we are as Europe today. I argue that Article 2 TEU in fact embraces this reality since this plurality is based on the recognition of human rights (democracy, equality, minority rights). Democracy embraces diversity and I argue that the CJEU indeed has a crucial role in conceiving and implementing the theory and philosophy of European legal pluralism, which has two foundations: diversity and uniformity. At this stage of my reflections, I tend to think that the principle of the autonomy of EU law needs to include the

<sup>&</sup>lt;sup>472</sup> Ziemele, I. (2019), "Constitutional Courts as Lock-Gates in the World of International-National Tension", in Europa-Visionen, Nomos, Baden-Baden, pp. 193-220.

recognition of legal pluralism better. At times, the case-law of the CJEU has taken too strict an approach to the autonomy of EU law that leads to exclusion rather than inclusion, notably as concerns the building of the common European human rights architecture.<sup>473</sup>

### 4 The importance of the dialogue among courts

I take the view that the CJEU has the necessary tools to carry out such dialogue. Two recent examples could be mentioned for further discussion. In respect of material EU law on the freedom of movement of EU citizens one should refer to the *Coman* case.<sup>474</sup> In that case the Constitutional Court of Romania, which had doubts, based on the Charter of Fundamental Rights of the European Union and the European Convention on Human Rights, about both the respect for the right to family life and the freedom of movement of an EU citizen, solicited the advice of the CJEU for a very good reason. This cooperation crystallised a very important statement for the purposes of the strengthening of the values within a common European legal space. The Consorzio Italian Management case<sup>475</sup> concerns procedural aspects of EU law. In it the CJEU stated that a national court or tribunal alone has jurisdiction to ascertain what the case in front of it amounts to. Similarly, it is solely for the national court or tribunal to assume responsibility to determine, in the light of the particular circumstances of the case, both the need for and the relevance of the questions it submits to the Court (in the context of a preliminary reference). It is a dialogue between all implicated actors, and acknowledgment of their freedom and responsibility, in their respective diversity, should be the dominant culture in building unity.

The Treaties have it all, including a very fine balance of the historical tensions implicit in the construction of the EU project. In principle, all have agreed to have this balance. I would emphasise, however, that, for as long as no major reconceptualisation is available, the devil is in the detail. The devil is exactly in the manner all courts, including both the European courts and especially the national constitutional courts, deliver that detail; this is also a question of a culture of speaking to each other that still needs to be developed. I would say that, within the balance provided for by the Treaties, legal pluralism is both a reality and a strength, and we need to work on the details of the common and, where necessary, the different - as part of the historical particularities of the country and subsystem concerned methodologies in explaining the law. I can fully subscribe to the words of Cambridge professor Philip Allott: "What judges do is a great deal more than to apply rules of law ... The importance of the question is that, as Bentham so passionately believed and as Dworkin repeatedly invites us to remember, the law is dealing with matters of life and death in the lives of real people. All that the people have as their defence against the law is the

<sup>&</sup>lt;sup>473</sup> Opinion 2/13 (Accession of the European Union to the ECHR) of 18 December 2014, EU:C:2014:2454.

<sup>&</sup>lt;sup>474</sup> Coman and Others, C-673/16, EU:C:2018:385, para. 16.

<sup>&</sup>lt;sup>475</sup> Consorzio Italian Management and Catania Multiservizi SpA v Rete Ferroviaria Italiana SpA, C-561/19, EU:C:2021:799.

rights which the law should see it as its duty to defend".<sup>476</sup> There are already ways available that allow the CJEU to engage much more with constitutional courts, such as giving another life to the idea of common constitutional traditions as a source of inspiration for EU law. Within the existing European project there are plenty of roads to explore, provided true meaning is given to the acknowledgment that plurality is a strength. The fact that there are roads to explore does not mean that new ideas cannot be aired now. What we are building is new, and any new idea that can be pertinent for the future can and should be put on the table now. The future is wonderful because there is a lot that all the riches of Europe can provide for us. One should not be afraid of that observation, but should definitely embrace it. Moreover, it is a wonderful field for lawyers, and especially judges, who, in the past, have been used to a more *squared* way of thinking and now have an opportunity to contribute to create a new type of common *European* narrative.

### 5 Conclusion

I would like to conclude with a quote that I have already referred to in the context of judicial dialogue, i.e. in my speech at the Riga conference 2021 on the first direct dialogue between the CJEU and the EU's national constitutional courts. This summer an interesting CNN comment, titled "Europe's disunity and lack of trust imperil the continent's future"<sup>477</sup>. summed up the important challenges that the EU faces in one short sentence: finding "the Union's long-term purpose and legitimacy". I share the view of those who continue to emphasise that the EU legal order, its institutions and processes need to engage fully with the reality of legal pluralism. As said, I certainly read in the Treaties the philosophy of legal pluralism as an important dimension, even the identity of the European legal space. I see full engagement with legal pluralism as a strength of supranationality and as its source of legitimacy. There are a number of elements, already present in the EU legal order and the case-law of the CJEU, that need to be further explored from the perspective of legal pluralism. For example, the notion of common constitutional traditions as a source for general principles of EU law has long been available for this purpose. EU law wants and needs the kind of legitimacy and authority, which goes beyond compliance with the Treaties based on the principle of good faith. We are beyond that idea for the very reason that EU law becomes the law of the land in every Member State and subsystem, and in fact provides subjective rights to each individual directly. It therefore must seek its moral authority in ties to its many community networks and through the articulation of real subjective rights.<sup>478</sup> Legal pluralism encompasses the ties to all legal systems and subsystems. There are, however, other

<sup>&</sup>lt;sup>476</sup> See Allott, op. cit. p. 53.

<sup>&</sup>lt;sup>477</sup> McGee, L., "Europe's disunity and lack of trust imperil the continent's future", available at the CNN website at the following link: https://edition.cnn.com/2021/08/29/europe/ european-union-rule-of-law-analysis-intl-cmd/index.html

<sup>&</sup>lt;sup>478</sup> Cotterell, R. (2003), *The Politics of Jurisprudence: A Critical Introduction to Legal Philosophy*, 2nd edn., Oxford University Press.

concepts and practical tools available to the CJEU and the national courts to provide the idea of legal pluralism with the necessary detail. I think we are now at a stage where the challenge is really in the details, to which other speakers will address themselves, and, as a judge, I would add that oftentimes one word makes a world of difference. Thank you for your attention.

# Constitutional pluralism and the principles of counterpoint law

#### **By Miguel Poiares Maduro\***

In the European Union (EU) we talk of legal pluralism in the sense that the EU legal order and EU rules apply throughout the different legal orders of Member States. Thus, the EU legal order can be considered an *order of orders*. However, more radically, we can talk, to a certain extent, not only of legal pluralism but of constitutional pluralism as well. We have an EU legal order where complete competing claims as to ultimate authority exist; claims that have been put forward, on the part of EU law, by the Court of Justice of the European Union (CJEU) and, on the part of national constitutional law, by the national constitutional courts of some Member States. It is what is often described as the question of who has the competence; who has the ultimate authority in the relationship between EU law and national constitutional law?

Now, for many years constitutional pluralism has appeared to be a theory that not only described well the reality of what was occurring between EU law and national constitutional law, but also served as a prescription of the approach that both national constitutional courts and the CJEU should follow in this area. Both the CJEU and national constitutional courts construct competing claims of ultimate authority in such a way that in the end there is no conflict of authority on the specific application of the law. In other words, the CJEU claimed that ultimate supremacy in the relationship between national law and EU law belonged to EU law, including over national constitutional law.479 In many cases, however, the Court has, at the same time, tried to accommodate the concerns of national constitutional courts and national constitutional law. It has, for example, incorporated the protection of fundamental rights into EU law albeit that the text of the Treaties did not so provide, thereby constructing a systemic identity of values as between EU legal order and national legal orders. At the same time, national constitutional courts were constructing this guestion of ultimate authority, in conceptual terms, as ultimately being owned by national constitutional law.<sup>480</sup> They did this in such a way as to recognise that EU law will prevail in concrete cases of legal conflict or conflicts of laws between EU and national law, including national constitutional law.

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<sup>&</sup>lt;sup>479</sup> Notably, for example, in the famous Judgment of 17 December 1970, *Internationale Handelsgesellschaft*, C-11/70, EU:C:1970:114.

<sup>&</sup>lt;sup>480</sup> For example, by recognising the primacy of EU law over specific national norms, but only by reference to the authority which was given to the EU by national constitutional law itself.

# 1 Constitutional pluralism as both a descriptive and a normative theory

This approach appears to make constitutional pluralism a theory that works both in descriptive and normative terms. In descriptive terms national constitutional courts presented their claims on the question of ultimate authority as remaining open, but in practice they acted to prevent conflicts between EU law and national constitutional law. At the same time legal pluralism has been the best normative approach in terms of how this relationship ought to develop and be constructed: in the context of the particular nature of the process of European integration, political authority is, to at large extent, still shared. Accordingly, it appears to offer the best way to construct a relationship that nurtures the degree of political integration and therefore the degree of legal supremacy in the relationship between EU law and national constitutional law.

Recent cases heard by national constitutional courts, and particularly the German Federal Constitutional Court and more recently the Polish Constitutional Court, have triggered doubt in some quarters as to the accuracy or even desirability of constitutional pluralism. This is so because these decisions seem to have transformed what were hypothetical claims as to ultimate authority into actual challenges to the supremacy of EU law. Some authors have even accused constitutional pluralism of favouring or helping to legitimate such judicial decisions. These criticisms seem to be based on the assumption that constitutional pluralism legitimates, or would legitimate, any decision of national constitutional courts challenging the authority of EU law, thus challenging its supremacy - but that is not the case in my view. It is based on an incorrect conception and understanding of constitutional pluralism. My own version of constitutional pluralism, and I. among others, have developed this conception of the relationship between EU law and national constitutional law, has always been based on a set of mutually agreed principles that both national constitutional courts and the CJEU need to accept for constitutional pluralism to be successful. In other words, in my view constitutional pluralism is not the absence of rules of conflict governing the relationship between EU law and national constitutional law. It is a different set of rules of conflict, accommodating pluralism, but at the same time making sure that it does not lead to actual conflicts between EU law and national constitutional law. In the same way that the simple fact that a constitutional court challenges the supremacy of EU law does not mean the end of supremacy, a decision by a constitutional court that erroneously invokes constitutional pluralism does not necessarily undermine constitutional pluralism.

### 2 How to ensure the consistency of constitutional pluralism with EU law

I posed the following question a long time ago in an article<sup>481</sup>: how do we guarantee that constitutional pluralism will not erode the uniform and coherent application of EU law? A pluralist conception of EU law may be attractive as an abstract form of legitimating EU law, and as a way of making sense of the competing claims of authority that have always been raised by constitutional courts. However, what some fear is that they may ultimately undermine the uniformity, authority and integrity of the EU legal order. It is the principle of coherence, to which all actors, national courts and the CJEU must adhere, that helps to prevent this. The concept of coherence requires that each new judicial decision is coherent with the previous judicial decisions. In fact it is this coherence that seems to be challenged when national constitutional courts, based on a constitutional pluralist authorisation, raise competing determinations of EU law and its relationship with national law. Therefore, this means that the pluralist conception needs to be linked to an equal commitment to engage in a coherent construction of the common legal order that is EU law. This is an internal link to a requirement for national constitutional courts also to think of the universalisability of the decisions they take with respect to the relationship between EU law and national constitutional law. In other words, they should take account of the possible impact of their decisions on other legal orders, to the extent to which this is feasible.

In their respective decisions, the Polish Constitutional Court and the German Federal Constitutional Court, in respect of their understanding of and claim to constitutional pluralism, did not take these requirements of universalisability and coherence into account. Therefore, in my view, those decisions do not respect the basic requirements of constitutional pluralism itself. On the one hand, the Polish Constitutional Court clearly ignores how the principle of the rule of law and judicial independence in the application of EU law is developed in the other national legal orders; on the other hand, it also ignores how these legal orders might have to implement decisions by constitutional courts which do not meet such common standards of independence. How can the Polish legal order and the Polish Constitutional Court expect courts in other Member States to continue to enforce decisions of Polish courts if they are not based on a shared understanding of the rule of law and judicial independence? The same problems, though to a different degree and in a very different manner, also appear in the *PSPP* decision of the German Federal Constitutional Court.<sup>482</sup> And thev appeared even with respect to the idea of coherence itself, as evidenced by the *Honeywell* case<sup>483</sup>, where the German Federal Constitutional Court

<sup>&</sup>lt;sup>481</sup> Maduro, M. P. (2003), "Contrapunctual Law: Europe's Constitutional Pluralism in Action", in Walker, N. (ed.) *Sovereignty in Transition*, Oxford, Hart Publishing, p. 501.

<sup>&</sup>lt;sup>482</sup> Judgment of the Bundesverfassungsgericht, 5 May 2020, PSPP, 2 BvR 859115, DE:BVerfG:2020:rs20200505.2bvr085915, English translation available at http:// www. bverfg.de/e/rs20200505\_2bvr085915en.html

<sup>&</sup>lt;sup>483</sup> Judgment of the *Bundesverfassungsgericht* of 6 July 2010; Honeywell, 2 BvR 2661/06, DE:BVerfG:2010:rs20100706.2bvr266106.

raised the possibility of declaring a judgment of the CJEU ultra vires, but only if it were manifestly wrong. In its *PSPP* decision the German Federal Constitutional Court uses the criteria developed in Honeywell to form its assessment of the CJEU's decision - but it clearly does so only to artificially and formalistically meet those criteria. This has in fact been recognised in statements made by judges of the German Federal Constitutional Court, who invoked the need to use that language in order to conform with the standards of Honeywell484 but without making any effort to actually justify why the CJEU's decision was so manifestly wrong. There are three aspects in which the German Federal Constitutional Court decision does not do that: (i) the way it applied the proportionality test, (ii) its focus on costs and benefits, not appropriateness or necessity, and (iii) the application of the proportionality test to decide on the matter of competence - the proportionality test is about the use of a competence not the existence of one. When challenging the CJEU's Weiss judgment, the German Federal Constitutional Court, which failed to meet its own requirements, used an (alleged) failure to provide reasons in the context of the proportionality assessment.

### 3 The counterpoint principles of constitutional pluralism

I would like to go back to the principles of constitutional pluralism that I have developed in my work. These principles are, in my view, required for the correct application of constitutional pluralism: one that does not lead to actual conflict with respect to supremacy or, at least, minimises such conflicts. I would like also to assess the extent to which these recent decisions by national constitutional courts can, or rather cannot, be called examples of the application of constitutional pluralism. I have called these principles *principles of counterpoint law* as a reference to the fact that in music the most successful pieces are those that contain different melodies that neither conflict with each other nor become noise but become better when played together, precisely because these different melodies are harmonised through principles of musical counterpoint. Something similar has always happened in the relationship between EU law and national courts.

These principles must be committed to by those who implement them. This commitment is voluntary and some present it as a limit to pluralism itself. While it may be argued as such, it is also necessary to allow the largest extent of pluralism possible. My theory of constitutional pluralism does not contend that national constitutional courts can do whatever they want with respect to EU law. It is a theory that comprehends the relationship between EU law and national constitutional law as one that respects the plurality of

<sup>&</sup>lt;sup>484</sup> See Huber, P. M., "Das EZB-Urteil war zwingend" (interview), *Frankfurter Allgemeine Zeitung*, 13 May 2020, p. 2; Huber, P. M., "Spieler auf Augenhöhe" (interview), *SZ*, 13 May 2020, p. 5; Voßkuhle, A., "Erfolg ist eher kalt" (interview), *Die Zeit*, 14 May 2020, p. 6.

the different legal orders that compose the EU legal order and, at the same time, tries to respect the various claims to authority made but in a way that makes the legal order viably coherent. Therefore, for a common basis of discourse between courts to be possible in such a context, it is necessary that all participants in this discourse share a set of principles, and that the construction of the legal order respects its coherence and integrity. These principles guarantee that the EU legal order both fulfils the aims involved in its pluralist conception with a contested ultimate normative authority, and, at the same time, guarantees the harmony that is necessary within it.

Thanks to these principles, the different arguments made by the various courts can underlie decisions taken under national and EU law while at the level of application these decisions remain compatible. It is not necessary for the hermeneutics of the national and EU legal orders to be based on the same criteria on how to define the applicable legal norms. What is necessary is for the different legal orders to mutually adjust to each other and their respective claims so as to prevent actual conflict from emerging. There are three requirements that, in my view, guarantee such mutual adaptation and the development of a coherent legal order in the context of constitutional pluralism: (i) the theories of deliberation and justification on which national and EU courts base their decisions must be universalisable to all the participants: (ii) each theory must be constructed so as to adjust and adapt to the competing theories; and (iii) they must be conducive to an agreement on specific outcomes. The fulfilment of these requirements is what guarantees both the pluralism of the EU legal order and its coherence and integrity in the context of such pluralism.

The principles of counterpoint law, as I call them, aim to guarantee that these requirements are fulfilled. The first of these principles is pluralism itself and this principle assumes a foundational and a participative dimension. The first of these dimensions relates to the requirement that any legal order, national or EU, must respect the identity of the other legal orders. Its identity must not be affirmed in a manner that either challenges the identity of the other legal orders or the pluralist conception of the EU legal order itself. Underlying this is the existence of a systemic identity among national and EU legal orders, i.e. the fact that they share the same set of foundational legal values. In other words, what makes constitutional pluralism possible, and therefore the different hermeneutic constructions of the relationship between EU law and national constitutional law also possible, is that at their core they share the same legal values and therefore that they contribute, through different systems of recognition of the applicable rules, to those same legal values. The Polish Constitutional Court decision is precisely one that disrespects this principle as it actually undermines one of the foundational aspects of this systemic identity respect for the rule of law and the need for judicial independence that follows from it. In other words, respect for this systemic identity is a necessary precondition to avoid constitutional pluralism itself being undermined, and to allow a pluralist construction that contributes to the furthering of that systemic identity on those fundamental values.

The other dimension of pluralism requires national courts to engage in a discourse with the CJEU and vice versa, in such a way as to promote the broadest participation possible among the EU and national legal actors that are involved in this collective development of the EU legal order. This requirement not only applies to national courts, but to the CJEU as well. The latter ought to incentivise and demonstrate that it takes dialogue with national courts seriously. The criticism that I would level at the CJEU, in the context of its PSPP decision485, is that it perhaps did not deal with the reference made by the German Federal Constitutional Court on the public sector purchase programme's procedure in a way that demonstrated its full engagement. I do not disagree with the outcome of the CJEU's decision in that case, in that preliminary ruling, but I thought that it ought to have shown a greater engagement with the questions posed by the German Federal Constitutional Court and the arguments it raised in the context of that preliminary ruling. The requirements of counterpoint law, on the other hand, also require national courts to show that they are fully aware that the decisions they issue on EU law will likely have consequences for other Member States. Therefore, they ought to demonstrate that when they are deciding on issues of EU law, either following a reference to the CJEU or in the absence of one, that they incorporate into their decisions the interests and dimensions that these questions might have in other Member States, i.e. throughout the EU legal order. In fact, this is a reflection of what the CJEU itself said in its CILFIT requirements.<sup>486</sup> Now, national courts might decide that the same legal guestion has relevance to national courts in all the legal orders. This is linked to two other principles as to how both the CJEU and, in particular, national courts, ought to construct the constitutional pluralist conception of the legal order: the principles of coherence and universalisability.

<sup>&</sup>lt;sup>485</sup> Judgment of 11 December 2018, *Weiss*, C-493/17, EU:C:2018:1000.

<sup>&</sup>lt;sup>486</sup> See Judgment of 6 October 1982, *CILFIT*, C-283/81, EU:C:1982:335.

## Dialogue between courts: what is the future for legal pluralism? A view from the Court of Justice of the European Union

By Juliane Kokott and Christoph Sobotta487

### 1 Introduction

Legal pluralism describes the co-existence of different legal orders. It is a very broad concept, reaching far beyond the rules created by the state.<sup>488</sup> For the purposes of this article, however, we shall focus on the relationship between European Union (EU) law and Member State law. We can consider this relationship an expression of legal pluralism because these legal orders co-exist and relate to each other in a multi-level legal system.<sup>489</sup> In fact, I would argue that the management of this multi-level legal system is one of the fundamental tasks of the Court of Justice of the European Union (CJEU). Moreover, Member State constitutional and supreme courts share this responsibility to a certain extent.

Nonetheless, members of the interested public<sup>490</sup>, and in particular legal scholars<sup>491</sup>, have long been diagnosing a conflict between the CJEU and Member State supreme courts over the final say in the resolution of conflicts between EU law and national constitutional law. Recently, this topic has received increased attention. Last year, the German Constitutional Court refused to accept a judgment by the CJEU<sup>492</sup> and criticised the ECB concerning the purchase of government bonds.<sup>493</sup> This

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<sup>&</sup>lt;sup>488</sup> See Benda-Beckmann (2002).

<sup>&</sup>lt;sup>489</sup> See Pernice (2002).

<sup>&</sup>lt;sup>490</sup> See, for example, Nußberger (2020) as well as Grunert and Gutschker (2021).

<sup>&</sup>lt;sup>491</sup> See, for example, Mayer (2003) and Kelemen (2016).

<sup>&</sup>lt;sup>492</sup> Judgment of 11 December 2018, *Weiss and Others*, C-493/17, EU:C:2018:1000.

<sup>&</sup>lt;sup>493</sup> Judgment of the *Bundesverfassungsgericht*, 5 May 2020, PSPP, 2 BvR 859/15, :DE:BVerfG:2020:rs20200505.2bvr085915.

year, the constitutional courts of Poland<sup>494</sup> and Romania<sup>495</sup> rejected the CJEU's jurisprudence on the rule of law and judicial independence.<sup>496</sup>

### 2 The Court's perspective

From the perspective of the CJEU, this debate appears to have been resolved many years ago: all Member States must apply EU law in the same way. We call this "uniform application".

EU law would, however, not uniformly apply across all Member States if the Member States were able to enact legislation that stands in conflict with EU law. Therefore, the Court has stated that EU law enjoys primacy over Member State law<sup>497</sup> and can have direct effect within the legal order of the Member States.<sup>498</sup> The primacy of EU law is not limited to its relationship with the ordinary law of the Member States, but also applies with regard to Member State constitutional law.<sup>499</sup>

For the same reason, the EU needs to have one judicial body that authoritatively determines the content and meaning of EU law. This judicial body is the CJEU. If Member State courts were able to deviate from the CJEU's case-law, uniform application of EU law would be undermined. Only in very specific, narrowly defined cases do the Treaties or secondary EU law allow Member States or their courts to diverge from EU rules. Nevertheless, the final interpretation of these exceptions is part of EU law and therefore remains a task reserved for the CJEU.

This system is laid down in the Treaties, and in particular in the provisions on the EU judicial system. The CJEU must ensure that the law is observed in the interpretation and application of the Treaties: Article 19(1) of the Treaty on European Union (TEU). In particular, in order to secure uniform interpretation, the Court has jurisdiction to give preliminary rulings on the interpretation of EU law: Article 267 of the Treaty on the Functioning of the

<sup>&</sup>lt;sup>494</sup> Judgment of the *Trybunał Konstytucyjny* of 7 October 2021 (K 3/21).

<sup>&</sup>lt;sup>495</sup> Judgment of the *Curtea Constituțională* of 8 June 2021 (No. 380).

<sup>&</sup>lt;sup>496</sup> On Poland, see the recent judgment of 15 July 2021, Commission v Poland (Disciplinary regime for judges, C-791/19, EU:C:2021:596; as well as orders of the Vice-President of the Court of 14 July 2021, Commission v Poland, C-204/21 R, EU:C:2021:593; and of 6 October 2021, Commission v Poland, C-204/21 R, EU:C:2021:834. On Romania, see in particular the judgment of 18 May 2021, Asociaţia "Forumul Judecătorilor din România" and Others, C-83/19, C-127/19, C-195/19, C-291/19, C-355/19 and C-397/19, EU:C:2021:393.

<sup>&</sup>lt;sup>497</sup> Judgment of 15 July 1964, *Costa*, 6/64, EU:C:1964:66.

<sup>&</sup>lt;sup>498</sup> Judgment of 5 February 1963, van Gend & Loos, 26/62, EU:C:1963:1.

<sup>&</sup>lt;sup>499</sup> Judgments of 17 December 1970, Internationale Handelsgesellschaft, C-11/70, EU:C:1970:114; of 8 September 2010, Winner Wetten, C-409/06, EU:C:2010:503, para. 61; and of 2 March 2021, A.B. and Others (Appointment of judges to the Supreme Court – Actions), C-824/18, EU:C:2021:153, para. 148.

European Union (TFEU). The preliminary ruling procedure is the keystone of the EU judicial system.<sup>500</sup>

The Member States accepted the system laid down in the Treaties when they joined the EU. Even if one does not agree with this interpretation of the Treaties by the Court, it must be admitted that the Member States have never questioned this interpretation when revising the Treaties. On the contrary, they added to the Treaty of Lisbon a declaration referring to the jurisprudence on the primacy of EU law over the law of the Member States.<sup>501</sup> Moreover, in contributing to the constant broadening of the scope of EU legislation, the Member States reduce the area where the primacy of EU law does not apply.

### 3 The Member States' perspective

Nevertheless, this is not the end of the debate. While the CJEU has the final say on the interpretation of EU law, this power is limited to EU law. The Court regularly confirms that it may not rule on the interpretation of provisions of national law.<sup>502</sup> The ratification of the founding treaties by the Member States is an act of national law. Therefore, the ratification act is subject to interpretation by the courts in the Member States, and these courts may verify whether the ratification act allows a contentious interpretation of EU law by the CJEU.<sup>503</sup>

Exceeding the powers conferred by the ratification act is considered *ultra vires*, i.e. an overstepping of competences. As the Member States originally set up the EU as an international organisation, it only has the powers that they have conferred on it. The term *ultra ratificationem* may however be a more precise description of the core of this potential issue. It highlights the fact that the respective courts' findings are expressed in the context of two different legal orders, namely the EU legal order and the legal order of the Member State. At least formally, both courts' decisions continue to exist side by side; they are not in conflict because they concern different legal orders, i.e. different levels of the European multi-level legal system. Therefore, in a narrow sense, these court findings do not compete for the final say. In the EU, which is multi-level and supranational, neither the CJEU nor Member State courts alone can, at least legally, have the final

<sup>&</sup>lt;sup>500</sup> Opinion 2/13 (Accession of the European Union to the ECHR) of 18 December 2014, EU:C:2014:2454, para. 176; and of 2 September 2021, Republic of Moldova, C-741/19, EU:C:2021:655, para. 46.

<sup>&</sup>lt;sup>501</sup> Declaration No. 17 to the Treaty of Lisbon (OJ L 115, 9.5.2008, p. 344).

<sup>&</sup>lt;sup>502</sup> Judgments of 15 July 1960, *Präsident and Others v High Authority*, 36/59 to 38/59 and 40/59, EU:C:1960:36, p. 438; of 22 October 1974, *Demag*, 27/74, EU:C:1974:104, para 8; of 18 January 2007, *Auroux and Others*, C-220/05, EU:C:2007:31, para. 25; and of 23 April 2009, *Angelidaki and Others*, C-378/07 to C-380/07, EU:C:2009:250, para. 48.

<sup>&</sup>lt;sup>503</sup> Judgments of the *Bundesverfassungsgericht* of 12 October 1993, Maastricht, 2 BvR 2134, 2159/92, BVerfGE 89, 155, at 188, of 6 July 2010; Honeywell, 2 BvR 2661/06, DE:BVerfG:2010:rs20100706.2bvr266106, paras. 55 to 57; and of 5 May 2020, PSPP, 2 BvR 859/15, DE:BVerfG:2020:rs20200505.2bvr085915, paras. 110 to 112.

say – precisely because the EU is not a federal state. This state of flux is the main reason why the concept of legal pluralism is applied to the EU and its Member States. Note that, taken in isolation, such divergent findings by Member State courts do not infringe on the primacy of EU law; they "merely" highlight differences of opinion about the scope of the conferred powers.

### 4 Conflict

Nevertheless, the situation is different where a decision by a Member State court means that, in practice, Member State authorities do not give effect to EU law as interpreted by the CJEU. In this case, there is an infringement of EU law. Such an outcome is not unlikely, because the internal legal order cannot simply accept that the EU exercises powers within the Member State's domain if those powers were not conferred on the EU.

The EU can punish such a breach of EU law. As a final course of action, the CJEU may impose unlimited financial penalties until the Member State puts an end to the infringement. In a case against Poland concerning the rule of law, the Commission had threatened to request the imposition of such a penalty.<sup>504</sup> In another rule of law case, the Court recently imposed a daily penalty of one million euro on Poland to enforce an interim injunction.<sup>505</sup>

Moreover, the EU recently introduced new rules for the protection of the EU budget in case of breaches of the principles of the rule of law in the Member States. These rules apply where breaches of the rule of law affect or seriously risk affecting the sound financial management of the EU budget or the EU's financial interests in a sufficiently direct way. If this is proven, the EU may cut or suspend certain payments to the Member State.<sup>506</sup>

At the same time, the Commission has not yet accepted Poland's and Hungary's recovery and resilience plans. That being so, it has not yet disbursed any funding to these Member States under the Recovery and Resilience Facility to aid recovery from the pandemic.<sup>507</sup> According to media reports, it appears that this is due to doubts with regard to the rule of law.<sup>508</sup>

<sup>&</sup>lt;sup>504</sup> European Commission (2021).

<sup>&</sup>lt;sup>505</sup> Order of the Vice-President of the Court of 27 October 2021, *Commission* v *Poland*, C-204/21 R, not published, EU:C:2021:877.

<sup>&</sup>lt;sup>506</sup> See Articles 1 and 4 of Regulation (EU, Euratom) 2020/2092 of the European Parliament and of the Council of 16 December 2020 on a general regime of conditionality for the protection of the Union budget (OJ L 433I, 22.12.2020. p.1).

<sup>&</sup>lt;sup>507</sup> On 24 November 2021, the Commission endorsed 22 Member State plans according the press releases available at ec.europa.eu/info/business-economy-euro/recoverycoronavirus/recovery-and-resilience-facility/recovery-and-resilience-facility-latest en.

<sup>&</sup>lt;sup>508</sup> Deutsche Welle of 14 September 2021, available at www.dw.com/en/will-the-eus-tightsqueeze-on-aid-rein-in-poland-and-hungary/a-59170734

If the conflict escalates in this manner, there are only two realistic ways forward: either the Member State confers the missing powers on the EU by adapting the ratification act, or the Member State withdraws from the EU. The following is the subtext of the *Wightman* case: Member States are always free to withdraw according to their own constitutional arrangements<sup>509</sup>, thereby putting an end to the tensions of legal pluralism.

### 5 Preventing conflict escalation

It is possible to prevent such escalation, in particular through dialogue. Note, however, that the former Vice President of the European Court of Human Rights, Angelika Nussberger, has rightly stressed that the outcome of such a dialogue may not be fixed in advance, as it would otherwise not be a dialogue.<sup>510</sup>

One instrument for such dialogue is the preliminary reference procedure. For example, the Italian Constitutional Court asked the CJEU for clarifications with regard to the *Tarricco* judgment. In the *Tarricco* case, the CJEU had found that short statutes of limitation should not bar criminal sanctions for the infringement of the EU rules on value added tax<sup>511</sup>, suggesting that a national court needed to disapply such legislation if it effectively hindered criminal sanctions. These findings were in conflict with the principle of *nullum crimen sine lege* enshrined in the Italian constitution, which requires that the statute of limitation for a crime be fixed by legislation. Consequently, the CJEU has limited the scope of the earlier judgment.<sup>512</sup> The German Constitutional Court presumably considered the CJEU's approach in the case on the purchase of government bonds, but did not choose this approach in the end.

Conversely, the origins of the CJEU's jurisprudence on the protection of fundamental rights testify to a very positive collaboration with the German Constitutional Court that is to the benefit of all EU citizens.<sup>513</sup> Since the Treaties did not initially provide for the systematic protection of fundamental rights, in the 1970s the German Constitutional Court reserved for itself the power to evaluate whether the European Economic Communities respected the fundamental rights enshrined in the German constitution.<sup>514</sup> However, at the time of the judgment, the CJEU had already begun to develop the protection of fundamental rights as general principles. The foundations of this jurisprudence are the shared constitutional traditions of the Member States<sup>515</sup> together with the international treaties common to the

<sup>&</sup>lt;sup>509</sup> Judgment of 10 December 2018, *Wightman and Others*, C-621/18, EU:C:2018:999.

<sup>&</sup>lt;sup>510</sup> Nussberger (2020).

Judgment of 8 September 2015, *Taricco and Others*, C-105/14, EU:C:2015:555.

<sup>&</sup>lt;sup>512</sup> Judgment of 5 December 2017, M.A.S. and M.B., C-42/17, EU:C:2017:936.

<sup>&</sup>lt;sup>513</sup> See Kokott and Sobotta (2010), pp. 2-4.

<sup>&</sup>lt;sup>514</sup> Order of the *Bundesverfassungsgericht* of 29 May 1974, *Solange I*, 2 BvL 52/71, BVerfGE 37, 271.

<sup>&</sup>lt;sup>515</sup> Judgment of 17 December 1970, *Internationale Handelsgesellschaft*, C-11/70, EU:C:1970:114, para. 4.

Member States, in particular the European Convention on Human Rights.<sup>516</sup> As a result of this development, the German Constitutional Court abandoned its reservation once the CJEU had affirmed this jurisprudence over a certain period of time.<sup>517</sup> Later, and long before the Charter of Fundamental Rights of the European Union became part of EU law<sup>518</sup>, the Member States confirmed this case law with the Treaty of Maastricht (Article F(2) TEU).<sup>519</sup>

Obviously, it is even better if the CJEU recognises a potential conflict in advance and manages to avoid it as far as possible. To a certain extent this depends on assistance from the parties to a case and, in particular, on the contribution of the Member States. For example, the UK Supreme Court once warned the CJEU that case-law<sup>520</sup> on the Directive on the Environmental Impact Assessment<sup>521</sup> could come into conflict with constitutional limitations to the judicial control of the business of Parliament in the United Kingdom.<sup>522</sup> Regrettably, during the relevant court proceedings the UK government had never mentioned this issue. Moreover, this government even supported an amendment to the Directive that codified the contentious jurisprudence of the CJEU, *after* the Supreme Court had issued its warning.<sup>523</sup>

Nevertheless, many potential conflicts will be obvious to the CJEU. A historic example is a case in 1991 from Ireland on information about access to abortion in the UK. In that case, the CJEU found that the freedom to provide services did not apply.<sup>524</sup> Similarly sensitive issues were raised in a more recent case concerning the recognition of parental rights of same-sex partners in a Member State in which no form of union with legal effects between same-sex partners is recognised. Following the Advocate General's Opinion<sup>525</sup>, the CJEU tried to strike a fair balance between the free movement rights of two women and their child on the one hand and the constitutional identity of the Member State in guestion on the other hand.<sup>526</sup>

<sup>&</sup>lt;sup>516</sup> Judgment of 14 May 1974, *Nold* v Commission, 4/73, EU:C:1974:51, para. 13.

<sup>&</sup>lt;sup>517</sup> Order of the *Bundesverfassungsgericht* of 22 October 1986, *Solange II*, 2 BvR 197/83, BVerfGE 73, 339.

<sup>&</sup>lt;sup>518</sup> On the Charter, see Kokott and Sobotta (2010).

<sup>&</sup>lt;sup>519</sup> Judgment of 15 December 1995, *Bosman*, C-415/93, EU:C:1995:463, para. 79.

<sup>&</sup>lt;sup>520</sup> In particular, judgments of 19 September 2000, *Linster*, C-287/98, EU:C:2000:468; of 18 October 2011, *Boxus and Others*, C-128/09 to C-131/09, C-134/09 and C-135/09, EU:C:2011:667; and of 11 September 2012, *Nomarchiaki Aftodioikisi Aitoloakarnanias* and Others, C-43/10, EU:C:2012:560.

<sup>&</sup>lt;sup>521</sup> Directive 2011/92/EU of the European Parliament and of the Council of 13 December 2011 on the assessment of the effects of certain public and private projects on the environment (OJ L 26, 28.1.2021, p. 1).

<sup>&</sup>lt;sup>522</sup> Judgment of the Supreme Court, *R* (on the application of HS2 Action Alliance Limited) v The Secretary of State for Transport and another [2014] UKSC 3, para. 202 et seq.

<sup>&</sup>lt;sup>523</sup> Council Document 9065/14.

<sup>&</sup>lt;sup>524</sup> Judgment of 4 October 1991, Society for the Protection of Unborn Children Ireland, C-159/90, EU:C:1991:378, paras. 26 and 27.

<sup>&</sup>lt;sup>525</sup> Opinion of Advocate General Kokott in *Stolichna obshtina, rayon "Pancharevo"*, C-490/20, EU:C:2021:296.

<sup>&</sup>lt;sup>526</sup> Judgment of 14 December 2021, *Stolichna obshtina, rayon "Pancharevo"*, C-490/20, EU:C:2021:1008.

The comparison of these two cases illustrates that it has, over time, become more difficult to avoid potential conflicts. In 1991 the scope of EU law was much more limited than it is today. For example, there is now EU law prohibiting discrimination on grounds of sexual orientation<sup>527</sup>, and in particular on the recognition of same-sex partnerships in the context of free movement.<sup>528</sup> Therefore, it may no longer be possible to avoid all contentious judicial findings on such issues.

Like the case on same-sex partners, such cases rarely concern a formal overstepping of conferred powers. They usually concern questions that the German Constitutional Court treats under the heading of *Identitätskontrolle* (the protection of the constitutional identity).<sup>529</sup> This means that the constitutional law of the Member State concerned does not allow for the conferral of certain competences to the EU. In some cases, even a constitutional amendment to allow such a conferral would not be possible.<sup>530</sup> The abovementioned Italian cases and the German cases on fundamental rights illustrate this. For Member States that adhere to the rule of law it is simply inconceivable that participation in the EU could create a sphere where fundamental rights do not limit public authority. This is probably the reason why the CJEU reacted so positively to these reservations.

There have also been instances where resistance by Member State courts did not result in EU-level action. For example, until 2009<sup>531</sup>, the French Council of State refused to accept the direct effect of directives.<sup>532</sup> In 2012, the Czech Constitutional Court considered a finding of the CJEU on social security rights in the follow-up to the separation of the Czech Republic and Slovakia<sup>533</sup> to be *ultra vires*.<sup>534</sup> Moreover, in 2016 the Danish Supreme Court refused to apply the CJEU's jurisprudence on the prohibition of age discrimination.<sup>535</sup> Note that the Danish Supreme Court does not accept the

<sup>&</sup>lt;sup>527</sup> Council Directive 2000/78/EC of 27 November 2000 establishing a general framework for equal treatment in employment and occupation (OJ L 303, 2.12.2000, p. 16).

<sup>&</sup>lt;sup>528</sup> See, in particular, Article 2(2) and Articles 4 and 7 of Directive 2004/38/EC of the European Parliament and of the Council of 29 April 2004 on the right of citizens of the Union and their family members to move and reside freely within the territory of the Member States amending Regulation (EEC) No 1612/68 and repealing Directives 64/221/EEC, 68/360/EEC, 72/194/EEC, 73/148/EEC, 75/34/EEC, 75/35/EEC, 90/364/ EEC, 90/365/EEC and 93/96/EEC (OJ L 158, 30.4.2004, p. 77), and the judgment of 5 June 2018 in Coman and Others, C-673/16, EU:C:2018:385.

<sup>&</sup>lt;sup>529</sup> Judgments of the *Bundesverfassungsgericht* of 30 June 2009, Lisbon, 2 BvE 2/08, ECLI:DE:BVerfG:2009:es20090630.2bve000208, para. 240.

<sup>&</sup>lt;sup>530</sup> Judgments of the Bundesverfassungsgericht of 12 October 1993, Maastricht, 2 BvR 2134, 2159/92, BVerfGE 89, 155, at 182), and of 18 July 2005, Statute on the European Arrest Warrant, 2 BvR 2236/04, ECLI:DE:BVerfG:2005:rs20050718.2bvr223604, para. 70.

 <sup>&</sup>lt;sup>531</sup> Decision of the Consell d'État of 30 October 2009, 298348, ECLI:FR:CEASS:2009:298348.20091030.

<sup>&</sup>lt;sup>532</sup> Decision of the Conseil d'État of 22 December 1978, Cohn Bendit (11604).

<sup>&</sup>lt;sup>533</sup> Judgment of 22 June 2011, *Landtová*, C-399/09, EU:C:2011:415.

<sup>&</sup>lt;sup>534</sup> Judgment of the Ústavní soud of 31 January 2012, Pl. ÚS 5/12, Slovak Pensions XVII; on this case see Komárek (2012).

<sup>&</sup>lt;sup>535</sup> Judgment of 19 April 2016, *DI*, C-441/14, EU:C:2016:278.

application of EU fundamental rights between private parties.<sup>536</sup> Nevertheless, none of these cases have given rise to infringement procedures or further disputes between the EU and the Member State concerned.

In a similar vein, we may imagine that, in some cases, Member State courts do not aim to decide on issues of EU law or jurisprudence where they see problems with regard to the conferral of powers. If such cases arise, they may be avoided if the *locus standi* is questionable or if they can be resolved in some other manner.

The conflict with Poland, however, shows that substantial differences of opinion can exist where it is difficult to imagine that the CJEU could accept a Member State's position or that the EU could ignore the dispute. After all, the independence of courts is fundamental for a union based on the rule of law.<sup>537</sup> Nevertheless, the Polish perspective is not completely without merit because, in principle, the organisation of the internal judiciary does not fall within the EU's powers.<sup>538</sup> In areas linked to the Member State's constitutional identity, the Court should therefore limit its control to the fundamental values laid down in Article 2 TEU, i.e. respect for human dignity, freedom, democracy, equality, the rule of law, and respect for human rights.<sup>539</sup>

### 6 Conclusion

For legal pluralism in the EU, this means that the EU legal order can operate with a certain degree of legal divergence between Member State legal orders and the EU legal order. Legal pluralism in the EU can integrate Member State principles or expressly or implicitly allow for the expression of divergent principles. However, there may be areas of dispute that the EU legal order will not simply ignore, but bring to some form of resolution. At all events, such a finding would put an end to legal pluralism in this specific area.

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<sup>&</sup>lt;sup>537</sup> Judgments of 25 July 2018, *Minister for Justice and Equality (Deficiencies in the system of justice)*, C-216/18 PPU, EU:C:2018:586, paras. 48 and 49; and of 24 June 2019, *Commission v Poland (Independence of the Supreme Court)*, C-619/18, EU:C:2019:531, paras. 46 and 57.

<sup>&</sup>lt;sup>538</sup> See, for example, judgment of 24 June 2019, *Commission* v *Poland (Independence of the Supreme Court)*, C-619/18, EU:C:2019:531.

<sup>&</sup>lt;sup>539</sup> Opinion of Advocate General Kokott in *V.M.A.*, C-490/20, EU:C:2021:296, para. 101.

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# A better alternative to legal pluralism: *e pluribus unum*

By Daniel Calleja Crespo and Tim Maxian Rusche\*

## 1 Legal pluralism: the origins and the main proposition of a legal theory

Following the judgment of the German Federal Constitutional Court on the Maastricht Treaty of 12 October 1993<sup>540</sup>, legal philosopher Neil MacCormick devised a sophisticated theory in order to come to terms with this judgment.<sup>541</sup> This is how the theory of legal pluralism – now most commonly known as *constitutional pluralism* – was first developed.<sup>542</sup>

Historically, the German Federal Constitutional Court considered that constitutional complaints against the legality of acts of European Union (EU) institutions were inadmissible.<sup>543</sup> The only initial hesitation relating to the primacy of EU law concerned the protection of fundamental rights.<sup>544</sup> Once the Court of Justice of the European Union (CJEU) had ensured protection of fundamental rights by relying on general principles of EU law

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<sup>&</sup>lt;sup>541</sup> See MacCormick, N. (1993), "Beyond the Sovereign State", in the Modern Law Review, vol. 56 no. 1, Blackwell Publishers; MacCormick, N. (1995), "The Maastricht-Urteil: Sovereignty Now", in the European Law Journal, vol. 1 no. 3, John Wiley & Sons; MacCormick, N. (1999), "Juridical Pluralism and the Risk of Constitutional Conflict", in: Questioning Sovereignty: Law, State, and Nation in the European Commonwealth, OUP.

<sup>&</sup>lt;sup>542</sup> See for an overview on the (abundant) academic literature and a critical assessment thereof, Davies, G. and Avbelj, M. (2018), *Research Handbook on Legal Pluralism and EU Law*, Edward Elgar; Cruz, J. B. (2008), "The Legacy of the Maastricht-Urteil and the Pluralist Movement", in the *European Law Journal*, John Wiley & Sons; Cruz, J. B. (2018), "Against Constitutional Pluralism", in *What's left of the law of integration? Decay and Resistance in European Union Law*, OUP, p. 28. For recent restatements and variations on the topic, see Walker, N. (2016), "Constitutional Pluralism Revisited", in the *European Law Journal*, John Wiley & Sons, p. 333; Davies, G. (2018), "Does the Court of Justice own the Treaties? Interpretative pluralism as a solution to over-constitutionalisation", in the *European Law Journal*, John Wiley & Sons, p. 358.

<sup>&</sup>lt;sup>543</sup> Judgment of the *Bundesverfassungsgericht* of 18 October 1967, 1 BvR 248/63 and 1 BvR 216/67.

<sup>&</sup>lt;sup>544</sup> Judgment of the *Bundesverfassungsgericht* of 29 May 1974, 2 BvL 52/71 (Solange I).

derived from the common legal traditions of EU Member States that hesitation was overcome.  $^{\rm 545}$ 

The Maastricht judgment introduced a new category of constitutional review of acts of EU institutions: *ultra vires* review. This was complemented in the Lisbon judgment<sup>546</sup> by *constitutional identity* review. The declared aim of those forms of review is to control the legality of the exercise of the powers conferred on the EU. Those same – or similar – theories were later developed by constitutional and supreme courts in some other Member States.

Legal – or constitutional – pluralism postulates that EU law is not in a hierarchical relation of primacy above national law, including national constitutional law.<sup>547</sup> According to that theory, there are multiple sources of normativity in the EU and each of them has a valid claim to primacy. The ensuing normative situation would be one of heterarchy: EU law and national constitutions would not stand in a hierarchical relationship, and the CJEU would not have the final word over the conflicts between EU law and national constitutional law.

This theory has a descriptive function, as it illustrates the status quo based on the judgments of some national constitutional and supreme courts, and a normative dimension, as it also portrays what the relationship between EU law and national constitutional law should be from a normative point of view.

As a normative theory legal pluralism cannot be reconciled with the core principles of EU law. Legal pluralism is unsustainable in the longer run and provides neither an attractive nor a predictable model for the interaction between EU law and national constitutional law. For those reasons, Member States have entrusted the CJEU with a monopoly over review of the legality of acts of EU institutions and the final word on the interpretation of EU law, pursuant to Article 19 of the Treaty on European Union (TEU) and Articles 263, 267 and 344 of the Treaty on the Functioning of the European Union (TFEU). As remarked by President von der Leyen in her statement dated 10 May 2020: "The final word on EU law is always spoken in Luxembourg. Nowhere else."<sup>548</sup>

In the exercise of that function, in its landmark judgments in *van Gend & Loos*<sup>549</sup> and in *Costa v ENEL*<sup>550</sup>, the CJEU has interpreted the Treaties as embodying the principles of direct effect and primacy of EU law. In

<sup>&</sup>lt;sup>545</sup> Judgment of the *Bundesverfassungsgericht* of 22 October 1986, 2 BvR 197/83 (Solange II).

<sup>&</sup>lt;sup>546</sup> Judgment of the *Bundesverfassungsgericht* of 30 June 2009, 2 BvE 2/08.

<sup>&</sup>lt;sup>547</sup> Thus contradicting the standing case-law of the CJEU. See for instance Case C-106/77, Simmenthal SpA, EU:C:1978:49; and Case C-11/70, Internationale Handelsgesellschaft, EU:C:1970:114.

<sup>548</sup> Statement by President Ursula Von der Leyen of 10 May 2020. Available at: https:// ec.europa.eu/commission/presscorner/detail/en/statement\_20\_846

<sup>&</sup>lt;sup>549</sup> Case C-26/62, van Gend & Loos, EU:C:1963:1.

<sup>&</sup>lt;sup>550</sup> Case C-6/64, Costa v ENEL, EU:C:1963:1.
*Internationale Handelsgesellschaft mbH*<sup>551</sup> and *Simmental SpA*<sup>552</sup>, the CJEU clarified that the principle of primacy also applies to national constitutional law. These principles fit better with the structure, aim and contents of the Treaties than the competing theory of constitutional pluralism.

Member States have confirmed their adherence to primacy as set by CJEU case-law in Declaration 17 to the Treaty of Lisbon.<sup>553</sup>

When a constitutional court unilaterally disapplies EU law within its jurisdiction the very essence of the EU as a legal order is put into question. EU law is based on mutual trust, which, according to the Treaties, is the guiding principle both for Member States and EU institutions.

As highlighted by CJEU President Koen Lenaerts, the ultimate consequence of accepting legal pluralism would be to accept the risk of a violation of the principle of equality of all EU citizens before the law and of the equality of the obligations deriving from EU law for all Member States, enshrined in Article 4(2) TEU.<sup>554</sup> In short, this would go against a principle that has been essential since the inception of EU law: the principle of non-discrimination on the basis of nationality.

## 2 The solution provided for by the Treaties to solve tensions between EU law and national constitutions

The first tension between EU law and national constitutions concerned the protection of fundamental rights. The CJEU solved it by recognising the protection of fundamental rights as a general principle of EU law. That recognition integrated the protection of fundamental rights into the EU legal order. The Treaty of Lisbon formally codified that integration and introduced the Charter of Fundamental Rights of the European Union into EU primary law.

<sup>&</sup>lt;sup>551</sup> Case C-11/70, Internationale Handelsgesellschaft, EU:C:1970:114.

<sup>&</sup>lt;sup>552</sup> Case C-106/77, Simmenthal SpA, EU:C:1978:49.

According to Article 31(3)(a) of the Vienna Convention on the Law of Treaties, declarations, such as Declaration 17, provide authentic interpretation of an international agreement and are binding for the interpretation of the international agreement.

<sup>&</sup>lt;sup>554</sup> Lenaerts, K., "Constitutional Relationships between Legal Orders and Courts within the European Union", Speech at the FIDE Congress 2021, 27 November 2021. Available at: https://fide2020.eu/wp-content/uploads/2021/11/FIDE-Opening-Ceremony\_-4-November-2021\_Koen-Lenaerts.pdf; Lenaerts, K., "L'égalité des Etats membres devant les traités: la dimension transnationale du principe de primauté", in *Revue du droit de l'Union européenne* 4/2020, 7; Lenaerts, K., Gutiérrez-Fond, J. A. and Adam, S. (2021), "Exploring the Autonomy of the European Legal Order", in *Zeitschrift für ausländisches öffentliches Recht und Rechtsvergleichung* 81, 47 at pp. 50-51 and 70.

Successive treaty changes, in particular since the Single European Act, have significantly broadened the competence of the EU. It now covers areas such as justice, home affairs and the single currency; sensitive areas for national constitutional courts as well.

EU law is well equipped to provide a solution for this tension *from within*. It is not necessary to rely on an external solution such as legal, or constitutional, pluralism.

## 2.1 Loyal cooperation between courts

The first important element by which to solve tensions from within is the duty of loyal cooperation. That duty has been present in the Treaties since the European Coal and Steel Community Treaty. The CJEU has shaped it through its case-law. Today, that duty is placed prominently in Article 4(3) TEU, immediately following the articles on the EU's values and goals. The duty of loyal cooperation constitutes a key principle of general application.<sup>555</sup>

# 2.1.1 A formal dialogue between judges: the preliminary reference procedure

The duty of loyal cooperation also applies to the relationship between the CJEU and national supreme and constitutional courts. That relationship is first and foremost framed by Article 267 TFEU. This article obliges judges of last instance to refer cases that raise questions of EU law, which have not yet been decided by the CJEU and do not constitute an *acte claire*, to the CJEU for a preliminary ruling. The preliminary reference procedure thus puts in place a formal dialogue between judges.

In the words of the CJEU, the preliminary ruling procedure is the keystone of the EU legal system. It sets up a dialogue between one court and another, the CJEU and the courts and tribunals of the Member States. It has the objective of securing uniform interpretation of EU law, thereby serving to ensure its consistency, its full effect and its autonomy as well as, ultimately, the particular nature of the law established by the Treaties.<sup>556</sup> Consequently, under the judicial system of the Treaties, a judgment in which the CJEU gives a preliminary ruling on the interpretation or validity of an act of an EU institution conclusively determines a question or questions of EU law and is binding on the national court for the purposes of the decision to be given by it in the main proceedings.<sup>557</sup>

<sup>&</sup>lt;sup>555</sup> See, for a detailed analysis, Klamert, M. (2014), *The Principle of Loyalty in EU Law*, OUP, p. 9.

<sup>&</sup>lt;sup>556</sup> Case C-284/16, *Achmea*, EU:C:2018:158, para. 37; *Opinion 2/13 (Accession of the EU to the ECHR)*, EU:C:2014:2454, para. 176 and the case-law cited.

<sup>&</sup>lt;sup>557</sup> Case C-52/76, *Benedetti*, EU:C:1977:16, para. 26; Case C-446/98, *Fazenda Pública*, EU:C:2000:691, para. 49; Case C-62/14, *Gauweiler*, EU:C:2015:400, para. 16; Case C-69/85, *Wünsche*, EU:C:1986:104, para. 13.

In the context of that dialogue, the CJEU may occasionally deliver judgments that not everybody agrees with.

However, compliance with the decisions of higher courts is inherent to any legal system. Member States are sometimes compelled to accept an interpretation by the CJEU that they struggle to share. This situation is eventually much better – including for the Member State concerned – than having to face a situation where the binding nature of acts of EU law is repeatedly denied by courts of any of the other 26 Member States on purely national grounds. This could quickly lead to chaos, and chaos is inimical to the law.

In addition, major tensions that arise as a result of that dialogue can be solved by applying the principle of loyal cooperation.

As the saying goes: "nobody is perfect". The CJEU may overlook, in the context of a preliminary ruling, something that is essential from the point of view of national constitutional law. That may be the case in particular where the order for reference has not drawn the CJEU's attention to that particular issue. There are also situations where careful analysis of a judgment by national courts, but also Member States authorities or academia, reveals shortcomings that raise the question of whether it would be necessary for the CJEU to have a second look.

Any resulting differences of view between a national court and the CJEU have to be resolved through dialogue in the preliminary ruling procedure, which can be, if needed, an iterative process (or repeated dialogue).<sup>558</sup> The authority of a preliminary ruling does not preclude the national court to which it is addressed from properly taking the view that it is necessary to make a further reference to the CJEU before giving judgment in the main proceedings. According to the case-law, such a procedure may be justified when the national court encounters difficulties in understanding or applying the judgment, when it refers a fresh question of law to the CJEU to give a different answer to a question submitted earlier.<sup>559</sup> The obligation to continue judicial dialogue and refer again follows from Article 267 TFEU, interpreted in the light of the principle of loyal cooperation enshrined in Article 4(3) TEU. Those considerations apply *a fortiori* where a court other than the referring court has comparable doubts.

Where necessary, the CJEU thus allows – or even requires – a second reference on the legality of the same act, or on the interpretation of the

<sup>&</sup>lt;sup>558</sup> See, for example, Case C-42/17, *M.A.S. and M.B. (Taricco II)*, EU:C:2017:936.

<sup>&</sup>lt;sup>559</sup> Case C-14/86, Pretore di Salo, EU:C:1987:275, para. 12; Case C-69/85, Wünsche, EU:C:1986:104, para. 15. In the same paragraph, the Court added: "However, it is not permissible to use the right to refer further questions to the Court as a means of contesting the validity of the judgment delivered previously, as this would call in question the allocation of jurisdiction as between national courts and the Court of Justice under Article 177 of the Treaty [Article 267 TFEU]".

same provision.<sup>560</sup> Furthermore, earlier rulings of the CJEU on the interpretation of EU law can be made subject to a preliminary ruling request for further interpretation. Second – or further – references cannot become an appeal or a revision procedure.

In that situation, it is of the utmost importance that the court referring a matter for the second time indicates precisely where the problem arises and what the constitutional constraints are. Indeed, the drafting of a preliminary reference and the indication of the scope for possible solutions are the parts of the dialogue between courts where the referring national court plays a crucial role.<sup>561</sup>

## 2.1.2 Complementary informal dialogue

The CJEU increasingly enters into additional dialogue with national supreme and constitutional courts outside of the procedure provided for under Article 267 TFEU.

For instance, in 2017, on the initiative of the President of the CJEU and the presidents of national supreme and constitutional courts, and on the occasion of the meeting of judges to celebrate the 60th anniversary of the signing of the Treaties of Rome, the Judicial Network of the European Union was created.<sup>562</sup> Similarly, in early September 2021, the Constitutional Court of Latvia and the CJEU hosted a conference gathering the constitutional courts of Member States to discuss the importance of constitutional traditions in the EU.<sup>563</sup> Under the French presidency of the EU, the *Conseil constitutionnel*, the *Conseil d'Etat* and the *Cour de cassation* will invite the presidents of the national supreme and constitutional courts to Paris to discuss topical issues of EU law.

Such additional, informal dialogue can serve as an *early warning system* and allow the diffusion of tensions and prevent misunderstandings in the more formalised relationship under Article 267 TFEU.

See, for example, Case C-42/17, M.A.S. and M.B. (Taricco II), EU:C:2017:936. The potential of that technique has also been recently underlined by the Editorial Board of the Common Market Law Review (2020), "Not mastering the Treaties: The German Federal Constitutional Court's PSPP judgment", in Common Market Law Review 57, p. 965, at p. 977; Mayer, F. C. (2020), "The Ultra Vires Ruling: Deconstructing the German Federal Constitutional Court's PSPP decision of 5 May 2020", in European Constitutional Law Review 16, p. 733, at pp. 756 and 765.

<sup>&</sup>lt;sup>561</sup> See in that regard Arroyo Jiménez, L. (2018), "Constitutional Empathy and Judicial Dialogue in the European Union", *European Public Law* 24, p. 57, at p. 65; Guastaferro, B. (2017), "The unexpectedly talkative 'dumb son': the Italian Constitutional Court's dialogue with the European Court of Justice in protecting temporary workers' rights in the public education sector", in *European Constitutional Law Review*, p. 293; Perlo, N. (2017), "L'affaire Taricco": la voie italienne pour preserver la collaboration des juges dans l'Union européenne", in *Revue trimestrielle du droit européen*, p. 739.

<sup>&</sup>lt;sup>562</sup> For more information, see www.curia.europa.eu

<sup>&</sup>lt;sup>563</sup> For more information, see https://www.satv.tiesa.gov.lv/en/wp-content/uploads/ sites/2/2021/08/programma-eng.pdf

## 2.2 Options for plurality built into the Treaties

The EU Treaties are neither hegemonic nor rigid. They are a flexible and reasonable framework that allows for an orderly plurality.

The following three examples illustrate this point.

# 2.2.1 The protection of national identity, pursuant to Article 4(2) TEU

The judgment in *Sayn-Wittgenstein*<sup>564</sup> exemplifies how this principle can be used to solve possible tensions. In this case, Austria relied on its "status as a Republic" to refuse the recognition of a title of nobility. The CJEU ruled that such refusal constitutes a restriction on free movement but could be justified on the basis of Article 4(2) TEU as necessary and proportionate to protect the national identity of Austria.

Thus far, the CJEU has only relied on the protection of national identity in a few cases. Academic writers take the view that this technique may have more potential for solving possible tensions between national constitutional law and EU law.<sup>565</sup>

National identity, however, does not justify the disapplication of the values set out in Article 2 TEU<sup>566</sup>, as recently recalled by the CJEU in its judgment in *Repubblika*<sup>567</sup>. A recent example of this limit – involving rule of law – can be found in the CJEU judgment in *Commission* v *Poland*<sup>568</sup>, where the Court held that, whereas Member States have competence to determine the organisation of their judiciary, all national courts must offer sufficient guarantees of independence and impartiality.

<sup>&</sup>lt;sup>564</sup> Case C-208/09, Sayn-Wittgenstein, EU:C:2010:806.

See, for example, Di Federico, G. (2019), "The Potential of Article 4(2) TEU in the Solution of Constitutional Clashes Based on Alleged Violations of National Identity and the Quest for Adequate (Judicial) Standards", in *European Public Law* 25, p. 347; Kaczorowska-Ireland, A. (2019), "What is the European Union required to Respect under Article 4(2) TEU?: The Uniqueness Approach", in *European Public Law* 25, p. 57.

<sup>&</sup>lt;sup>566</sup> See Rossi, L. S. (2020), "La valeur juridique des valeurs. L'article 2 TUE: relations avec d'autres dispositions de droit primaire de l'Union européenne et remèdes juridictionnels", in *Révue Trimestrielle de droit européen*, July-August 2020, Dalloz, pp. 639-658.

<sup>&</sup>lt;sup>567</sup> Case C-896, *Repubblika*, EU:C:2021:311.

<sup>&</sup>lt;sup>568</sup> Case C-791/19, Commission v Poland (Disciplinary regime applicable to judges).

## 2.2.2 The higher fundamental rights standard, enshrined in Article 53 of the Charter of Fundamental Rights of the European Union

Article 53 of the Charter of Fundamental Rights of the European Union provides that nothing in the Charter can be interpreted "as restricting or adversely affecting human rights and fundamental freedoms as recognised, in their respective fields of application, by ... the Member States' constitutions".

In situations not fully governed by EU law, the CJEU has interpreted this principle as allowing room for higher standards of protection, within reasonable limits.<sup>569</sup> In particular, national fundamental rights that go beyond the rights guaranteed by the Charter cannot put into jeopardy the uniform application of fully harmonised rules of EU law.

## 2.2.3 The margin of discretion granted to Member States in some fields

The CJEU's judgment in *Centraal Israëlitisch Consistorie van België*<sup>570</sup> recognised for the first time explicitly that Member States enjoy in some fields a margin of discretion. This judgment draws inspiration from the case-law of the European Court of Human Rights.

Accordingly, "where matters of general policy, such as the determination of relations between the State and religions, are at stake, on which opinions within a democratic society may reasonably differ widely, the role of the domestic policy-maker should be given special weight".

Thus, the CJEU confers on Member States a broad discretion when it comes to reconciling the protection of animal welfare and the freedom of religion. In fact, they can prohibit the slaughter of animals without prior stunning – including in the context of religious rites – without infringing the freedom of religion, as established in the Charter.

## 2.2.4 Flexibility in the Treaties

In a similar manner, the Treaties offer the EU legislator flexibility, which can help to protect national constitutional specificities. The following can be regarded as examples of this flexibility:

<sup>&</sup>lt;sup>569</sup> See Case C-617/10, *Åkerberg Fransson*, EU:C:2013:280; Case C-42/17, *M.A.S. and M.B. (Taricco II)*, EU:C:2017:936.

<sup>&</sup>lt;sup>570</sup> Case C-336/19, Centraal Israëlitisch Consistorie van België, EU:C:2020:1031.

- The procedure of enhanced cooperation, which, by way of example, has been used in the area of private international law to respect the position of certain Member States concerning registered partnerships.<sup>571</sup>
- In other areas, national specificities have been respected by the co-legislator by providing for certain derogations in the application of EU law.<sup>572</sup>
- Moreover, long transition periods can help Member States as well as their societies – gradually adapt to legal change.<sup>573</sup>

## 2.2.5 The EU legal system as a dynamic legal system

Finally, the Treaties offer the basis for a dynamic legal system. Going forward, tensions can be solved by legal innovation within that system. In reaction to health, economic and geopolitical challenges of the past years, the innovative force of the Treaties has been confirmed on the following occasions:

- The adoption of the Next Generation EU recovery plan, as a way of addressing the health and economic crisis created by COVID-19.
- The new proposals in the area of common commercial policy, such as the proposal for a regulation on foreign subsidies distorting the internal market<sup>574</sup>, which shows a robust reaction on the part of the EU to developments in other countries.

<sup>&</sup>lt;sup>571</sup> For example, Council Regulation (EU) 2016/1104 of 24 June 2016 implementing enhanced cooperation in the area of jurisdiction, applicable law and the recognition and enforcement of decisions in matters of the property consequences of registered partnerships (OJ L 183, 8.7.2016, p. 30). See also Council Regulation (EU) 2016/1103 of 24 June 2016 implementing enhanced cooperation in the area of jurisdiction, applicable law and the recognition and enforcement of decisions in matters of matrimonial property regimes (OJ L 183, 8.7.2016, p. 1).

<sup>&</sup>lt;sup>572</sup> For instance, Directive 2013/32/EU of the European Parliament and of the Council of 26 June 2013 on common procedures for granting and withdrawing international protection (OJ L 180, 29.6.2013, p. 60) provides for certain express derogations from some of its provisions on the basis of national law. For example, Article 8(2) allows the limitation of access of organisations and persons providing advice and counselling where, by virtue of national law, they are objectively necessary for the security, public order or administrative management of the crossing points, and provided that access is not thereby severely restricted or rendered impossible.

<sup>&</sup>lt;sup>573</sup> For example, the Accession Treaties provide for transitional derogations from the principle of free movement of capital in relation to the acquisition of agricultural land and were, therefore, allowed to temporarily maintain the prohibition on nationals of other EU Member States or European Economic Area countries acquiring land. These derogations expired on 1 January 2014 for Bulgaria and Romania, on 1 May 2014 for Hungary, Latvia, Lithuania and Slovakia, on 1 May 2016 for Poland, and will expire on 30 June 2023 for Croatia.

<sup>&</sup>lt;sup>574</sup> Proposal of the European Commission of 5 May 2021 for a new Regulation on foreign subsidies distorting the internal market COM (2021) 223 final.

## 3 Conclusion

EU law offers Member States sufficient *flexibility from within* to accommodate national identities and higher protection standards. However, to avoid fragmenting or undermining the EU legal system this flexibility has to be orderly. Tensions can be managed and solved within the EU legal system. The crux of the matter, institutionally, is the proper use of the preliminary ruling procedure. This procedure links EU law and national law, EU courts and national courts, with a spirit of loyal cooperation.

Legal pluralism seems to be a *false good idea*. It has been used to put into question the very essence of the EU legal order: the values on which the EU is built according to Article 2 TEU. But, most importantly, it is not needed. The system created by the Treaties offer sufficient flexibility to accommodate Member States' constitutional specificities. The system created by the Treaties is, in fact, one that promotes unity in diversity.



Panel 2: Rule of law: what is the fate of the rule of law in the EU?

# Rule of law: what is the fate of the rule of law in the European Union?

#### **By Edouard Fernandez-Bollo\***

The notion of the "rule of law" is a complex ideal dating from at least the era of classical Greek philosophy, as raised by Aristotle in his *Politics* in the 4th century BC in terms of the question of whether it is better to be ruled by a man or by the law.<sup>575</sup> It became an essential issue during the Enlightenment in the 18th century<sup>576</sup>, when equality before the law became a driver of momentous political changes, and has finally been embedded as a leading principle of the legal construction of modern states, be it in the British jurisprudential tradition<sup>577</sup> or the German *Rechtstaat*.<sup>578</sup>

While the formulations of this notion may not do justice to its richness and to the debates that it has given rise to, for the purposes of a discussion putting emphasis on the legal realities of the European Union (EU) in the 21st century, we might try to build upon Dicey's synthetic formulation that "no man is above the law" by emphasising two closely related features it implies for a legal system:

- (a) The law that governs a society should be in principle applicable equally to all its members, equally subject to the law: that is, no legal or natural person has the privilege of being exempt from its application and, in particular, both rulers and the ruled should be accountable to the law. This should apply not only to those vested with legal executive powers, as were monarchs and their officers, or nowadays the government and the administration, but also more generally in terms of the application of the law also to other kind of de facto powers, such as the rich or the famous, in the same way as to the anonymous or destitute citizen.
- (b) To enforce this principle in real life, the protection of the law should also be accessible to all: the ruled should have the same access to legal protection as their rulers. This has implications both for its content (it should be public and as clear and predictable as possible) and for its

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<sup>&</sup>lt;sup>575</sup> *Politics*, Book 3, section 1287a.

<sup>&</sup>lt;sup>576</sup> A seminal work being Montesquieu's *Spirit of the Laws*, which characterised despotism as being a will that does not follow any rule or law. See Book II, chapter 1.

<sup>&</sup>lt;sup>577</sup> See, for instance, Dicey's classical 1885 definition conception that "no man is above the law", as expressed in his *Introduction to the Study of the Law of the Constitution*, Part II, IV.

<sup>&</sup>lt;sup>578</sup> See Böckenförde, E.-W. (1969), "Entstehung und Wandel des Rechtsstaatsbegriffs", in Horst Ehmke, Carlo Schmid and Hans Scharoun (eds.), *Festschrift für Adolf Arndt zum 65. Geburtstag.* Frankfurt am Main, pp. 53-76.

form of application (everybody should have the right to a fair trial, where cases are adjudicated in an impartial way with equality of arms and independent judges).

The rule of law is indeed nowadays considered an essential feature of all democratic nations and organisations, and clearly also of the EU, as one of the cornerstone common European values on which it has been founded, and now enshrined in Article 2 of the Treaty on European Union (TEU).

The Commission has commented on this point extensively, for instance in Communication COM/2019/163: "The rule of law is enshrined in Article 2 of the Treaty on European Union as one of the founding values of the Union. Under the rule of law, all public powers always act within the constraints set out by law, in accordance with the values of democracy and fundamental rights, and under the control of independent and impartial courts. The rule of law includes, among others, principles such as legality, implying a transparent, accountable, democratic and pluralistic process for enacting laws; legal certainty; prohibiting the arbitrary exercise of executive power; effective judicial protection by independent and impartial courts, effective judicial review including respect for fundamental rights; separation of powers; and equality before the law. These principles have been recognised by the European Court of Justice and the European Court of Human Rights."

We therefore see that the embodiment of this principle of the rule of law in the EU also interacts with Article 19 TEU and Article 47 of the Charter of Fundamental Rights of the European Union, i.e. the right to a fair trial. The case-law of the Court of Justice of the European Union (CJEU) has indeed interpreted Article 19 as denoting a common function and mission for the whole system, composed of both the EU courts and national courts, to ensure the proper and consistent application of EU law (as Lenaerts<sup>579</sup> has noted, there is no system of EU district and appeals courts as there is in the US, so national courts are also EU courts). This system is tenable only to the extent that mutual trust exists among courts which are part of this system composed of an EU and several national levels (note that mutual trust needs also to exist between national courts). The independence of the courts is a necessary prerequisite for such mutual trust as a common understanding of the rule of law can be directly linked to this value. Alongside these general principles, a system of institutional arrangements and tools has been set up to ensure their enforcement.

Article 7 TEU envisages the possibility to sanction breaches of this principle (or risks of breaches). The unanimity required for the European Council to act in the most severe cases has, however, undermined the possibility to apply this procedure (in practice if two Member States are both in breach it is not possible to proceed). Around this formal procedure, the Commission has built a rule of law mechanism to monitor the application of the rule of law throughout the EU. In 2019 the Commission launched a review of this

<sup>&</sup>lt;sup>579</sup> Lenaerts, K. (2007), "The rule of law and the coherence of the judicial system of the European Union", *Common Market Law Review*, Vol. 44, issue 6, pp. 1625-1659.

mechanism, in the context of which the ECB participated by contributing some reflections in a communication which also restates the importance of the rule of law for central banks.

Indeed, the rule of law principle also relates to the reasons why the roles of independent agencies such as central banks, which often also carry out banking supervisory functions<sup>580</sup>, are elevated. Within the context of the separation of powers, while law is adopted by the legislature to be applicable to everyone, and courts are there to ensure this application and enforce it in a legally binding manner, the executive exists to take care of the application of rules in those cases where such application requires tasks to be carried out by public bodies. These tasks are sometimes delegated to "independent" agencies, so that the exercise of their powers in this regard is relatively insulated from the legislature and the executive, essentially for efficiency reasons in the pursuit of well-defined legislative goals.

There has been a stream of scholarship on monetary policy showing that central bank independence is instrumental to delivering price stability, and in Europe this principle has been given constitutional value by including it in the Treaties, as a basic principle of the European Monetary Union. The case has been less clear cut for banking supervision, as this function has historically been exercised not only by central banks but also by administrative departments or agencies of finance ministries. This could be linked to the role played by governments in rescuing the banking system in times of crisis, as banking supervision tends to be built upon in response to a banking crisis.<sup>581</sup>

It is thus no coincidence that when the European legislators wanted to break the bank-sovereign loop in the aftermath of the twin financial and sovereign crises that Europe experienced in the last decade, the Europeanisation of this task, entrusted to the ECB with the setting up of the Banking Union, was a conscious step to ensure its independence from the national level, thus helping to protect public funds.

This evolution towards more independent entities performing public tasks can be thus construed as steps to strengthen the rule of law by ensuring that the mandates entrusted by law to independent bodies are exercised without interference by persons that are pursuing other objectives.

Indeed, as a practitioner directly involved in the tasks of ECB banking supervision, I can bear witness that from the beginning the duty to ensure uniform application of EU law has played an essential role in guiding our action. At the same time, the role of a supervisor is to consider practical cases of application and thus balance general rules with the specificities of individual cases, and this difficult balance which we as supervisors have to

<sup>&</sup>lt;sup>580</sup> See part IV of Tucker, P. (2018), Unelected Power, Princeton University Press.

<sup>&</sup>lt;sup>581</sup> See Vanatta, Sean (15 December 2020), "Histories of Bank Supervision", available at SSRN: https://ssrn.com/abstract=3749116 or http://dx.doi.org/10.2139/ssrn.3749116

perform is the daily challenge presented by what may otherwise appear to be a theoretical concept.<sup>582</sup>

But clearly this everyday experience of directly exercising an administrative task illustrates one of the possible evolutions to ensure the rule of law in Europe: reinforcing the direct exercise at EU level of administrative and enforcement powers. In fact this panel about the fate of the rule of law in the EU evidences that its concrete embodiment cannot be taken for granted just by the mere fact that it is integrated in the Treaties: making it a reality is a task that faces many challenges.

In this perspective, the intervention of **Renáta Uitz** has made us acutely aware that the founding EU values and principles, including the principle of the primacy of EU law, are openly contested by some national authorities and national courts. She underlined that the EU institutions may appear powerless in the face of constant attacks on European values and the primacy of EU law: while the CJEU has tried with all its powers to protect the values of the EU and the primacy of EU law, in the political arena there is a certain degree of reticence from the Commission towards bringing infringement action, which power is not used systematically, and little transparency in enforcing budgetary accountability in respect of the Member States. She stressed the importance of the EU institutions' reactions to decisions challenging the primacy of EU law made by the Polish Constitutional Court that employ legal arguments that do not come from an independent and impartial tribunal in accordance with EU law.

In the same vein, Michal Bobek's reflections on the fate of the rule of law in the EU also stressed that it will depend on how at the end of the day the key European players act to enforce this founding value. This relates to two fundamental questions. The first concerns the nature of the EU. Is it an economic union based on mutual cooperation, a value-based community, or something in between? The second concerns why we care about the rule of law in the EU. Is it to preserve the rule of law nature of our community, to help deviating states to get back on track, or to protect the rest of the community - to protect ourselves from having to participate, even indirectly, in the exercise of public power in a manner we cannot agree with? Divergent starting assumptions lead to very different visions of what ought to be done and different actors are likely to embrace, in realist terms, different visions. Michal Bobek has emphasised that while national and European courts naturally have a crucial role to play in ensuring that the law is observed, other actors also play an essential role, particularly in relation to enforcement. Consequently the CJEU has certainly not shied away from its responsibility to deliver the correct interpretation of EU law. The Commission is also involved to a degree in acting on these issues, but important players for enforcement issues, i.e. the other Member States and the Council, are much less to the fore in terms of action. He underlined that a community that is unwilling to enforce its founding values cannot be

<sup>&</sup>lt;sup>582</sup> Indeed, this perspective is nothing new: Aristotle highlighted the need for *epikeia*, the consideration of equity to balance the application of the law. See *The Nicomachean Ethics*, V, 15, 1137b26.

considered a value community, but will in reality be a different type of community, even if not conscious of its true nature: the nature of a community is defined as much bottom-up, by the actions of its members, as by its top-down description.

Armin von Bogdandy aimed at providing a perspective about how the challenges of today prepare the ground for tomorrow. To this end, he identified the systemic deficiencies in some Member States as being the rule of law challenge of the day, mentioning in particular the overhaul of a Member State's judicial system (i.e. Poland's), and proposed an innovative doctrinal approach to address it. He thus outlined an argument in favour of attributing criminal responsibility of judges who seriously and knowingly violate EU values. Armin von Bogdandy built this argument starting from the judicial applicability of Article 2 TEU values, operationalised through more specific provisions such as Article 19 TEU. Next, he pointed to the duty of domestic authorities to apply national law in conformity with the values enshrined in Article 2 TEU and set aside national law in case of conflict. Criminal liability for disrespecting EU values is then construed by linking national criminal law provisions with the case-law of the CJEU on penalising infringements of EU law under conditions which are analogous to those applicable to infringements of national law. Armin von Bogdandy sees the criminal liability of judges as preparing the ground for tomorrow in the sense of entrenching liberal democracy by removing perpetrators, in particular judges instrumental in political repression – he drew a parallel with the specific examples of lawfully removing compromised officials as key to stabilising democratic transitions in Latin America and other parts of the world.

Laura Codruţa Kövesi's contribution was based on her personal experience that if prosecutorial activities are independent and efficient, they contribute decisively to upholding democratic values in society. The EU is clearly a community of values and there can be no union without the rule of law, which is one of the EU's common values. The European Public Prosecutor's Office (EPPO) is a really sharp tool by which to defend the rule of law, even if only in a specific field of competence for the Member States that have opted in. Its mission is to fight fraud and corruption in the implementation of the EU budget. More generally she reminded us that each institution has to play its role, implement and enforce existing rules in accordance with its mandate and prerogatives.

The discussion indeed converged on emphasising that each institution has to play its role to support the rule of law. This consistency of action with principles was considered by all as essential to confirm in practice the nature of the EU, which the preamble to the TEU describes as "ever closer union". However, it was emphasised that this idea has a very important forward-looking dimension.

On the more optimistic side of the discussion, this entails confidence in the underlying direction of realising the founding values in the context of the ultimate objective of an EU society that lives up to the promise stated in Article 2 TEU. To advance in that direction it is important to stress that time

is not running against these values but is on the side of those who strive for them. When we look at the measures adopted by the institutions, we should give them time and refrain from declaring that those measures have failed because they did not act immediately. The example of other transitions, in Eastern Europe and South America, tend to show that it is a long race, where upholding the rule of law is on the right side of time. However, relying on a future transition may raise questions: is it counterproductive to announce that once you are out of power there will be legal means to pursue past breaches of rule of law? We may be thus giving incentives not to facilitate the transition out of fear of its possible consequences. One might prefer a system that facilitates transition. Nevertheless, the example of these transitions do show that they do not rely on incentives given to former regimes: no regime lasts forever.

This point about taking a forward-looking approach is also relevant, for instance, when we have to value the subsidiary nature of the EPPO. Especially in a context where corruption becomes problematic, offering flexibility to the Member States to join or not could hamper the efficiency of the tool. And of course, at EU level it would be ideal to have all Member States on board to increase the level of protection of EU money. The EPPO can act as a single office for participating Member States, share information and allow those Member States to benefit from cross-border support, while these possibilities do not exist for the other Member States where different frameworks need to be put in place. The hope is that the increased efficiency of the work carried out at a more integrated European level will convince the other Member States to join in time.

It was considered very likely that over time indeed a new equilibrium will emerge, probably a trade-off between fully realising the community of values and a purely pragmatic approach to cooperation. But the path is neither clear cut nor sure, for instance if the EU goes down the route of carving out specific regimes, one for "normal" Member States and another for particular cases. But if the EU works permanently with two parallel sets of rules and procedures this creates a problem: it could be argued that it may even legitimise an abnormal situation if the key players keep engaging with those responsible for this situation through an ordinary cooperative approach. There is indeed a paradox in the fact that the political institutions, which by their composition have more ability to discriminate than the judiciary, and therefore the possibility to be more selective, seem in Europe to rely more on the courts than on political action to address deviating practices.

However, it is precisely because of this prominent role played by the more technical institutions and actors that the best contribution they can make to keeping the EU on a path conducive to the full realisation of its values is that each one continues to implement and enforce existing rules in accordance with its mandate and prerogatives.

Time will be on the side of the rule of law, provided that we make good use of it.

## How the European rule of law can support democratic transitions: on the criminal responsibility of biased judges

By Armin von Bogdandy and Luke Dimitrios Spieker\*

## 1 The challenge and the ground for tomorrow

This panel asks about the fate of the rule of law in the European Union (EU). This question is to be answered by looking at how the challenges of today prepare the ground for tomorrow. We argue that the rule of law enshrined in Article 2 of the Treaty on European Union (TEU) can support a Member State's society in overcoming a government that has systematically violated it. In this sense, Article 2 TEU can become a tool for democratic transitions. In this contribution, we will demonstrate how a *challenge of today* (systemic deficiencies in some Member States) can *trigger a doctrinal innovation* (criminal responsibility) that *prepares the ground for tomorrow*, i.e. entrenching liberal democracy by removing perpetrators, in particular judges who are instrumental for political repression.

This challenge arises most acutely in Poland. After packing the Constitutional Tribunal, dismissing many judges or forcing them into retirement, hijacking the appointment processes and creating tools to cow judges<sup>583</sup>, the Polish government seems ready to instrumentalise this judiciary for its own ends. Especially the disciplinary chamber of the Supreme Court, which is packed with judges who strongly support the government, is used as a repressive tool aimed at punishing judges that

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<sup>&</sup>lt;sup>583</sup> On these measures, see European Commission, Proposal for a Council Decision on the determination of a clear risk of a serious breach by the Republic of Poland of the rule of law, COM/2017/0835 final. On the status quo, see the country chapters on Poland in the Commission's 2021 (SWD(2021) 722 final) and 2020 Rule of Law Report (SWD/2020/320 final). For an in-depth assessment, see Sadurski, W. (2019), *Poland's Constitutional Breakdown*, Oxford University Press.

render inconvenient decisions or request preliminary rulings to defend their independence.  $^{\tt 584}$ 

This contribution presents a doctrinal response to such developments. We argue that judges who deliberately disrespect EU values, specifically those who allow themselves to become an instrument of government repression, should be made subject to criminal responsibility. Before diving into the specifics of such criminal responsibility (Section 4), we must establish, first, the judicial applicability of Article 2 TEU's values (Section 2) and, second, the duties of domestic authorities that flow from these values (Section 3). The following argument will certainly go beyond the law as it stands. The task of legal scholarship, however, is not only to describe, systematise and criticise the legal status quo but also to show possible paths of legal development. This applies especially to new challenges. At the same time, we strongly hold that the proposed developments remain *intra vires*, supported by relevant precedents and coherent with the current setup of EU law.

## 2 The judicial applicability of Article 2 TEU values

The very premise of the proposed doctrine is the judicial applicability of the values enshrined in Article 2 TEU. Such an applicability is not self-evident. Based on the misleading value semantics, some even doubt their status as being law. In this spirit, the Polish Constitutional Tribunal stated that "[t]he values mentioned in Article 2 of the TEU are merely of axiological significance".<sup>585</sup> Such doubts are hardly convincing.<sup>586</sup> The values of Article 2 TEU are laid down in the operative part of a *legal* text, the TEU. They are applied in *legally* determined procedures by public institutions (see Article 7 and Articles 13(1) and 49(1) TEU) and their disregard leads to sanctions, which are of *legal* nature.

Even if Article 2 TEU values are part of EU law, they are nonetheless vague and open. As such, they fall short of the criteria for direct effect which require a Treaty provision to be clear, precise and unconditional.<sup>587</sup> With deepening legal integration, however, these requirements have been increasingly relaxed. Some even argue for a presumption that provisions of

<sup>&</sup>lt;sup>584</sup> Werner, I. (2021), "Kampf um die Unabhängigkeit der Gerichte in Europa: Interview mit Beata Morawiec und Igor Tuleya", *Deutsche Richterzeitung*, p. 142.

See the press release accompanying the judgment of 7 October 2021 by the Polish Constitutional Tribunal in Case K3/21. However, uncertainties were also harboured by the Commission: see its reasoned proposal, op. cit., para. 1.

<sup>&</sup>lt;sup>586</sup> In this sense, see e.g. Rossi, L. S. (2020), "La valeur juridique des valeurs", 57 *Revue trimestrielle de droit européen*, p. 639; Scheppele, K. L, Kochenov, D. and Grabowska-Moroz, B. (2020), "EU Values are Law, after All", 38 *YEL*, pp. 3, 66 ff.; Martín y Pérez de Nanclares, J. (2019), "La Unión Europea como comunidad de valores", 43 *Teoría y Realidad Constitucional*, pp. 121, 135.

<sup>&</sup>lt;sup>587</sup> On the state of the art, see Bobek, M. (2020), "The effects of EU law in the national legal systems", in Barnard, C. and Peers, S. (eds.), *European Union Law*, 3<sup>rd</sup> edn., Oxford University Press, pp. 143, 159.

EU law are directly applicable by courts.<sup>588</sup> So far, the Court has avoided the contentious step of applying Article 2 TEU as a freestanding provision.<sup>589</sup> Instead, it has started to combine Article 2 TEU with other Treaty provisions in its seminal *ASJP* judgment.<sup>590</sup> The values in Article 2 TEU gain legal effect through a value-oriented interpretation of a directly applicable Treaty provision. In turn, this Treaty provision is read in an expansive way justified by the respective value. One might speak of a "mutual amplification" of the combined provisions.<sup>591</sup>

This fends off the possible critique that Article 2 TEU is being turned into the freestanding and unpredictable core of a centripetal, Member Statedevouring constitution. At the same time, the Court remains on the solid ground of established legal methodology. Interpreting provisions of a legal order consistently with other provisions, in particular in the light of its basic principles, is part and parcel of the established method of systematic (or contextual) interpretation.<sup>592</sup> If this leads to a dynamic evolution of the law, that is to be expected in a dynamic society, in particular from an apex court in a situation where its legal system faces unprecedented challenges.

How the Court operates can be best demonstrated by reference to its seminal judgment in *ASJP*. That decision concerned salary reductions of Portuguese judges based on a memorandum of understanding concluded in the context of the euro area crisis. A Portuguese court asked the Court of Justice whether this reduction violated judicial independence. Arguably, these measures escaped the scope of EU law as perceived traditionally and thus also the reach of the Charter of Fundamental Rights.<sup>593</sup> In this sense, the Court could have declared the case inadmissible and *ASJP* would have disappeared discreetly as another clarification of the meandering post-*Åkerberg Fransson* case-law. Yet this is not what happened. The Court relied on Article 19(1)(2) TEU, which stipulates that "Member States shall provide remedies sufficient to ensure effective legal protection in the fields covered by Union law". According to the Court,

<sup>&</sup>lt;sup>588</sup> For detailed analysis, see Wohlfahrt, C. (2016), Die Vermutung unmittelbarer Wirkung des Unionsrechts. Ein Plädoyer für die Aufgabe der Kriterien hinreichender Genauigkeit und Unbedingtheit, Springer.

<sup>&</sup>lt;sup>589</sup> For an approach relying directly on Article 2 TEU, see Hillion, C. (2016), "Overseeing the Rule of Law in the EU: Legal Mandate and Means", in Closa, C. and Kochenov, D. (eds.), *Reinforcing Rule of Law Oversight in the European Union*, Cambridge University Press, pp. 59, 66 ff.; Skouris, V. (2018), *Demokratie und Rechtsstaat. Europäische Union in der Krise*?, C.H.Beck, p. 50.

<sup>&</sup>lt;sup>590</sup> Judgment of 27 February 2018, Associação Sindical dos Juízes Portugueses (ASJP), C-64/16, EU:C:2018:117. For the first appearance of such an approach, see Closa, C. and Kochenov, D. (2016), "Reinforcing the Rule of Law Oversight in the European Union: Key Options", in Schroeder, W. (ed.) (2016), Strengthening the Rule of Law in Europe, Hart, pp. 173, 182-184.

<sup>&</sup>lt;sup>591</sup> For the first articulation of this idea, see Spieker, L. D. (2019), "Breathing Life into the Union's Common Values: On the Judicial Application of Article 2 TEU in the EU Value Crisis", 20 *GLJ*, pp. 1182, 1204 ff. In this sense, see also Rossi, op. cit., 650.

<sup>&</sup>lt;sup>592</sup> See e.g. Martens, S. A. E. (2013), *Methodenlehre des Unionsrechts*, Mohr Siebeck, p. 443. More generally, see Lenaerts, K. and Gutierrez-Fons, J. A. (2020), *Les méthodes d'interprétation de la Cour de justice de l'Union européenne*, Bruylant, pp. 27 ff.

<sup>&</sup>lt;sup>593</sup> See the subsequent clarification in Judgment of 24 June 2019, *Commission* v Poland (Independence of the Supreme Court), C-619/18, EU:C:2019:531, para. 51.

effective legal protection presupposes an independent judiciary. Read in this light, Article 19(1)(2) TEU contains a general obligation for the Member States to ensure judicial independence in the "fields covered by Union law".<sup>594</sup>

These "fields" are interpreted in broad terms. Importantly, the Court applies Article 19(1)(2) TEU "irrespective of whether the Member States are implementing Union law, within the meaning of Article 51(1) of the Charter".<sup>595</sup> While the Charter is limited to situations of *actually* applying EU law<sup>596</sup>, Article 19(1)(2) TEU has a far broader scope of application.<sup>597</sup> In the Court's reading, it requires the Member States to guarantee the independence of any national court that "*may* rule ... on questions concerning the application or interpretation of EU law.<sup>7598</sup> Given the breadth of EU law today, it is hard to imagine that any Member State court is outside those "fields". Thus, the entire national judiciary has to comply with the EU requirements of judicial independence.

Two rationales justify the ample scope of Article 19(1)(2) TEU. First, the Court employs the well-established *effet utile* rationale by referring to the functioning of the preliminary reference procedure under Article 267 Treaty on the Functioning of the European Union (TFEU). Such a system cannot work if Member State courts are not independent. Not without reason, a key criterion for launching preliminary references is an institution's independence.<sup>599</sup> Further, national courts have an indispensable position in the effective and uniform application of EU law.<sup>600</sup> By applying EU law over national law, they are

<sup>&</sup>lt;sup>594</sup> Judgment of 27 February 2018, *ASJP*, C-64/16, EU:C:2018:117, para. 36.

<sup>&</sup>lt;sup>595</sup> ibid., para. 29.

<sup>&</sup>lt;sup>596</sup> Sarmiento, D. (2013), "Who's Afraid of the Charter? The Court of Justice, National Courts and the New Framework of Fundamental Rights Protection in Europe", *50 CML Rev.*, pp. 1267, 1279.

<sup>&</sup>lt;sup>597</sup> Lenaerts, K. (2019), "Upholding the Rule of Law through Judicial Dialogue", 38 YEL, pp. 3, 5; von Danwitz, T. (2018), "Values and the rule of law: Foundations of the European Union – an inside perspective from the ECJ", (4) *Revue du droit de l'Union européenne*, pp. 263, 268. See also Pech, L. and Platon, S. (2018), "Judicial Independence under threat: The Court of Justice to the rescue in the ASJP case", *55 CML Rev.*, pp. 1827, 1837; Badet, L. (2020), "Å propos de l'article 19 du Traité sur l'Union européenne, pierre angulaire de l'action de l'Union européenne pour la sauvegarde de l'État de droit", 56 *Cahiers de droit européen*, p. 57.

<sup>&</sup>lt;sup>598</sup> Judgment of 27 February 2018, *ASJP*, C-64/16, EU:C:2018:117, para. 40 (emphasis added).

<sup>&</sup>lt;sup>599</sup> For cases in which the CJEU actually assessed the independence of the referring entity, see e.g. Judgment of 6 October 2015, *Consorci Sanitari del Maresme*, C-203/14, EU:C:2015:664, para. 19; Judgment of 19 September 2006, *Wilson*, C-506/04, EU:C:2006:587; Judgment of 17 September 1997, *Dorsch Consult*, C-54/96, EU:C:1997:413, paras. 34-36.

<sup>&</sup>lt;sup>600</sup> See Judgment of 5 February 1963, van Gend & Loos, C-26/62, EU:C:1963:1. Regarding the essential position of the preliminary reference procedure in the EU legal order, see e.g. judgment of 6 March 2018, Achmea, C-284/16, EU:C:2018:158, para. 36; Opinion of 18 December 2014, Opinion 2/13, ECHR Accession II, EU:C:2014:2454, para. 176; Opinion of 8 March 2011, Opinion 1/09, Agreement creating a Unified Patent Litigation System, EU:C:2011:123, paras. 84-85.

also "Union courts".<sup>601</sup> This explains why EU law entails procedural and institutional requirements for these courts. As judges can hardly split in half (a European and a domestic function), they must meet the EU requirements of judicial independence even in fulfilment of their domestic functions.

Second, a central justification for the ample scope of Article 19(1)(2) TEU can be found in its combination with Article 2 TEU. In a crucial passage, the Court states that "Article 19 TEU ... gives concrete expression to the value of the rule of law stated in Article 2 TEU".<sup>602</sup> As mentioned before, the CJEU operationalises the value of the rule of law enshrined in Article 2 TEU through the directly applicable Article 19(1)(2) TEU. At first sight, however, this seems to have no effect on the latter's scope. Even if the values enshrined in Article 2 TEU feature an unrestricted scope of application<sup>603</sup>, they depend on the scope of the operationalising provision. With regard to Article 19(1)(2) TEU, this means the "fields covered by Union law". Accordingly, this operation does not seem to justify the establishment of obligations for *any* national court.

As indicated before, we argue that the operationalisation of EU values is no one-way street. Instead, both provisions exert a reinforcing effect on each other. While the specific provision operationalises the value enshrined in Article 2 TEU, a value-oriented interpretation of the specific provision justifies its expansive reading. In other words, this interplay leads to a "mutual amplification" of both provisions. As such, Article 2 TEU and its specific "carrier" can create legal obligations for the Member States even in situations that otherwise would be considered to fall outside the scope of EU law.<sup>604</sup>

Of course, such an interpretation cannot and does not *a priori* establish the judicial applicability of any Article 2 TEU value to any national measure. Yet it shows how the judicial applicability of EU values can be established in a specific case. It all depends on finding a specific provision giving expression to a value enshrined in Article 2 TEU. The Court reaffirmed this intrinsic link between Article 2 TEU and a specific provision of EU law in its subsequent case-law. It repeatedly stressed that "Article 19 TEU ... gives

<sup>&</sup>lt;sup>601</sup> See Judgment of 9 March 1978, Simmenthal, C-106/77, EU:C:1978:49. More recently Opinion of 8 March 2011, Opinion 1/09, Agreement creating a Unified Patent Litigation System, EU:C:2011:123, para. 80. See also Bobek, M. (2020), "Institutional Report: National Courts and the Enforcement of EU Law", in Botman, M. and Rijpma, J. (eds.), National Courts and the Enforcement of EU Law. The XXIXth FIDE Congress Publications, Vol. 1, Eleven, p. 61.

<sup>&</sup>lt;sup>602</sup> Judgment of 27 February 2018, ASJP, C-64/16, EU:C:2018:117, para. 32.

<sup>&</sup>lt;sup>603</sup> This is uncontroversial. See European Commission (footnote 583), p. 5; Council, Opinion of the Legal Service: Commission's Communication on a New EU Framework to Strengthen the Rule of Law: Compatibility with the Treaties, 10296/14, para. 17. See also Klamert, M. and Kochenov, D. (2019), "Article 2 TEU", in M. Kellerbauer et al. (eds.), *The Treaties and the Charter of Fundamental Rights: A Commentary*, Oxford University Press, pp. 22, 24, para. 4; Hilf, M. and Schorkopf, F. (2021), "Art. 2 EUV", in Grabitz, E. et al. (eds.), *Das Recht der Europäischen Union*, 72<sup>nd</sup> edn., loose-leaf, C.H.Beck, para. 18.

<sup>&</sup>lt;sup>604</sup> See Spieker, op. cit.

concrete expression to the value of the rule of law affirmed in Article 2 TEU". $^{605}$ 

This "mutual amplification" considerably expands the reach of EU law. For that reason, it must not only be methodologically sound but also respect the order of competences. Indeed, there is an argument that there might be no legal mandate for the courts and, in particular, the CJEU to assess whether Member States respect Article 2 TEU. In fact, Article 269 TFEU limits the Court's role to verifying the procedural stipulations laid down in Article 7 TEU. In this sense, many have argued for the exclusivity of political procedures, especially in situations beyond the scope of any other EU law.<sup>606</sup> Any interpretation that puts the CJEU in the position that Article 7 TEU attributes to political institutions faces high argumentative burdens.

However, this argument does not preclude Article 2 TEU from playing a role when the Court discharges its mandate to ensure that the law is observed pursuant to Article 19(1)(1) TEU.<sup>607</sup> While the former Treaties have kept the EU's foundational principles out of the Court's reach<sup>608</sup>, the Lisbon Treaty does not contain any such limitation with regard to Article 2 TEU. Article 269 TFEU is an exception to the CJEU's general competence under Article 19(1)(1) TEU, which, being an exception, has to be interpreted narrowly. Moreover, since *van Gend & Loos*<sup>609</sup>, the CJEU has considered legal proceedings to complement action by political institutions. Today, this judicial innovation is generally recognised to be at the heart of the

<sup>&</sup>lt;sup>605</sup> See e.g. Judgment of 24 June 2019, Commission v Poland (Independence of the Supreme Court), C-619/18, EU:C:2019:531, para. 47; Judgment of 5 November 2019, Commission v Poland (Independence of ordinary courts), C-192/18, EU:C:2019:924, para. 98; Judgment of 15 July 2021, Commission v Poland (Régime disciplinaire des juges), C-791/19, EU:C:2021:596, para. 51. See also Judgment of 19 November 2019, A.K. (Independence of the Disciplinary Chamber of the Supreme Court), Joined Cases C-585/18, C-624/18 and C-625/18, EU:C:2019:982, para. 167; Judgment of 20 April 2021, Repubblika, C-896/19, EU:C:2021:311, para. 63; Judgment of 18 May 2021, Asociația "Forumul Judecătorilor Din România", Joined Cases C-83/19, C-127/19, C-195/19, C-291/19, C-355/19 and C-397/19, EU:C:2021:393, paras. 162, 188.

<sup>European Commission (footnote 583), p. 5; Council, Opinion of the Legal Service (footnote 603), paras. 16 ff.; European Parliament, Resolution on the proposal for a Council decision on the determination of a clear risk of a serious breach by the Republic of Poland of the rule of law (17 September 2020), 2017/0360R(NLE), Rec. B. See also Lenaerts, K. and Gutiérrez-Fons, J. A (2017), "Epilogue on EU Citizenship: Hopes and Fears?", in Kochenov, D. (ed.),</sup> *EU Citizenship and Federalism*, Cambridge University Press, pp. 751, 774; Martenczuk, B. (2018), "Art. 7 EUV und der Rechtsstaatsrahmen als Instrument der Wahrung der Grundwerte der Union", in Kadelbach, S. (ed.), *Verfassungskrisen in der Europäischen Union*, Nomos, pp. 41, 45.

<sup>&</sup>lt;sup>607</sup> See e.g. Schmidt, M. and Bogdanowicz, P. (2018), "The Infringement Procedure in the Rule of Law Crisis: How to Make Effective Use of Art. 258 TFEU", 55 *CML Rev.*, pp. 1061, 1069-1073; Waelbroeck, M. and Oliver, P. (2017), "La Crise de l'État de Droit dans l'Union Européenne: Que Faire?", 26 *Cahiers de droit européen*, pp. 299, 335; Skouris, op. cit., pp. 50 ff.

<sup>&</sup>lt;sup>608</sup> According to Article 46(d) TEU-Nice the CJEU was only competent for what was then Article 6(2) TEU-Nice but not for the principles laid down in Article 6(1) TEU-Nice. But even then, those principles were relevant, see Judgment of 3 September 2008, *Kadi*, C-402/05 P, EU:C:2008:461, para. 303.

<sup>&</sup>lt;sup>609</sup> Judgment of the Court of 5 February 1963, van Gend & Loos, C-26-62, EU:C:1963:1

European legal edifice. Finally, the political Article 7 TEU and the judicial Articles 258 and 267 TFEU procedures have different objects and consequences.<sup>610</sup> Article 7 TEU concerns a political assessment and, as an *ultima ratio*, entails the suspension of Member State rights, eventually leading to a sort of legal "quarantine". In contrast, the Court adjudicates an individual case and its sanctioning powers are limited to Article 260 TFEU (penalty payments). For example, the Court cannot suspend Member State rights.<sup>611</sup> Thus, there is no identity between the judicial and the political procedures imposing the latter's exclusivity.

These arguments justify the Court's recent path in *ASJP*, which applies Article 2 TEU in combination with more specific provisions. Against the backdrop of *ASJP*, the CJEU has held in a series of decisions, that the Polish overhaul of the judiciary infringes Article 19(1)(2) TEU and Article 2 TEU.<sup>612</sup>

## 3 The duties of domestic authorities

What does this mean for national authorities involved in judicial proceedings that violate the Union's values? Their duties flow from the doctrines of direct effect and primacy. Any Member State judge has to interpret and apply domestic law in conformity with EU law.<sup>613</sup> As argued previously, this includes the EU's common values enshrined in Article 2 TEU. Any Member State judge has a duty to heed these doctrines in any national proceeding when an infringement of Article 2 TEU is at stake.<sup>614</sup> Hence, all national law, including domestic criminal and disciplinary law, must be interpreted in the light of EU values.<sup>615</sup> This includes, for instance, laws explicitly permitting charges against politically inconvenient judges. If domestic courts are called to interpret and apply such laws, they must set them aside to the extent that they stand in conflict with a European value.

<sup>&</sup>lt;sup>610</sup> See especially AG Tanchev, Opinion in *Commission* v *Poland (Independence of the Supreme Court)*, C-619/18, EU:C:2019:325, para. 50.

<sup>&</sup>lt;sup>611</sup> Judgment of 25 July 2018, *Minister for Justice and Equality (Deficiencies in the system of justice)*, C-216/18 PPU, EU:C:2018:586, paras. 70 ff.

<sup>&</sup>lt;sup>612</sup> See e.g. Judgment of 24 June 2019, Commission v Poland (Independence of the Supreme Court), C-619/18, EU:C:2019:531; Judgment of 5 November 2019, Commission v Poland (Independence of ordinary courts), C-192/18, EU:C:2019:924; Judgment of 15 July 2021, Commission v Poland (Régime disciplinaire des juges), C-79119, EU:C:2021:596. See also Judgment of 19 November 2019, A.K. (Independence of the Disciplinary Chamber of the Supreme Court), Joined Cases C 585/18, C-624/18 and C-625/18, EU:C:2019:982; Judgment of 2 March 2021, A.B. (Nomination des juges à la Cour suprême - Recours), C-624/18, EU:C:2021:153.

<sup>&</sup>lt;sup>613</sup> From the plethora of cases, see only Judgment of 6 November 2018, *Max-Planck-Gesellschaft*, C-684/16, EU:C:2018:874, para. 59.

<sup>&</sup>lt;sup>614</sup> See also von Bogdandy, A. Grabenwarter, C. and Huber, P. M. (2022), "Constitutional Adjudication in the European Legal Space", MPIL Research Paper No. 2021-25, forthcoming in *The Max Planck Handbooks in European Public Law, Vol. IV*, Oxford University Press.

<sup>&</sup>lt;sup>615</sup> On the value-conform interpretation of *Union* law, see Potacs, M. (2016), "Wertkonforme Auslegung des Unionsrechts?", 51 *Europarecht*, p. 164.

This holds true also for any official called upon to execute such a judicial decision.  $^{\rm 616}$ 

By giving such directions to national judges, Union law puts them in a difficult position, in particular in countries where the government's respect for judicial independence is low. Judges handling sensitive cases might be intimidated by political pressure or the threat of disciplinary measures.<sup>617</sup> In Poland, the Constitutional Tribunal has been further captured by the ruling party. Since 2015, it has degenerated into a loyal servant of the current Polish government.<sup>618</sup> As such, Polish judges will search in vain for the Tribunal's support. Instead, they face decisions that rubberstamp the government's overhaul of the judiciary.

Yet, a national judge does not stand alone but finds support in the European union of courts. Indeed, many Polish courts have turned to the Luxembourg court to protect their independence. The CJEU might shield those judges from governmental pressure. For instance, it has declared in several decisions that the disciplinary chamber of the Polish Supreme Court violates Article 19(1)(2) TEU and Article 2 TEU.<sup>619</sup>

Initially, the Polish government seemed responsive to such decisions. After interim measures were ordered in 2018<sup>620</sup> it immediately reversed parts of its reforms that violated judicial independence.<sup>621</sup> But more recent developments cast doubt on this responsiveness. Despite the CJEU's judgments, the disciplinary chamber continues its activities. While the Polish government indicated its readiness to make concessions, it started to pit the captured Constitutional Tribunal against Luxembourg. It comes as no surprise that the Tribunal followed suit. For one, it declared the CJEU's interim order imposing the disciplinary chamber's suspension<sup>622</sup> to

<sup>&</sup>lt;sup>616</sup> Generally, on the obligation of any public official to conform with EU law, see Judgment of 4 December 2018, *Garda Síochána*, C-378/17, EU:C:2018:979, para. 38; Judgment of 22 June 1989, *Fratelli Costanzo*, C-103/88, EU:C:1989:256, para. 32; Judgment of 29 April 1999, *Ciola*, C-224/97, EU:C:1999:212, para. 30.

<sup>&</sup>lt;sup>617</sup> On the disciplinary measures against Polish judges, see Justice Defence Committee (KOS), "A Country That Punishes. Pressure and Repression of Polish Judges and Prosecutors" (February 2019); Helsinki Foundation, "Disciplinary Proceedings against Judges and Prosecutors" (February 2019); Mazur, D., "Judges under special supervision", Themis Association of Judges, Report, 5 April 2019, p. 38.

<sup>&</sup>lt;sup>618</sup> On the unlawful composition of the Polish Constitutional Tribunal, see ECtHR, Judgment of 7 May 2021, App. 4907/18, *Xero Flor v Poland*, paras. 252 ff. On its jurisprudence, see Sadurski, W. (2018), "Polish Constitutional Tribunal Under PiS: From an Activist Court, to a Paralysed Tribunal, to a Governmental Enabler", 11 *HJRL*, p. 63.

 <sup>&</sup>lt;sup>619</sup> Judgment of 15 July 2021, Commission v Poland (Régime disciplinaire des juges), C-791/19, EU:C:2021:596. See also Judgment of 19 November 2019, A.K. (Independence of the Disciplinary Chamber of the Supreme Court), Joined Cases C-585/18, C-624/18 and C-625/18, EU:C:2019:982.

<sup>620</sup> See the orders of 19 October and 17 December 2018 in Commission v Poland, C-619/18.

<sup>&</sup>lt;sup>621</sup> See press release, President Signs Bill Amending Law on Supreme Court (17 December 2018), www.president.pl/en/news/art,926,president-signs-bill-amendinglaw-on-supreme-court.html

<sup>622</sup> Order of 8 April 2020, Commission v Poland, C-791/19 R, EU:C:2020:227.

constitute an *ultra vires* act.<sup>623</sup> In a second ruling, the Tribunal went even further by stating, inter alia, that the CJEU's interpretation of Article 2 and Article 19(1)(2) TEU is incompatible with the Polish Constitution.<sup>624</sup>

Consequently, Polish judges are confronted with diverging rulings from Luxemburg and Warsaw.<sup>625</sup> Nevertheless, it seems clear that decisions taken by a captured institution such as the Polish Constitutional Tribunal cannot be regarded as validly issued rulings of a constitutional court. Besides these institutional reasons, there are also substantive arguments to disregard its decisions. Even if national judges may not accept the unconditional primacy of EU law, there can be no doubt that a constitutional court cannot rely on constitutional identity arguments – as propounded by the Polish Constitutional Tribunal – to justify violations of the Union's common values.<sup>626</sup> In this spirit, the CJEU has consistently reiterated its decisions imposing the disciplinary chamber's suspension<sup>627</sup> and ordered a daily penalty payment of EUR 1 million until Poland complies.<sup>628</sup> Accordingly, national judges can trust that the CJEU will not shy away from entering into direct confrontation and taking considerable risks.

# 4 Criminal responsibility for disrespecting EU values

This leads to the question of what happens if judges violate the values enshrined in Article 2 TEU by sanctioning other judges with their decisions? Indeed, quite a few judges owe their position to the recent overhaul of the Polish judiciary and are considered to support the government's agenda. We argue that if they seriously and knowingly disrespect EU values, they could face criminal responsibility. Why?

<sup>&</sup>lt;sup>623</sup> Trybunał Konstytucyjny, Judgment of 14 July 2021, P 7/20.

<sup>&</sup>lt;sup>624</sup> Trybunał Konstytucyjny, Judgment of 7 October 2021, K 3/21.

<sup>&</sup>lt;sup>625</sup> In two cases, the Polish Constitutional Tribunal further decided that the implementation by the Polish Supreme Court of the CJEU judgment in *A.K.*, which concerned the Disciplinary Chamber, was unconstitutional, see Polish Constitutional Tribunal, Judgment of 20 April 2020, U 2/20 and Judgment of 21 April 2020, Kpt. 1/20.

<sup>&</sup>lt;sup>626</sup> See e.g. AG Cruz Villalón, Opinion in *Gauweiler*, C-62/14, EU:C:2015:7, para. 61; AG Kokott, Opinion in *Stolichna obshtina, rayon "Pancharevo"*, C-490/20, EU:C:2021:296, paras. 73, 116 ff. See also Rossi, L. S. (2018), "2, 4, 6 (TUE) ... l'interpretazione dell' 'Identity Clause' alla luce dei valori fondamentali dell'Unione", in *Liber Amicorum Antonio Tizzano*, Giappichelli, pp. 858, 866; Voßkuhle, A. (2018), *The Idea of the European Community of Values*, Bittner, p. 117.

<sup>627</sup> Order of 14 July 2021, Commission v Poland, C-204/21 R, EU:C:2021:593.

<sup>628</sup> Order of 27 October 2021, Commission v Poland, C-204/21 R, EU:C:2021:593.

Let's take one step back. Seriously and knowingly exceeding public powers, even as a judge, is sanctioned under most legal orders.<sup>629</sup> The relevant provisions of the Polish Criminal Code show the various forms this may take. For example, Article 231(1) punishes the general excess of authority: "A public official who, by exceeding his or her authority, or not performing his or her duty, acts to the detriment of a public or individual interest, is liable to imprisonment for up to three years." This includes – under strict conditions – also the activity of judges.<sup>630</sup>

Without doubt, judges may err. As such, not every judicial decision that violates the law is per se a perversion of justice. Indeed, non-accountability is a core element of judicial independence. An independent judiciary is not only a manifestation of the separation of powers but also an inherent component of effective judicial protection.<sup>631</sup> At the same time, this independence is in continuous conflict with a judge's obligation to observe the law. A balance has to be struck between these competing elements. Even if different standards apply in each Member State, it is obvious that the criminal responsibility of judges can apply only *ultima ratio* – it is confined to very exceptional cases. Further, special procedural safeguards must be in place. This is particularly true in Poland, where judicial immunity is explicitly enshrined in the Constitution (see Article 173, Article 180(1) and (2) and Article 181 of the Polish Constitution).<sup>632</sup>

How is this reflected in EU law? First, EU law is an independent source of law in national procedures. The principles of primacy and direct effect require a domestic judge to directly apply EU law and, eventually, to disapply or re-interpret conflicting national laws (see Section 3). Thus, it does not make any difference whether a national judge disregards national or rather Union law – both can equally trigger the criminal responsibility of a judge. Second, according to an established line of jurisprudence,

<sup>&</sup>lt;sup>629</sup> See the study by Cappelletti, M. (1983), "Who Watches the Watchmen? A Comparative Study on Judicial Responsibility", 31 American Journal of Comparative Law, p. 1. On individual jurisdictions, see e.g. Joly-Hurard, J. (2006), "La responsabilité civile, pénale et disciplinaire des magistrats", 58 Revue International de Droit Comparé, p. 439; Díez-Picazo, L. M. (2006), "Judicial Accountability in Spain: An Outline", in Canivet, G., Andenas, M. and Fairgrieve, D. (eds.), Independence, Accountability and the Judiciary, BIICL, p. 211; Fiandaca, G. (2009), "Sulla responsabilità penale del giudice", 132 Il Foro Italiano, p. 409; SingeInstein, T. (2019), Strafbare Strafverfolgung, Nomos, pp. 157 ff.

<sup>&</sup>lt;sup>630</sup> For an application of that provision to judges (yet not a conviction), see e.g. Polish Supreme Court, Judgment of 30 August 2013, SNO 19/13. On the questionable current use of Article 231 with regard to judges, see the critical report of Mazur, op. cit., pp. 26 ff.

<sup>&</sup>lt;sup>631</sup> With regard to Article 47 of the Charter of Fundamental Rights, see Judgment of 25 July 2018, *Minister for Justice and Equality (Deficiencies in the system of justice)*, C-216/18 PPU, EU:C:2018:586, paras. 48, 54, 63-67; Judgment of 14 June 2017, *Online Games*, C-685/15, EU:C:2017:452, paras. 60 ff.; Judgment of 19 September 2006, *Wilson*, C-506/04, EU:C:2006:587, paras. 49 ff.

<sup>&</sup>lt;sup>632</sup> On the importance of judicial immunity in Poland, see Polish Constitutional Tribunal, Judgment of 28 November 2007, Case K 39/07; Judgment of 2 May 2015, Case P 31/12. On the special procedure for lifting the judicial immunity, see Bodnar, A. and Bojarski, L. (2012), "Judicial Independence in Poland", in Seibert-Fohr, A. (ed.), *Judicial Independence in Transition*, Springer, pp. 667, 716.

"infringements of EU law must also – at the very least – be punishable under conditions, both procedural and substantive, which are analogous to those applicable to infringements of national law of a similar nature and importance."<sup>633</sup>

This Member State obligation is a specific expression of the principles of effectiveness and equivalence. In short this means: "Member States are required ... to penalise any persons who infringe [EU] law in the same way as they penalise those who infringe national law."<sup>634</sup> It is potentially a criminal offence under domestic law if a judge deliberately disregards constitutional law, as determined by the constitutional court, to the detriment of the person subject to the proceedings. Accordingly, the same must apply in cases where a national judge knowingly disregards EU law as determined by judgments of the CJEU.

Determining the thresholds for the criminal responsibility of judges – even if they disregard Union law – is a matter of national criminal law. Yet, EU law can guide its concrete operation. With regard to the Polish disciplinary regime for judges, the Court of Justice noted that judicial independence cannot justify the total exclusion of any disciplinary liability. To prevent disciplinary regimes from becoming an instrument of political pressure, however, they must be confined to entirely exceptional cases that concern "serious and totally inexcusable forms of conduct … which would consist, for example, in violating deliberately and in bad faith, or as a result of particularly serious and gross negligence, the national and EU law".<sup>635</sup> This must apply *maiore ad minus* to the criminal responsibility of judges.

In this light, the threshold for criminal responsibility will probably be reached where a judge *seriously and knowingly* violates the applicable law to the detriment of a party in the proceedings. To clarify this with an example, let's assume a constitutional court decides to strike down a specific law or to declare a certain interpretation of that law as unconstitutional. If judges knowingly disregard these dicta and continue to apply said law (or the unconstitutional interpretation thereof) to silence government critics, they exceed their powers and trigger their criminal responsibility. It should be stressed that constitutional court decisions can exert said effects only if they have not degenerated into an instrument of government repression (see Section 3).

 <sup>&</sup>lt;sup>633</sup> See AG Kokott, Opinion in *Taricco*, C-105/14, EU:C:2015:293, para. 80. See also Judgment of 2 May 2018, *Scialdone*, C-574/15, EU:C:2018:295, para. 28; Judgment of 19 July 2012, *Redlihs*, C-263/11, EU:C:2012:497, para. 44; Judgment of 3 May 2005, *Berlusconi and Others*, Joined Cases C-387/02, C-391/02 and C-403/02, EU:C:2005:270, para. 65. See also Lenaerts, K. and Gutiérrez-Fons, J. A. (2016), "The European Court of Justice and fundamental rights in the field of criminal law", in Mitsilegas, V., Bergström, M. and Konstadinides, T. (eds.), *Research Handbook on EU Criminal Law*, Elgar, pp. 7 ff.

<sup>&</sup>lt;sup>634</sup> Judgment of 21 September 1989, *Commission* v *Greece*, C-68/88, EU:C:1989:339, para. 22.

<sup>&</sup>lt;sup>635</sup> Judgment of 15 July 2021, *Commission v Poland (Régime disciplinaire des juges)*, C-791/19, EU:C:2021:596, paras. 137-140.

When is this threshold reached at EU level? A serious infringement is unlikely to occur in the day-to-day application of EU law. The threshold could be reached when Article 2 TEU values are violated. Admittedly, these values are vague and open, and thus difficult to apply. However, this neither excludes their legal nature nor their judicial applicability (see Section 2). For that reason, national law must be applied or interpreted in a way that complies with Article 2 TEU. This includes the meaning these values have acquired through the CJEU's interpretation. The Court's interpretation of EU law has binding force.<sup>636</sup> Therefore, disregarding a consolidated CJEU jurisprudence is unlawful unless it is referred again to the Court.<sup>637</sup> Accordingly, the values of Article 2 TEU, as interpreted by the CJEU, become relevant for national procedures establishing the criminal responsibility of judges.

What does that mean for Polish judges who decide in disciplinary proceedings as in the case of Judge Tuleya? By interpreting the respective legal basis for such proceedings in a way that blatantly violates judicial independence protected under Article 2 TEU, a judge sitting in the disciplinary chamber might reach the threshold for criminal responsibility. However, any conviction requires proving the intention of the judge concerned, i.e. substantiating that he or she knew the relevant law and deliberately disregarded its effects. Determining this intention falls to the trial judge. But here again, actions by EU institutions will be important. If a Polish judge knowingly disrespects a CJEU decision that protects EU values *in the case at hand*, a red line and, in all likelihood, the threshold of criminal responsibility are crossed. Hence, the CJEU's pronouncements are key.

Divergent decisions by the Polish Constitutional Tribunal that prevent national courts from applying the CJEU's rulings and which confirm the constitutionality of the provisions at issue cannot lead to a different evaluation. Under normal circumstances, such pronouncements would be likely to exclude the criminal responsibility of national judges. Yet, as the European Court of Human Rights (ECtHR) has recently ascertained, the Tribunal's composition has been established in manifest violation of Polish law. Hence, it can no longer be considered a "tribunal established by law"<sup>638</sup> and the decisions taken in its current composition must therefore be disregarded.

<sup>&</sup>lt;sup>636</sup> Broberg, M and Fenger, N. (2021), *Preliminary References to the European Court of Justice*, 3<sup>rd</sup> edn., Oxford University Press, pp. 406 ff.; Schima, B. (2015), *Das Vorabentscheidungsverfahren vor dem EuGH*, 3<sup>rd</sup> edn., Manz, p. 114. See Trabucchi, A. (1976), "L'Effet 'erga omnes' des décisions préjudicielles rendues par la Cour de justice des Communautés européennes", 10 *Revue trimestrielle de droit européen*, p. 56.

<sup>&</sup>lt;sup>637</sup> This is undoubtedly the case for courts of last instance, while a similar binding force (together with an obligation to refer) is discussed for lower courts, see Lenaerts, K., Maselis, I. and Gutman, K. (2014), *EU Procedural Law*, Oxford University Press, para. 3.61.

<sup>638</sup> ECtHR, Judgment of 7 May 2021, App. 4907/18, Xero Flor v Poland, paras. 252 ff.

It should be noted that a judge of the Polish disciplinary chamber who acts in the way described above would not only violate the rule of law but probably also the essence of human rights protected by Article 2 TEU. Indeed, initiating disciplinary or criminal proceedings as a tool of repression might also violate the principle of *nulla poena sine lege*. This principle is enshrined in the Universal Declaration, Article 15 of the International Covenant on Civil and Political Rights, Article 7 of the ECHR, Article 49(1) of the Charter, and, not least, Article 42(1) of the Polish Constitution. Its importance for the EU legal order has recently been stressed by the *Taricco* saga.<sup>639</sup> The *nulla poena* principle is not only infringed when a legal basis is missing (i.e. non-existent or non-applicable) but also in cases of arbitrary judicial interpretation of said basis. According to the ECtHR, "Article 7 of the Convention cannot be read as outlawing the gradual clarification of the rules of criminal responsibility through judicial interpretation from case to case, provided that the resultant development is consistent with the essence of the offence and could reasonably be foreseen".640 An interpretation of national provisions as allowing disciplinary proceedings against judges who take decisions that are inconvenient for the government would not meet these requirements. If there is, on top of that, a CJEU decision declaring that these national provisions violate EU values, the respective judge's criminal responsibility suggests itself.

Two fundamental objections to these conclusions could be raised. First, the criminal responsibility of judges for infringements of EU law could be understood as an inadmissible harmonisation of the substantive criminal law of the Member States. The exercise of criminal justice is a competence firmly in the hands of the Member States, and so it would remain following our proposal. Seriously and knowingly violating EU law is the point of reference for national offences that constitute the criminal responsibility of judges. It neither extends the competences of the EU institutions nor does it unify the substantive criminal law of the Member States.

Second, our proposal could have unforeseeable implications for the relationship of national judges and the Union legal order. The trust of national courts in EU law and their essential cooperation with the Court of Justice could be severely damaged and its authority dangerously undermined.<sup>641</sup> However, there are two rejoinders to such a threat. On the

 <sup>&</sup>lt;sup>639</sup> Judgment of 5 December 2017, *M.A.S. and M.B.*, C-42/17, EU:C:2017:936, paras. 51
ff. See Judgment of 3 May 2007, *Advocaten voor de Wereld*, C-303/05,
EU:C:2007:261, para. 46. See further Timmerman, M. (2018), *Legality in Europe: On the Principle Nullum Crimen, Nulla Poena Sine Lege in EU Law and Under the ECHR*, Intersentia, pp. 147 ff.

<sup>&</sup>lt;sup>640</sup> See ECtHR, Judgment of 17 October 2017, Case No. 101/15, Navalnyye v Russia, para. 55 (emphasis added). The CJEU employs a similar conception ("reasonably foreseeable"), see Judgment of 20 December 2017, Vaditrans, C-102/16, EU:C:2017:1012, para. 52; Judgment of 22 October 2015, AC-Treuhand, C-194/14 P, EU:C:2015:717, para. 41; Judgment of 28 June 2005, Dansk Rørindustri and Others v Commission, Joined Cases C-189/02 P and Others, EU:C:2005:408, paras. 217 ff.

<sup>&</sup>lt;sup>641</sup> So far, the authority of the CJEU has been spared (with a few exceptions) from the increasing backlash against international courts, see Hofmann, A. (2018), "Resistance against the Court of Justice of the European Union", 14 *International Journal of Law in Context*, p. 258.

one hand, the criminal responsibility of judges, as shown above, is limited to extreme cases and only applies under very narrow conditions. On the other hand, criminal proceedings against judges deliberately violating Union values are part of a *national* process to restore the rule of law. These trials are conducted before *national* courts in accordance with *national* criminal law.

## 5 Outlook

It seems rather unlikely that judges or politicians who seriously and knowingly violate EU values will face prosecution anytime soon. But no government lasts forever. Biased public officials can be held accountable once the political landscape has changed. Such criminal proceedings do not constitute an unacceptable "victor's justice" if they are pursued in a manner that itself respects the EU's common values.<sup>642</sup> Drawing again on the CJEU's jurisprudence, such proceedings must be conducted before an independent institution and in procedures that respect the rights under Articles 47 and 48 of the Charter.<sup>643</sup> If these standards are guaranteed, they might be an important tool to re-establish a judicial system in line with the rule of law.<sup>644</sup>

So how do the challenges of today prepare the ground for tomorrow? Looking at the recent developments, there has been much change. In 2012 the idea of bringing Article 2 TEU values to life in judicial proceedings against Member States seemed difficult.<sup>645</sup> That has changed in response to the challenges posed by authoritarian tendencies. Today, the judicial applicability of Article 2 TEU values has become established jurisprudence which aims at protecting the constitutional fundamentals of the European Union and its society. The values enshrined in Article 2 TEU apply to any Member State action through mutual amplification with a specific provision of EU law. This leads to the responsibility of national courts to act as "EU courts": they have a duty to interpret national law in conformity with EU values and to set it aside it in the event of irreconcilable conflict. If they knowingly disregard these duties and inflict harm in a manner that violates a value of Article 2 TEU, they may face criminal responsibility. Thereby, this doctrine provides a path to clear the courts and support the affected Member State's democratic transition in a manner that complies with the European rule of law. This is how perhaps today's gravest challenge might help to prepare the ground for tomorrow.

 <sup>&</sup>lt;sup>642</sup> On the risks of instrumentalising such procedures, see, in the German context Müller,
I. (1984), "Die Verwendung des Rechtsbeugungstatbestands zu politischen Zwecken",
17 Kritische Justiz, p. 119.

<sup>&</sup>lt;sup>643</sup> Judgment of 15 July 2021, Commission v Poland (Régime disciplinaire des juges), C-791/19, EU:C:2021:596, para. 61.

<sup>&</sup>lt;sup>644</sup> On such processes, see Eser, A., Sieber, U. and Arnold, J. (eds.) (2012), Strafrecht in Reaktion auf Systemunrecht: Vergleichende Einblicke in Transitionsprozesse. Teilband 14: Transitionsstrafrecht und Vergangenheitspolitik, Duncker & Humblot.

<sup>&</sup>lt;sup>645</sup> See von Bogdandy, A., Kottmann, M., Antpöhler, C., Dickschen, J., Hentrei, S. and Smrkolj, M. (2012), "Reverse Solange – Protecting the Essence of Fundamental Rights Against EU Member States, 49 *CML Rev.*, p. 489.

# The CJEU and the normalisation of the rule of law crisis

### By Renáta Uitz\*

By 2022 the rule of law crisis had normalised into an everyday constitutional and political experience in the European Union (EU). High level interinstitutional conflicts fomented by illiberal Member States are routinely complemented by serious challenges to the primacy of EU law. One such challenge was launched in May 2020 by the German Constitutional Court, claiming that the Court of Justice of the European Union (CJEU) had acted ultra vires.646 In June 2021, the Romanian Constitutional Court forbade national courts from giving effect to CJEU judgments in order to defend the "fundamental identity nucleus of the Romanian Constitution".<sup>647</sup> Thereafter, the Polish Constitutional Tribunal issued two rulings defending constitutional identity and national sovereignty in the face of EU integration: in July 2021, it held that interim measures imposed by the CJEU were ultra vires<sup>648</sup>, following which, in October 2021, it declared certain provisions of the Treaty on European Union (TEU) unconstitutional.<sup>649</sup> This outcome was hardly a surprise in the bitter dialogue between the Polish Constitutional Tribunal and the CJEU concerning judicial independence in Poland.

In academic legal circles, attacks on the primacy of EU law and the authority of the CJEU reignited decade-old debates about legal pluralism and EU law.<sup>650</sup> In a broader context, these developments are seen as symptoms of differentiating EU governance: that is, as the logical extension of differentiated integration.<sup>651</sup> Whether it considers the rule of law crisis peripheral or central to the daily operation of the EU, any serious inquiry into legal pluralism or differentiated governance in the EU has to confront

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<sup>646 2</sup> BvR 859/15, 5 May 2020.

<sup>&</sup>lt;sup>647</sup> Decision No 390/2021, 6 June 2021, https://www.ccr.ro/wp-content/uploads/2021/07/ Decizie\_390\_2021\_EN.pdf, concerning Asociația Forumul Judecătorilor din România și alții, Joined Cases C 83/19, C 127/19, C 195/19, C 291/19, C 355/19 and C 397/1, EU:C:2021:393.

P. 7/20 (14 July 2021), https://trybunal.gov.pl/en/hearings/judgments/art/11589obowiazek-panstwa-czlonkowskiego-ue-polegajacy-na-wykonywaniu-srodkowtymczasowych-odnoszacych-sie-do-ksztaltu-ustroju-i-funkcjonowaniakonstytucyjnych-organow-wladzy-sadowniczej-tego-panstwa (English translation).

<sup>&</sup>lt;sup>649</sup> K. 3/21 (7 October 2021), https://trybunal.gov.pl/en/hearings/judgments/art/11662ocena-zgodnosci-z-konstytucja-rp-wybranych-przepisow-traktatu-o-unii-europejskiej (English translation).

<sup>&</sup>lt;sup>650</sup> See, for example, Davies, G. and Avbelj, M. (eds.) *Research Handbook on Legal Pluralism and EU Law*, Edward Elgar, Cheltenham, 2018.

<sup>&</sup>lt;sup>651</sup> Fabbrini, S. "Differentiation or Federalisation: Which Democracy for the Future of Europe?" (2021) *European. Law Journal* 1, DOI: 10.1111/eulj.12384.

the following question: to what extent can founding values of the EU – such as the rule of law – be differentiated?  $^{\rm 652}$ 

In recent years the CJEU has repeatedly described the nature of the EU's constitutional architecture in terms of its contribution to "the implementation of the process of integration".<sup>653</sup> The CJEU is committed to safeguarding the autonomy of EU law and its unique constitutional framework, which "encompasses the founding values set out in Article 2 TEU... the general principles of EU law, the provisions of the TEU and TFEU, and the provisions of the EU and FEU, which include, inter alia, rules on the conferral and division of powers, rules governing how the EU institutions and its judicial system are to operate, and fundamental rules in specific areas".<sup>654</sup>

This contribution argues that the future of the European project hinges on the robust defence of the EU's constitutional order and its founding values (Article 2 TEU). Part I provides an overview of the EU's constitutional order's "new normal"; it shows how the muddling through approach to the rule of law crisis led to open attacks on the primacy of EU law. Against this background, Part II shows that in recent years the CJEU has carefully developed several arguments that are essential for countering illiberal attacks on the EU's constitutional order and founding values.

# 1 From muddling through dialogues to attacks on the primacy of EU law

## 1.1 Muddling through the crisis: dialogues and compromises

The rule of law crisis may have started with objections against judicial reforms in illiberal Member States, yet, over the years – through institutional dialogue – it turned into a full-blown challenge to the EU's constitutional and legal order. In early November 2021, in his opening address to the XXIX FIDE Congress, the President of the CJEU, Koen Lenaerts, described the EU as being at a constitutional crossroads: "[I]ts foundations as a Union based on the rule of law are under threat and ... the very survival of the European project in its current form is at stake."

Since the early days of the rule of law crisis, which occurred in the shadow of Brexit, EU institutions were committed to muddling through. The

Kelemen, R.D. "Is Differentiation Possible in the Rule of Law?" (2019) Comparative European Politics, Vol. 17, pp. 246-260.

<sup>&</sup>lt;sup>653</sup> Opinion 1/ 17, *EU-Canada CET Agreement*, 30 April 2019, EU:C:2019:341, para. 110, citing Opinion 2/13, *Accession of the Union to the ECHR*, 18 December 2014, EU:C:2014:2454, para. 158; Judgment of 2 September 2021, *Moldova v Komstroy LLC*, C-741/19, EU:C:2021:655, para. 44.

<sup>&</sup>lt;sup>654</sup> Opinion 1/ 17, para. 110.

<sup>&</sup>lt;sup>655</sup> https://fide2020.eu/wp-content/uploads/2021/11/FIDE-Opening-Ceremony\_-4-November-2021\_Koen-Lenaerts.pdf

underlying premise behind this was one of dialogue through compromises in the spirit of loyal cooperation – a premise counselling against calling out even the most blatantly wilful mockery and subversions of EU rules and processes.

Although Article 7(1) TEU provides dedicated preventive measures to safeguard the EU's founding values, key EU institutions were intent on reaching compromises with the offending Member States through political dialogue in the course of the application of legal and policy tools (ranging from classic infringement action to the European semester) that were not specifically developed to address a crisis at the level of the foundations of the EU. As the crowning achievement of its commitment to continuing the dialogue, in 2020, after extensive consultation with stakeholders, the Commission launched the flagship instrument of its rule of law toolkit: a comprehensive annual rule of law report that is intended to treat all Member States alike, that is, with equal dignity.656 This annual report is complemented by a new regulation that permits the withholding of EU funds from any Member State that breaches the principles of the rule of law, thereby posing a risk to the EU's financial interest.657 The Commission has been reluctant to utilise this new regulation before the CJEU assesses the challenges brought by the Polish and Hungarian governments.<sup>658</sup> For its part, the European Parliament has been urging the Commission to put the mechanism to work; it passed resolutions demanding action from the Commission.659

The Commission's rule of law toolbox is not the product of strategic engineering: it is a set of legal and political tools that have evolved over time, often against a backdrop of serious contestation regarding their legal basis and appropriateness. The most consequential tool in the Commission's rule of law toolkit remains old-fashioned infringement action: it is deployed surgically (not systematically<sup>660</sup>) and heavily relies on the CJEU finding increasingly recalcitrant Member States to be in violation of EU law and – potentially – of founding values.

<sup>&</sup>lt;sup>656</sup> 2021 Rule of Law Report, www.ec.europa.eu

<sup>&</sup>lt;sup>657</sup> Regulation (EU, Euratom) 2020/2092 of the European Parliament and of the Council of 16 December 2020 on a general regime of conditionality for the protection of the Union budget (OJ L 433I, 22.12.2020, p. 1).

<sup>&</sup>lt;sup>658</sup> Hungary v Parliament and Council, C-156/21, and Poland v Parliament and Council, C-158/21 (pending cases). See Advocate General's Opinion in Case C-156/21 and Case C-157/21, 2 December 2021.

<sup>&</sup>lt;sup>659</sup> European Parliament resolution on the application of Regulation (EU, Euratom) 2020/2092, the rule-of-law conditionality mechanism (2021/2582(RSP)) (25 March 2021); European Parliament resolution on the rule of law situation in the European Union and the application of the Conditionality Regulation (EU, Euratom) 2020/2092 (2021/2711(RSP)) (10 June 2021).

<sup>&</sup>lt;sup>660</sup> Scheppele, K. L., Kochenov, D. and Grabowska-Moroz, B. (2020), "EU Values Are Law, after All: Enforcing EU Values through Systemic Infringement Actions by the European Commission and the Member States of the European Union", Yearbook of European Law, Vol. 39, pp. 3-121.

## 1.2 The new normal: attacks on the primacy of EU law

Recently, the rule of law crisis turned from disputing the founding values of the EU to challenging the primacy of EU law – a key feature of the EU's legal order. In the course of the normalisation of the rule of law crisis, the long-familiar judicial objections against ultra vires actions by the CJEU became animated by references to national constitutional identity<sup>661</sup> paying lip service to the Treaties while boasting about national sovereignty in the face of the pressures of European integration. The resulting legal and political debates are deeply intertwined – not only due to court packing in illiberal Member States, but also as illiberal leaders regularly present their positions on legal developments in the European public discourse. It is no accident that, in late November 2021, the Hungarian Prime, Minister Viktor Orbán, called on the Commission in an open letter "to suspend all infringement procedures that undermine the measures taken by member states to protect the territorial and national integrity of their citizens and their security".<sup>662</sup> And by that he meant specifically infringement action seeking to enforce the judgments of the CJEU on the rights of asylum seekers.663

In May 2020, illiberal national governments received support for their struggle against oppression by Brussels from an unlikely ally: the German Federal Constitutional Court, which entered into a bitter and direct confrontation with the CJEU concerning the European Central Bank's Public Sector Purchase Programme (PSPP).<sup>664</sup> Somewhat unexpectedly, the judges themselves decided to discuss the judgment in the press.<sup>665</sup> In an interview with *Die Zeit* the outgoing president of the Constitutional Court, Andreas Vosskuhle, dismissed the notion that the German Constitutional Court should have taken into account how its judgment may be instrumentalised by courts in illiberal democracies (such as the Polish Constitutional Court), and argued that judicial disagreement did not undermine the unity of the European legal order.<sup>666</sup> Unusual as it may be for the CJEU to present its position regarding legal developments in a

<sup>&</sup>lt;sup>661</sup> Fabbrini, F. and Sajó, A. (2019), "The Dangers of Constitutional Identity", *European Law Journal*, Vol. 25, No 4, pp. 457-473.

<sup>&</sup>lt;sup>662</sup> "PM Orbán in a letter to Ursula von der Leyen" (22 November 2021), https:// abouthungary.hu/news-in-brief/pm-orban-in-a-letter-to-ursula-von-der-leyen-ec-mustsuspend-infringement-procedures-that-undermine-the-territorial-and-national-integrityof-member-states-and-the-security-of-their-citizens

<sup>&</sup>lt;sup>663</sup> Commission v Hungary, 17 December 20, C-808/18, EU:C:2020:1029. See Migration: Commission refers Hungary to the Court of Justice of the European Union over its failure to comply with Court judgment, 12 November 2021, https://ec.europa.eu/ commission/presscorner/detail/en/ip\_21\_5801

<sup>664 2</sup> BvR 859/15, 5 May 2020.

See Hipold, P. (2021), "So Long Solange? The PSPP Judgment of the German Constitutional Court and the Conflict between the German and the European 'Popular Spirit'", *Cambridge Yearbook of European Legal Studies*, pp. 1-34, 17 at note 68. doi:10.1017/cel.2021.3.

<sup>&</sup>lt;sup>666</sup> Interview with Andreas Vosskuhle: "Erfolg ist eher kalt", *Die Zeit*, 13 May 2020, https:// www.zeit.de/2020/21/andreas-vosskuhle-ezb-anleihenkaeufe-corona-krise
press release<sup>667</sup>, the CJEU responded by distinguishing between judicial dialogue and "divergences between courts".<sup>668</sup> It also posited that giving effect to CJEU judgments "is the only way of ensuring the equality of Member States in the Union they created".<sup>669</sup> The President of the CJEU, Koen Lenaerts, warned in a newspaper interview that "the first member state that ignores a judgment could unravel the entire European legal order".<sup>670</sup>

The CJEU is particularly aware of this unravelling as it has itself become the direct subject of attacks along the way. On 14 July 2021, a panel of five judges of the Polish Constitutional Tribunal ruled that the interim measures imposed by the CJEU earlier that day interfered with the organisation of the Polish judiciary in an ultra vires manner.<sup>671</sup> The CJEU's interim order required the suspension of the Disciplinary Chamber of the Polish Supreme Court in line with its earlier decisions. Formally, the October 2021 ruling of the Polish Constitutional Tribunal responded to Prime Minister Morawiecki's request.<sup>672</sup> The majority of the full Tribunal asserted the primacy of the Polish Constitution over EU law (Articles 1 and 19 TEU) and defended Poland's sovereignty in the face of an "ever closer Union". The case may affect the legitimacy of hundreds of judges appointed by the Prawo i Sprawiedliwość (PiS), the ruling Polish party.673 The October 2021 ruling followed a judgment of the CJEU from a day earlier. In that judgment, the CJEU emphasised that the principle of the primacy of EU law "requires all Member State bodies to give full effect to the various EU provisions, and the law of the Member States may not undermine the effect accorded to those various provisions in the territory of those States".674

On 19 October 2021, the European Parliament held a debate on the rule of law crisis and the primacy of EU law (in the shadow of an Article 7 TEU process that appears to be rather dormant in the Council). In his speech at the European Parliament, Prime Minister Morawiecki emphasised that the October ruling of the Constitutional Tribunal was narrow and very specific, affecting particular provisions of the Treaty in a specific case.<sup>675</sup> He also

<sup>&</sup>lt;sup>667</sup> Lindeboom, J. (2020), "Is the Primacy of EU Law Based on the Equality of the Member States? A Comment on the CJEU's Press Release Following the PSPP Judgment", *German Law Journal*, Vol. 21, No 5, pp. 1032-44.

<sup>&</sup>lt;sup>668</sup> Press Release Following the Judgment of the German Constitutional Court of 5 May 2020 (8 May 2020), www.curia.europa.eu

<sup>669</sup> ibid.

<sup>&</sup>lt;sup>670</sup> Interview with President Koen Lenaerts: "Europese Hof komt meer center stage", NRC (May 17, 2020), https://www.nrc.nl/nieuws/2020/05/17/president-koen-lenaertseuropese-hof-komt-meer-center-stage-a4000000

<sup>&</sup>lt;sup>671</sup> P. 7/20 (14 July 2021), above; *Commission* v *Poland*, C 204/21 R, 14 July 2021 (interim order), EU:C:2021:593.

<sup>672</sup> K. 3/21 (7 October 2021), above.

<sup>&</sup>lt;sup>673</sup> Woznicki, L., "CJEU Receives Another Case Questioning the Legitimacy of Hundreds of PiS-Appointed Judges" wyborcza.pl (9 April 2021), https://wyborcza. pl/7,173236,26963654,cjeu-receives-another-case-questioning-the-legitimacy-ofhundreds.html?disableRedirects=true

<sup>674</sup> Case C-487/19, para. 156; repeated in C-791/19 R, para. 18.

<sup>&</sup>lt;sup>675</sup> "Statement by Prime Minister Mateusz Morawiecki at the European Parliament" (19 October 2021), https://www.gov.pl/web/primeminister/statement-by-prime-ministermateusz-morawiecki-in-the-european-parliament

cited several examples in which European constitutional courts, including the German Constitutional Court, took similar stances.<sup>676</sup>

For its part, the European Parliament emphasised that it "[d]eeply deplores the decision of the illegitimate 'Constitutional Tribunal' of 7 October 2021 as an attack on the European community of values and laws as a whole, undermining the primacy of EU law as one of its cornerstone principles in accordance with well-established case-law of the CJEU; expresses deep concern that this decision could set a dangerous precedent; underlines that the illegitimate "Constitutional Tribunal" not only lacks legal validity and independence, but is also unqualified to interpret the Constitution in Poland" (paragraph 1) and that "no EU taxpayers' money should be given to governments that flagrantly, purposefully and systematically undermine values enshrined in Article 2 TEU" (paragraph 11).<sup>677</sup>

It is tempting to explain the twists and turns of the rule of law crisis as illustrations of a difficult integration process or a phase in which new Member States negotiate the terms of belonging to the EU. The recent tensions over the primacy of EU law in Poland are a response to the Commission's follow-up work, which sought to safeguard judicial independence at the national level. Such follow-up work does not necessarily have to escalate into extreme measures in the Member States. In response to infringement action that followed the German Constitutional Court's judgments in the *PSPP / Weiss* case, the German Government provided the Commission with satisfactory assurances. As a result, the case was closed in December 2021 without a reference to the CJEU.<sup>678</sup>

More generally, as compliance rates with CJEU judgments are far from perfect in other Member States, including those whose membership is of long duration<sup>679</sup>, creative compliance is hardly a speciality of illiberal Member States.<sup>680</sup> It is impossible to tell what inspired the Hungarian Constitutional Court when it ruled on the question of the Minister for Justice on the constitutionality of the implementation of the CJEU's judgment concerning the rights of asylum seekers (C-808/18) under the Fundamental Law's Europe clause (Article E(2)).<sup>681</sup> The Constitutional Court emphasised the "inalienable right of Hungary to determine its territorial unity, population, form of government and State structure" and elaborated at length on constitutionality, sovereignty and identity control. In particular, it emphasised the natural bonds of the member of the (political) community created by birth and geographic proximity that the State is obliged to

<sup>676</sup> ibid.

<sup>&</sup>lt;sup>677</sup> European Parliament resolution on the rule of law crisis in Poland and the primacy of EU law (2021/2935(RSP)) (21 October 2021).

<sup>&</sup>lt;sup>678</sup> "June Infringement Package: Key Decisions" (9 June 2021), www.ec.europa.eu

<sup>&</sup>lt;sup>679</sup> Falkner, G. (2008), "A Causal Loop? The Commission's New Enforcement Approach in the Context of Non-compliance with EU Law Even After CJEU Judgments", *Journal* of European Integration Vol. 40, No 6, pp. 769-784.

Batory, A. (2016), "Defying the Commission: Creative Compliance and Respect for the Rule of Law in the EU", *Public Administration*, Vol. 94, No 3, pp. 685-699.

<sup>&</sup>lt;sup>681</sup> X/477/2021 decision, 10 December 2021, http://hunconcourt.hu/uploads/ sites/3/2021/12/x\_477\_2021\_eng.pdf

protect. Ultimately, the Constitutional Court stressed that "Hungary shall be entitled, in accordance with the presumption of reserved sovereignty, to exercise the relevant non-exclusive field of competence of the EU, until the institutions of the European Union take the measures necessary to ensure the effectiveness of the joint exercise of competences".<sup>662</sup> In short, despite an open invitation from the Minister for Justice, the Hungarian Constitutional Court did not enter into open confrontation with the CJEU on the primacy of EU law. This gives the Hungarian Government some wiggle room to address the Commission's concerns about the state of the rule of law as a precondition for access to EU funds.<sup>683</sup> Meanwhile, in December 2021 the Commission launched infringement action against the rulings of the Polish Constitutional Tribunal that contest the primacy of EU law.<sup>684</sup>

## 2 The CJEU's efforts to defend the EU's constitutional order

In recent years the CJEU has taken considerable care to outline the key features EU's constitutional order and founding values. These judgments deserve closer attention as they outline a much-needed legal framework to counter the normalisation of illiberal democracy in the EU.

#### 2.1 Asserting the autonomy of the EU's constitutional order

The CJEU has outlined several features that make the autonomous constitutional order of the EU unique. Building on the familiar concept of the EU being a community based on the rule of law<sup>685</sup>, the CJEU emphasises that the EU's constitutional order is distinct from international law and national constitutional law in its very nature: as "a structured network of principles, rules and mutually interdependent legal relations linking the EU and its Member States, and its Member States with each other" engaged in "creating an ever closer union among the peoples of Europe".<sup>686</sup> This emphasis on mutually interdependent relations sounds rather sharp in the light of former Federal Constitutional Court President Andreas Vosskuhle's comments dismissing the suggestion that the German

<sup>682</sup> ibid.

Bayer L. and Wanat, Z. (2021), "Commission Questions Hungary and Poland on Corruption, Judiciary" 20 November 2021, https://www.politico.eu/article/eucommission-questions-hungary-on-corruption-judiciary/

<sup>&</sup>lt;sup>684</sup> "Rule of Law: Commission launches infringement procedure against Poland for violations of EU law by its Constitutional Tribunal", 22 December 2021, www.ec. europa.eu

<sup>&</sup>lt;sup>685</sup> Judgment of 23 April 1986, Les Verts v Parliament, C-294/83, EU:C:1986:166, para. 23.

 <sup>&</sup>lt;sup>686</sup> Opinion 2/13, Accession of the EU to the ECHR, 18 December 2014, EU:C:2014:2454, para. 167, reinforced in Judgment of 6 March 2016, *Slovak Republic* v Achmea, C-284/16, EU:C:2018:158, para. 33; Judgment of 10 December 2018, *Wightman*, C-621/18, EU:C:2018:999, para. 45; Judgment of 2 September 2021, *Moldova v Komstroy*, C-741/19, EU:C:2021:655, paras. 43-44.

Constitutional Court should have considered how its *PSPP / Weiss* judgment may be misused by illiberal actors.

In terms of its content, the EU's unique autonomous constitutional order comprises such familiar elements as the Treaties, the Charter, values set out in Article 2 TEU and the general principles of EU law.<sup>687</sup> Recently, the CJEU affirmed that for the purposes of the application of the Charter (Article 51(1)) the concept of "implementing EU law" covers instances where a Member State relies on exceptions provided by EU law to justify a restriction.<sup>688</sup>

As a key feature of this autonomous legal order, the CJEU emphasises the primacy of EU law, complete with the Member States' obligation to give full effect to EU law in their territory.<sup>689</sup> In terms of institutional and procedural safeguards securing the autonomy of the EU's legal order, the CJEU points to the judicial system (Article 19 TEU) and, in particular, to the preliminary ruling procedure (Article 267 TFEU).<sup>690</sup> In recent cases in which the primacy of EU law has come under attack, a connection has been made between the concepts of interdependence and reciprocal relations, judicial independence (e.g. on account of access to an independent and impartial tribunal)<sup>691</sup>, and the effective legal protection of the rights of individuals.<sup>692</sup> Most recently, the CJEU has imposed significant fines on Poland for failing to give effect to the CJEU's judgments in these cases, thereby violating of the primacy of EU law.<sup>693</sup>

In the course of the ongoing contestation concerning judicial independence in Poland, the vice-president of the CJEU emphasised that: "the national provisions on the organisation of justice in the Member States may be subject to review in the light of the second subparagraph of Article 19(1) TEU in the context of an action for failure to fulfil obligations"<sup>694</sup>; and – equally importantly – "[t]he fact that a national constitutional court declares that such measures are contrary to the constitutional order of the Member State concerned in no way alters the assessment".<sup>695</sup> This is in line with the

<sup>&</sup>lt;sup>687</sup> Opinion 1/17, para. 110.

<sup>&</sup>lt;sup>688</sup> Judgment of 21 May 2019, Commission v Hungary (agricultural usufruct), C-235/17, EU:C:2019:432, para. 66.

<sup>&</sup>lt;sup>689</sup> Judgment of 24 June 2019, *Poplawski*, C-573/17, EU:C:2019:530, para. 52, also paras 53-54; Judgment of 19 November 2019, *A.K.*, C 585/18, C 624/18 and C 625/18, EU:C:2019:982, paras. 156-159.

<sup>&</sup>lt;sup>690</sup> Opinion 1/17, para. 111.

<sup>&</sup>lt;sup>691</sup> See Judgment of 19 November 2019, *A.K.*, C 585/18, C 624/18 and C 625/18, EU:C:2019:982, paras. 156-159.

<sup>&</sup>lt;sup>692</sup> See, for example, Judgment of 2 September 2021, *Moldova* v *Komstroy*, C-741/19, EU:C:2021:655, para. 45.

<sup>&</sup>lt;sup>693</sup> Order of 20 September 2021, *Czech Republic v Poland*, C-121/21, EU:C:2021:752 (order of the Vice-President (interim measure), imposing a EUR 0.5 million daily penalty; and Order of 27 October 2021, *Commission v Poland*, C-204/21 R, EU:C:2021:878 (order of the Vice-president (interim measure)) imposing a EUR 1 million daily penalty.

<sup>&</sup>lt;sup>694</sup> Order of 6 October 2021, *Commission* v *Poland*, C 204/21 R, EU:C:2021:834 (interim measure), para. 22.

<sup>&</sup>lt;sup>695</sup> Order of 6 October 2021, *Commission* v *Poland*, C 204/21 R, EU:C:2021:834 (interim measure), para. 23.

longstanding position of the CJEU according to which "a Member State cannot plead provisions, practices or situations prevailing in its domestic legal order to justify failure to observe obligations arising under EU law".<sup>696</sup>

The CJEU's press release in response to the German Constitutional Court's *PSPP / Weiss* judgment leaves open the intriguing question as to the relationship between the primacy of EU law and the principle of equality.<sup>697</sup> In his scholarly writing, President Lenaerts appears to favour anchoring primacy in the principle of equality as a "grounding principle securing that all Member States – regardless of their size, policy views or economic power – are treated equally before the law".<sup>698</sup> This approach would certainly address complaints by illiberal governments about being subjected to double standards.

#### 2.2 Defending the rule of law beyond judicial independence

Beyond the guarantees of judicial independence and the affirmation of the primacy of EU law, a recently emerging strand in the CJEU's jurisprudence focuses on threats and risks illiberal legal engineering poses to the EU's legal order.

The CJEU's focus has been on identifying the chilling effect of legal rules.<sup>699</sup> In response to the infringement action concerning "foreign-funded" NGOs in Hungary, the CJEU pointed out that the violation of the freedom of association resulted from the *deterrent effect of the rules*, noting that the regulation created "a generalised climate of mistrust vis-à-vis the associations and foundations at issue, in Hungary, and to stigmatise them".<sup>700</sup> In the case concerning the freedom to establish foreign private universities in Hungary, the CJEU assessed whether the new accreditation criteria had the *potential* to undermine academic freedom<sup>701</sup>, and found that the *legal uncertainty* created by the new rules limited academic freedom.<sup>702</sup> This is exactly the kind of risk assessment that would be required under Article 7 TEU to defend the EU's founding values. Note that the European Parliament already demonstrated in its resolution of 8 July 2021 on the

<sup>&</sup>lt;sup>696</sup> See, for example, Order of 6 October 2021, *Commission* v *Poland*, C-204/21 R, EU:C:2021:878 (interim measure), para. 54. See more generally, Schütze R. and Tridimas, T. (eds.) (2018), Oxford Principles of European Union Law: The European Union Legal Order, Oxford University Press, Oxford, p. 954.

<sup>&</sup>lt;sup>697</sup> See Lindeboom (2015), criticising Fabbrini, F. "After the OMT Case: The Supremacy of EU Law as the Guarantee of the Equality of the Member States", *German Law Journal*, Vol. 16, No 4, pp. 1003-1023.

Lenaerts, K. (2020), "No Member State is More Equal than Others: The Primacy of EU law and the Principle of the Equality of the Member States before the Treaties", 8 October 2020, https://verfassungsblog.de/no-member-state-is-more-equal-thanothers/

<sup>&</sup>lt;sup>699</sup> Pech, L. "The Concept of Chilling Effect" Open Society European Policy Institute (March 2021), https://www.opensocietyfoundations.org/publications/the-concept-ofchilling-effect

<sup>&</sup>lt;sup>700</sup> Commission v Hungary, C-78/18, EU:C:2020:476, para.118.

<sup>&</sup>lt;sup>701</sup> Commission v *Hungary*, C-66/18, EU:C:2020:792, para. 228.

<sup>&</sup>lt;sup>702</sup> Commission v Hungary, C-66/18, para. 229.

Hungarian bill on prohibiting the "propaganda of homosexuality" that it is able to recognise and willing to call out the chilling effect of deliberately vague laws.<sup>703</sup>

The deterrent effect of legal rules is also central to the CJEU's judgments concerning judicial reforms, the self-government of the judiciary and disciplinary processes. The CJEU is especially concerned about the deterrent effect of disciplinary sanctions imposed on judges for submitting questions for preliminary rulings (Article 267 TFEU) as well as the potential (on the part of the political executive) for exerting influence over national courts through the appointment of senior judicial officials.<sup>704</sup> The CJEU had serious concerns about the process of secondment of Polish judges that allows the Minister for Justice – who is also the Prosecutor General – to move judges across ordinary courts. According to the CJEU, this mechanism should be assessed in the light of "a risk of that secondment [may be] used as a means of exerting political control over the content of judicial decision".<sup>705</sup>

The CJEU engaged in a very careful risk assessment exercise when it considered the impact of the violation of national rules on judicial appointments on the independence and impartiality of national courts in Poland. The CJEU relied on the reasoning of the European Court of Human Rights (ECtHR).<sup>706</sup> It also adapted the ECtHR's emphasis on the appearance of a court's independence: "[I]t was still necessary to ensure that the substantive conditions and procedural rules governing the adoption of those appointment decisions are such that they cannot give rise to reasonable doubts, in the minds of individuals, as to the imperviousness of the judges concerned to external factors and as to their neutrality with respect to the interests before them, once appointed as judges."<sup>707</sup> A key premise of the CJEU's assessment was that national judges – whose independence and impartiality may be compromised at the national level – apply EU law in cases involving the rights of EU citizens.

### 2.3 Reinforcing pre-commitment - halting constitutional retrogression

In the course of the Brexit-related legal drama the CJEU took the opportunity to emphasise that EU membership is the result of a free and voluntary political undertaking "for the benefit of which the Member States... have limited their sovereign rights".<sup>708</sup> At the same time, the CJEU

<sup>&</sup>lt;sup>703</sup> Resolution on breaches of EU law and of the rights of LGBTIQ citizens in Hungary as a result of the legal changes adopted by the Hungarian Parliament (2021/2780(RSP)) (8 July 2021) www.europarl.europa.eu, recital C.

<sup>&</sup>lt;sup>704</sup> Joined cases C-83/19, C-127/19, C-195/19, C-291/19, C-355/19 and C-397/1, op. cit.

<sup>&</sup>lt;sup>705</sup> Judgment of 16 November 2021, *Prokuratura Rejonowa* v *Mińsku Mazowieckim*, 16 November 2021, Joined cases C-748/19, para 73.

<sup>&</sup>lt;sup>706</sup> Especially in Judgment of 1 December 2020, *Ástráðsson* v *Iceland*, Application No 26374/18; see C-487/19, paras. 124-125.

<sup>&</sup>lt;sup>707</sup> C-487/19, op. cit. para. 148.

<sup>&</sup>lt;sup>708</sup> Judgment of 10 December 2018, *Wightman*, C-621/18, EU:C:2018:999, para. 45.

emphasised that such a free and voluntary commitment to EU membership also implied a commitment "to those values, and EU law is thus based on the fundamental premiss that each Member State shares with all the other Member States, and recognises that those Member States share with it, those same values".<sup>709</sup> This free and voluntary pre-commitment to the EU's founding values is of central relevance for addressing a key feature of the rule of law crisis – namely, constitutional retrogression.

While the principle of non-retrogression is familiar from the area of socioeconomic rights, it is far from being a well-developed general principle of human rights law<sup>710</sup>, let alone of European constitutional law. Recently, in the Maltese judges' case, the CJEU addressed the issue of constitutional retrogression in relation to ground principles, reading Article 2 TEU in conjunction with Article 49 TEU. The CJEU asserted that a Member State's decision to join the EU is an instance of constitutional pre-commitment.<sup>711</sup> According to the CJEU, a Member State's free and voluntary commitment to the EU's founding values at the time of accession entails that a Member State may not, after accession, amend its constitution to effect a reduction of the protection its constitution provides to the EU's founding values.<sup>712</sup>

The consequences of viewing EU accession as an act of pre-commitment to the EU's founding values are significant for boosting the capacity of EU institutions to address illiberal democratic backsliding: it opens up both the possibility of testing respect for the founding values outside the (severely compromised) framework of Article 7 TEU and the ways of addressing departures from – and violations of – founding values contained in the Treaties.

The rapidly unfurling war on the concept of gender in the name of defending Christian values (and illiberal Christian democracy) provides ample opportunity to recast the debate in terms of pre-commitment and, consequently, the principle of non-retrogression. The consequences of embedding pre-commitment in constitutional interpretation are well illustrated in the judgment of the Romanian Constitutional Court that found a statutory ban on "spreading the theory of opinion of gender identity" in public schools to be unconstitutional in December 2020.<sup>713</sup> The Constitutional Court referred to the ECtHR's jurisprudence and several elements of the EU acquis to demonstrate the transformation of the meaning of constitutional equality protection since EU accession. It concluded that combating gender stereotypes has been attached to the

<sup>709</sup> ibid, para. 63.

<sup>&</sup>lt;sup>710</sup> Warwick, B.T.C. (2019), "Unwinding Retrogression: Examining the Practice of the Committee on Economic, Social and Cultural Rights", *Human Rights Law Review*, Vol. 19, No 3, pp. 467-490. Admittedly, it has also been a contentious topic in EU law ever since. See Judgment of 26 February 2013, *Melloni v Ministerio Fiscal*, C-399/11, EU:C:2013:107.

<sup>&</sup>lt;sup>711</sup> Judgment of 20 April 2021, *Repubblika* v *II-Prim Ministru*, C-896/19, EU:*C*:2021:31, paras. 60-61.

<sup>&</sup>lt;sup>712</sup> ibid., para. 63.

<sup>&</sup>lt;sup>713</sup> Decision No 907 of 16 December 2020, https://www.ccr.ro/wp-content/ uploads/2021/02/Decizia\_907\_EN.pdf (English translation).

traditional approach to the roles of men and women in society (paragraph 76). What gives constitutional significance to such developments in secondary EU law at the national level is the pre-commitment to upholding the founding values of the EU embedded in the decision to join the EU.<sup>714</sup>

An emphasis on pre-commitment may also turn into a potent counterweight to justifications of measures restricting fundamental rights in the name of constitutional identity. The narrative of constitutional identity is not the exclusive terrain of constitutional jurisprudence in illiberal democracies. In October 2021, the Bulgarian Constitutional Court stated that, for the purpose of the Bulgarian Constitution, "sex" refers to "biological sex" (to the exclusion of a less deterministic concept of gender). The Court made reference to principles that reflect the values of Bulgarian society as well as the traditional values associated with Eastern Orthodoxy, as a reflection of national psychology.<sup>715</sup> The Bulgarian Constitutional Court also considered that, in the EU, several Member States (such as Slovakia, Croatia, Hungary, Latvia, Poland and Lithuania) use a binary definition of marriage in their constitution. It also considered provisions of the Greek Constitution and the Hungarian Fundamental Law that emphasise the unique historical significance of former established churches for their societies. This judgment is a significant step towards defining the Bulgarian constitutional identity: it is a step that the Constitutional Court was not ready to take in 2018, when it found, in violation of the principle of the rule of law, that the ratification of the Istanbul Convention would introduce the legally hazy concept of gender into the Bulgarian legal system.716

#### 3 Conclusion

This article has surveyed the CJEU's efforts to build solid legal foundations to safeguard the EU's constitutional order in the midst of the normalisation of the rule of law crisis in the EU.

The familiar tropes of legal pluralism and differentiation seek to diffuse tensions and conceal the efforts of EU institutions – and especially of the CJEU – to defend the EU's founding values and the foundations of the EU constitutional order. The imagery of differentiation – whether in relation to differentiated integration or differentiated governance – may well enable the EU to muddle through.<sup>717</sup> While a legalistic and technical definition of differentiation leads to the reassuring conclusion that differentiation "removes the most Eurosceptic states from the most advanced integration

<sup>&</sup>lt;sup>714</sup> As a side note, the Romanian judgment demonstrates the significance of unblocking the legislative process on the Horizontal Discrimination Directive, urged by the July 8 EP resolution (para. 21).)

<sup>&</sup>lt;sup>715</sup> Decision No 6/2021 of 26 October 2021.

<sup>&</sup>lt;sup>716</sup> Decision No 13/2018 of 27 July 2018. See Smilova, R. "Promoting 'Gender Ideology': Constitutional Court of Bulgaria Declares Istanbul Convention Unconstitutional", 22 August 2018, https://ohrh.law.ox.ac.uk/promoting-gender-ideology-constitutional-courtof-bulgaria-declares-istanbul-convention-unconstitutional/.

<sup>&</sup>lt;sup>717</sup> Fabbrini, F. (2021), *Brexit and the Future of the European Union*, Oxford University Press, Oxford, p. 81.

schemes and circumvents their veto on future integration decisions"<sup>718</sup>, the normalisation of illiberal political practices during the rule of law crisis suggests that the logic of differentiation also provides ample opportunity for illiberal Member States to take advantage of EU membership without respecting its legal foundations or sharing the values it is built on.

The recent ruling of the Polish Constitutional Tribunal declaring the primacy of national law over EU law is both a symptom of the escalation of the rule of law crisis, and an opportunity to reset the terms of the EU's response to the strategic and systemic disrespect for the legal foundations of the EU. In May 2021, the ECtHR confirmed that the composition of the Constitutional Tribunal was unconstitutional under Polish law, and, as such, cannot be regarded as a "tribunal established by law".<sup>719</sup> In that judgment, the ECtHR confirmed the existence of a "very close interrelationship" between a tribunal established by law and the independence and impartiality of that tribunal.<sup>720</sup> This concern was immediately picked up on by the Commission in its latest rule of law report. Therefore, the legal value or weight of the Constitutional Tribunal's rulings concerning the constitutionality of its own composition is questionable at best.

Several strands of recent CJEU case-law provide ample support and inspiration for doing so, including the express recognition of precommitment and a keen eye for spotting the misuse and chilling effect of legal rules. Recognising such ills and attaching credible sanctions to them is the only way to halt the dismantling of the EU's legal order, a process that runs on constitutional retrogression in defiance of the commitments that Member States made upon their entry to the EU. Consistent reminders of the lasting significance of such pre-commitment are also a solid foundation for guarding the constitutional idea(I) of the EU as a "community of values and of laws".

<sup>&</sup>lt;sup>718</sup> Schimmelfenning, F. and-Winzen, T. (2020), *Ever Looser Union?* Oxford University Press, Oxford, p. 121.

<sup>&</sup>lt;sup>719</sup> Xero Flor w Polsce sp. z o.o. v Poland, Application No 4907/18, Judgment of 7 May 2021.

<sup>&</sup>lt;sup>720</sup> Xero Flor w Polsce sp. z o.o. v Poland, Application No 4907/18, Judgment of 7 May 2021, para. 247.

# What is the fate of the rule of law in the EU?

By Laura Codruța Kövesi\*

#### 1 No community in Europe without the rule of law

Legal practitioners are in the first line of defence of the rule of law. It is one of the common values of the European Union (EU) and its people, enshrined in the Treaty on European Union and the Charter of Fundamental Rights of the European Union.

There can be no community in Europe that is not a community of law. There can be no Union in Europe without the rule of law.

Within the EU, there are several tools and mechanisms defending the rule of law:

First, the European Commission, as guardian of the Treaties, can launch infringement proceedings to ensure respect for the rule of law. Responsible for ensuring the application of EU law and the protection of the fundamental rights under the Charter, the Commission has deployed a large vision of the rule of law through its monitoring reports linked to the Charter.

These reports are communicated to the Council, the European Parliament and the consultative committees to trigger political debates in the EU institutions. They cover four pillars: the justice system, the anti-corruption framework, media pluralism and other institutional issues related to checks and balances.

Second, in line with Article 7 of the Treaty on European Union, the European Council can suspend any rights deriving from EU membership, such as voting and representation, as an outcome of a long and complex procedure, once a persistent breach of the EU's founding values by a Member State has been identified.

Third, in the General Conditionality Regulation, the European legislator has given a more precise definition of the rule of law and has established a new mechanism to protect it. This mechanism, once triggered by the Commission, allows the EU to suspend, reduce or restrict access to EU funding in a manner proportionate to the nature, gravity and scope of the breaches.

European Public Prosecutor, European Public Prosecutor's Office.

The protection mechanism set out in the General Conditionality Regulation has a subsidiary nature. This means that measures under it can be considered only where other procedures set out in EU law would not allow for more effective protection of the EU budget. This includes procedures under the applicable sector-specific and financial rules and infringement procedures under the Treaty on the Functioning of the European Union.

There are many more actors involved in defining and protecting the rule of law, both at national and EU level. These include the courts, together with prosecution services and police forces, anti-fraud services, auditors, controllers, diverse certifying bodies and citizens.

This is why, when we talk about the fate of the rule of law in the EU, it is a matter of how each actor, each institution plays the role it is supposed to.

#### 2 The role of the European Public Prosecutor's Office

The European Public Prosecutor's Office (EPPO) is mentioned in the General Conditionality Regulation, which refers to reports from the EPPO as one of the possible sources of information to be assessed by the Commission when it attempts to identify breaches of the rule of law.

The EPPO acts in the interest of justice. The act of prosecution, viewed as that of rendering justice, is a material expression of the values of justice. In other words, the EPPO embodies the Europe of justice.

Moreover, the EPPO is the result of a transfer of sovereignty from the participating Member States. Beyond its principal office, which is situated next to the European Court of Justice in Luxembourg, the EPPO is also an institutional reality in 22 participating Member States. There is only one comparable construct in the EU architecture: the European System of Central Banks.

The EPPO is an EU body embedded in the national judiciaries. The European Delegated Prosecutors investigate and prosecute in accordance with national criminal laws and national procedural criminal laws, and bring their cases for judgment before national tribunals.

As a specialised prosecution office tasked with the protection of the EU budget, the EPPO fights fraud, corruption and money laundering.

The European Prosecutors act in the interest of justice in a field in which this endeavour has not hitherto been self-evident or systematically approached. Limited to crimes against the EU budget, the EPPO's specialisation means that there are now, in all the participating Member States, prosecutors with the same priority. So far, the level of protection of the financial interests of the EU has varied across the Member States. In some Member States, hundreds of investigations have taken place while in others two or even fewer have taken place.

The second key element is that the EPPO is independent from governments, the Commission, and other EU institutions, bodies, and agencies. This is very important, because its independence and that of its prosecutors is a necessary condition for its efficiency.

A third reason for the increased level of protection of the EU's financial interests is linked to the main characteristic of the type of criminality that the EPPO fights: the speed with which criminals shift their modus operandi in reaction to law enforcement actions. The EPPO has unprecedented possibilities to act in this respect:

- · by aggregating and analysing information at EU level;
- · by conducting cross-border investigations within a single office;
- · by systematising the use of the most efficient investigative tactics;
- by using evidence collected in another Member State without the need for excessive formalities.

The Treaties recognise that threats to the rule of law at national level are immediate threats to the EU legal order and provide for specific instruments to ensure respect for the rule of law.

The EPPO is a very sharp tool, in a particular field of competence, and it has a systemic role from a rule of law perspective. For this reason, any interference with the exercise of the EPPO's competences should trigger an appropriate reaction.



### Panel 3: Relationship between law and markets

# On the relationship between law and markets

By Isabel Schnabel\*

#### 1 Introduction

Many economists consider frictionless markets as an ideal allocation mechanism, ensuring first-best outcomes and thereby maximising social welfare. In reality, however, such markets do not exist. Real world markets are fraught with various types of imperfections, including market power and externalities. Financial markets, in particular, are plagued by frictions. Most importantly, such frictions emerge due to the pervasiveness of asymmetric information in financial relationships.

A consistent set of legal rules is therefore indispensable to ensure the proper functioning and integrity of financial markets. For example, debt contracts and their enforcement crucially rely on a functioning legal and judicial system.

Given the importance of the interactions between the legal system and financial markets, this year's ECB Legal Conference has dedicated a panel to this topic. The panel will provide an opportunity to discuss the relationship between the law and markets with four distinguished panellists who cover a broad range of fields in both academia and policy. Before I open the discussion with a few short remarks on the panel's theme, I would like to introduce the panellists in the order of their appearance.

#### 2 The panellists

Our first panellist is **Katharina Pistor**. She is the Edwin B. Parker Professor of Comparative Law, and the Director of the Center on Global Legal Transformation, at Columbia Law School. She specialises in comparative law, corporate governance, the governance of financial systems, as well as law and development.

In addition to her numerous publications in leading legal and social science journals, Katharina has authored several books. *The Code of Capital: How the Law Creates Wealth and Inequality* has been praised by voices as diverse as Martin Wolf of the Financial Times and the economist Thomas Piketty. The Financial Times named *The Code of Capital* as one of the best books of 2019.<sup>721</sup>

Executive Board member of the European Central Bank (ECB).

<sup>&</sup>lt;sup>721</sup> See Financial Times (2019), "Best books of 2019: Economics", 3 December.

Our panel is also joined by **Vivien Ann Schmidt** who is the Jean Monnet Professor of European Integration, and Professor of International Relations and Political Science, at Boston University. Her particular areas of expertise and the focus of her research are European political economy and political theory.

Vivien's comparative work analyses the role of Europe in a globalising world, and her publications examine the impact of ideas and discourse on the dynamics of change.<sup>722</sup> Published in 2020, her most recent book is *Europe's Crisis of Legitimacy: Governing by Rules and Numbers in the Eurozone*. Her book *Democracy in Europe*, published in 2006, was named by the European Parliament in 2015 as one of the "One Hundred Books on Europe to Remember".<sup>723</sup>

**Marco Dani**, our third panellist, is Associate Professor of Comparative Public Law at the University of Trento. His areas of expertise comprise the constitutional implications of the European integration process, and the question of how the judicial review of legislation can facilitate and impede government. He is known for his 2013 book *II diritto pubblico europeo nella prospettiva dei conflitti (European public law from the perspective of conflicts*) as well as many articles published in academic journals, covering topics related to European and constitutional law.

Finally, the discussion during today's panel will benefit from the perspective of a policymaker. **Barbara Balke** is Director General and General Counsel at the European Investment Bank (EIB). Her successful career at the EIB spans over two decades. Before becoming General Counsel in 2020, Barbara was the Deputy General Counsel. Her earlier roles as director of various legal departments at the EIB have provided her with expertise in corporate policy, matters relating to the EIB Statute, and legal aspects of financing operations in Central and Eastern Europe.

#### 3 The relationship between law and markets

Before I give the floor to our distinguished panellists, I would like to briefly introduce the panel discussion by identifying three broad themes, which will subsequently also be taken up in the panellists' individual contributions.

#### 3.1 Central banks and markets

The first relevant theme is the relationship between central banks and markets.

<sup>&</sup>lt;sup>722</sup> This aspect was also identified by the Guggenheim Memorial Foundation as a core element of Vivien's work when she was awarded a Guggenheim Fellowship in 2018.

<sup>&</sup>lt;sup>723</sup> The European Parliament's list of 100 books is available https://www.europarl.europa. eu/100books/en/list.htm

The ECB is an important player in financial markets. However, it is different from other market participants due to its central role in providing liquidity and its power to shape markets by means of its monetary policy. Katharina describes the nature of this relationship in her work on the "legal theory of finance".<sup>724</sup>

The ECB's relationship with markets is delineated by our legal framework. As a public institution, we need to respect the limits of our mandate as stipulated in the Treaties. According to Article 127(1) of the Treaty on the Functioning of the European Union (TFEU), the ECB's primary objective is to maintain price stability. In addition, under the secondary objective, the ECB must support the general economic policies in the European Union (EU) as long as this does not prejudice or conflict with the primary objective of price stability. When pursuing these objectives, the ECB is subject to the general provisions of EU primary law and some specific rules, including the prohibition of monetary financing as well as the principles of proportionality and of an open market economy. To ensure compliance with the legal framework, our monetary policy measures are subject to legal scrutiny by the Court of Justice of the European Union (CJEU).

The legal framework has direct implications for the implementation of our monetary policy operations, the frontline of our interaction with financial markets. It imposes constraints on the terms and conditions under which we can intervene in markets. For example, the legal framework prohibits the buying of government bonds in the primary market. It also prevents us from distorting markets through excessive bids, thus ensuring that we buy "alongside the market". And it guides us in choosing the monetary policy instruments with the most favourable balance of benefits and costs.

The prescriptions of our legal framework therefore require continuous re-evaluation of our measures over time. But not all elements of the Treaties provide us with unambiguous guidelines for the implementation of our monetary policy. For example, the interpretation of certain aspects of the legal framework – such as the proportionality principle – might be subject to change as the economic environment evolves.

#### 3.2 The flexibility of legal frameworks

This brings me to the second broad theme, the flexibility of legal frameworks.

While legal frameworks enhance legal certainty, they come at the cost of constraining flexibility. This highlights an important trade-off: while legal rules ought to be sufficiently rigid to provide certainty to market participants, they should also be flexible enough not to stifle adaptation to a changing

<sup>&</sup>lt;sup>724</sup> Pistor, K. (2013), "A Legal Theory of Finance", *Journal of Comparative Economics*, Vol. 41, No 2, pp. 315-330.

economic and societal environment. Such flexibility also matters for public institutions, including the ECB.

From the perspective of the ECB, the Treaties constitute a solid foundation for the effective implementation of our monetary policy. The legal framework has served us well in the past. Despite the clear limitations that the Treaties impose on the ECB, they provide sufficient flexibility to pursue our mandate in changing economic circumstances that can have a profound impact on the functioning of markets.

Our rapid and effective response to the recent pandemic illustrates the inherent flexibility of the legal framework provided by the Treaties. Based on our existing monetary policy toolkit, we swiftly tailored our policy instruments to address the unprecedented economic shock induced by the pandemic.<sup>725</sup> Our ability to design and implement forceful measures within the remit of our mandate was essential in mitigating the economic consequences of the pandemic crisis in the euro area.<sup>726</sup>

In this regard, the ECB's situation is similar to that of the EIB. As Barbara will argue, the flexibility of the overarching legal framework enables public institutions like the EIB to respond to long-term structural shifts in the economic environment while remaining faithful to their legal mandates.<sup>727</sup> However, the flexibility of legal rules can also lead to disagreements regarding their interpretation.

In contrast, both Vivien and Marco stress a need for greater flexibility of the legal framework of the Economic and Monetary Union (EMU). They consider the rules of EMU to be tilted in favour of "neoliberal" ideology. To mitigate this perceived inherent bias, Marco advocates significant changes to the Treaties.

#### 3.3 Independence versus politicisation

A crucial part of the EMU's institutional architecture is the ECB's political independence, the final broad theme I would like to highlight.

Political independence is one of the constituent features of modern central banks' legal frameworks. It also served as a guiding principle for the ECB's institutional set-up: the Treaties contain detailed prescriptions regarding the

<sup>&</sup>lt;sup>725</sup> Mersch, Y. (2020), "Legal aspects of the ECB's response to the coronavirus (COVID-19) pandemic – an exclusive but narrow competence", 2 November.

<sup>&</sup>lt;sup>726</sup> Schnabel, I. (2021), "Lessons from an unusual crisis", 1 October.

<sup>&</sup>lt;sup>727</sup> Article 309 of the TFEU states that "the task of the European Investment Bank shall be to contribute, by having recourse to the capital market and utilising its own resources, to the balanced and steady development of the internal market in the interest of the Union. For this purpose the Bank shall, operating on a non-profitmaking basis, grant loans and give guarantees which facilitate the financing of the following projects in all sectors of the economy ..."

ECB's legally protected independence.<sup>728</sup> This legal stringency implies that the ECB consistently ranks as one of the most independent central banks in the world.<sup>729</sup>

Historical experience has validated the view that delegating the task of maintaining price stability to an independent institution with a clearly defined mandate is best suited to resolve the underlying time inconsistency problem that has historically affected the conduct of monetary policy. Since the late 1970s, legally protected independence has allowed central banks to effectively safeguard price stability, resulting in a long period of low and stable inflation.<sup>730</sup>

However, independence is only granted in exchange for a narrow definition of central banks' mandates. In addition, the privilege of political independence necessarily requires public accountability, including the obligation to explain our decisions to the public.

Thus, central banks' political independence does not discharge them from regularly reflecting on their role and societal responsibilities. In the context of the ECB's recent monetary policy strategy review, we therefore conducted public listening events to better understand citizens' expectations about the ECB's role and responsibilities.<sup>731</sup> These public listening exercises were an important complement to detailed in-house staff analysis that was conducted during the strategy review process.<sup>732</sup>

But the principle of accountability also begs the question of whether the ECB can respond to public requests to address pressing societal concerns – such as climate change or inequality – or whether such an involvement of the public would lead to excessive politicisation. One important legal constraint is that while the ECB is required to support the general economic policies in the EU, it is not allowed to autonomously determine them. But

<sup>730</sup> Schnabel, I. (2021), "Societal responsibility and central bank independence", 27 May.

<sup>&</sup>lt;sup>728</sup> For example, Article 130 of the TFEU stipulates that "when exercising the powers and carrying out the tasks and duties conferred upon them by the Treaties and the Statute of the ESCB and of 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 from any other body".

<sup>&</sup>lt;sup>729</sup> Dall'Orto Mas, R. et al. (2020), "The case for central bank independence", *Occasional Paper Series*, No 248, October; Bodea, C. and Hicks, R. (2015), "Price Stability and Central Bank Independence: Discipline, Credibility and Democratic Institutions", *International Organization*, Vol. 69, Winter 2015, pp. 35-61; Garriga, A. C. (2016), "Central Bank Independence in the World. A New Data Set", *International Interactions*, Vol. 42, No. 5, May, pp. 849-868; see also Schnabel, I. (2021), "Societal responsibility and central bank independence", 27 May.

<sup>&</sup>lt;sup>731</sup> As part of the monetary policy strategy review process, the ECB and the Eurosystem's national central banks (NCBs) organised a range of listening events with citizens, civil society organisations, political representatives and academics. These listening exercises were conducted between October 2020 and April 2021. A summary of the NCB's listening events is available on the ECB's website.

<sup>&</sup>lt;sup>732</sup> The staff analysis in support of the ECB's comprehensive monetary policy strategy review has been published in several occasional papers which are available on the ECB's website.

this constraint still leaves some scope for the ECB to take wider societal challenges into consideration, for example if they directly affect our primary objective or constitute side effects to be considered in our proportionality analysis.

But is this constraint sufficient to separate political decisions from the realm of central banking? Katharina wonders whether central banks' policy measures can even be distinguished from autonomous policymaking. Vivien asks how the ECB could gain legitimacy for choosing secondary objectives without requiring a change of the Treaties. Marco goes a step further by openly questioning the ECB's primary mandate as well as the need for political independence.

#### 4 Conclusion

Given the controversial nature of these topical issues, this panel discussion promises to be highly engaging. Based on my reading of the panellists' diverse conference contributions and the themes that I have highlighted in my opening remarks, we will cover a broad range of fascinating topics at the intersection of law and markets.

I look forward to our discussion.

### Lending, liquidity and the law

#### **By Katharina Pistor\***

Outside the field of economics, it is widely recognised that markets are socially constituted. They are the product of social conventions and/or legal rules that govern the rights and obligations of individuals and organisations when they trade goods, services or capital. For no market is this truer than for financial markets as financial assets owe their very existence to the law. Every financial asset is an IOU that finds willing buyers only if they can be assured that the promise is enforceable. Their value is expressed in state-issued money, in dollars or euros for example, which is likewise the means in which payment typically has to be made. Central banks in turn determine the conditions under which private parties may gain access to liquidity. In short, law shapes lending relations and determines access to public money and is linked to power in both its institutionalised (legal) and discretionary (extralegal) forms.

#### 1 Introduction

Outside the field of economics, it is widely recognised that markets are socially constituted. They are the product of social conventions and/or legal rules that govern the rights and obligations of individuals and organisations when they trade goods, services or capital. For no market is this truer than for financial markets as financial assets owe their very existence to the law. Every financial asset is an IOU that finds willing buyers only if they can be assured that the promise is enforceable. Their value is expressed in state-issued money, in dollars or euros for example, which is likewise the means in which payment typically has to be made. Central banks in turn determine the conditions under which private parties may gain access to liquidity. Not all state currencies play an equally central role as a unit of account for other financial assets. More importantly, no privately issued financial instruments (hereinafter "private money") ever serve as such on a sustained basis, notwithstanding the fact that they far outnumber stateissued money and promise much greater returns. The reason for this division of functions, I will argue in this paper, lies in the liquidity protection only (some) states can afford.

This paper builds on my previous work on the legal theory of finance (LTF)<sup>733</sup> as well as related literature explaining the interdependent relations of lending, liquidity, and the law. In this introductory section, I will summarise the core features of LTF and will introduce some core concepts

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<sup>&</sup>lt;sup>733</sup> Pistor (2013).

and their definitions. Subsequent sections will draw implications from LTF for the evolution of money systems.

#### 1.1 The legal theory of finance

LTF is a structural theory developed on the basis of an extensive and collaborative research project on the operation of financial markets, in particular of debt markets.<sup>734</sup> LTF holds (i) that contemporary financial systems are coded in law, which makes them eminently scalable, but also sets them up for (ii) the *Law and Finance Paradox* – the dual role of law as creator and potential destroyer of the financial system; (iii) that financial markets are neither private nor public, but essentially hybrid; and (iv) that when the financial system faces a major crisis, it can be rescued only by a public entity without a binding survival constraint: a sovereign or a central bank sponsored by one or more sovereigns. Important implications of this structural analysis are that financial systems are hierarchical<sup>735</sup> and that this hierarchy tends to be reinforced by financial crises, as seen when entities deemed critical for the survival of the system are protected against failure while actors on the periphery of the system are allowed to fail.

Many students of finance agree that law is an important ingredient for financial markets, including equity and debt markets. In particular, the voluminous empirical literature on law and finance has shown that better protection of investor rights, including shareholder and creditor rights, is associated with bigger and more liquid financial markets.<sup>736</sup> This literature. however, overlooks several critical dimensions of law's role in finance.737 First, both financial assets and intermediaries are creatures of the law of contract, property, collateral, trust, and corporate law. Public regulation imposes constraints on how these legal modules can be used to forge new assets and intermediaries. These regulations, however, can be, and often are, circumvented by the imaginative use of private law or legal arbitrage.738 Second, the desire to make financial assets scalable means that they have been cloaked in legal devices that make them prone to the Law and Finance Paradox: the use of credible legal commitments for scaling financial systems to size, on the downside, encapsulates the danger of a procyclical exercise of contractual rights (such as margin calls) that can bring the financial system to its knees.

Third, law governs more than just the relations among private parties to financial contracts. It also sets the conditions for accessing central bank liquidity, a critical source of liquidity when there are no longer private takers for assets. By establishing conditions for accessing central bank liquidity – at the discount window or through asset purchases – and by changing these conditions over time, central banks control the expansion and

<sup>&</sup>lt;sup>734</sup> Pistor (2013a) and Pistor (2013b).

<sup>735</sup> Mehrling (2012).

<sup>&</sup>lt;sup>736</sup> La Porta et al. (1998) and La Porta et al. (2008).

<sup>&</sup>lt;sup>737</sup> Pistor (2013b).

<sup>&</sup>lt;sup>738</sup> Pistor (2019)

contraction of liquidity.<sup>739</sup> Central banks also shape the financial system by incentivising certain types of assets that intermediaries will issue or hold at different times in the light of the liquidity premium they offer.

It follows that not only finance in general, but liquidity in particular, is coded in law: in the contractual commitments private parties make to each other, including collateral and margin calls, and in the conditions central banks establish for accessing liquidity in normal times, as well as in their capacity and willingness to render these rules elastic in times of crisis. Herein lies the paradoxical relation of law to finance: on the upside law can help scale financial systems, but it can bring them down as well. To avoid this outcome, law, at least selectively, has to be made elastic *ex post*, even if this undermines its ability to scale financial systems based on legal commitments alone.

Law's elasticity, as manifested in central bank (and governmental) emergency powers and ad hoc rescue strategies, reveals where power is located in the financial system: in the hands of those who declare an emergency and suspend the ordinary operation of legal rules. Private parties may not unilaterally alter their contracts and will be liable for breach if they rescind them without cause. Moreover, private parties have only limited capacity to provide relief in times of crisis. Unlike sovereigns, they are subject to a binding survival constraint: according to the ground rules of a competitive market economy, they must exit if they cannot balance their liabilities.

In contrast, true monetary sovereigns can expand liquidity without limitation. Exercising this power has deep distributional implications: some assets will receive a lower haircut than others and certain new assets will become central bank eligible, while others will not. It then follows that the ways in which central banks manage liquidity within established rules and render legal commitments elastic *ex post* by exercising discretionary power shape financial markets and determines winners and losers of this inherently unstable system.<sup>740</sup> Arguing that the ultimate power to declare an emergency lies with central banks is not the same as saying they have a choice in exercising it – especially when the alternative is the self-destruction of the financial system. Private actors don't wield emergency powers themselves, but they can force the hands of powerful public actors by creating put options they will find hard to refuse.

The purpose of this paper is to illuminate the interdependent relationship between private and public money. As we will see, within this framework it makes little sense to separate monetary policy from financial market regulation or government action, and even less to assume that there is such a thing as natural markets that government or central bank intervention might distort.

<sup>&</sup>lt;sup>739</sup> Pozsar (2014); Jobst and Ugolini (2016); Nyborg (2016); Bindseil, Corsi, Sahel and Visser (2017).

<sup>&</sup>lt;sup>740</sup> Minsky (1977).

#### 1.2 Concepts and definitions

Following Mehrling's "money view", I will use the shorthand money system to denote the interdependent system of private and public money, where private money stands for debt instruments issued by private parties that are denominated in public money, and public money for currencies issued by states. The term "money" is often reserved for state-issued currency that serves as the primary (if not only) means of payment, as a store of value and as a unit of account. These descriptive features of money are widely recited but rarely theorised. Recent advances in legal-institutional scholarship on money highlight the central role of the state, especially for the two latter features of money (store of value and unit of account). Indeed, these features can be explained only within the broader political economy framework of state power and its legitimacy.<sup>741</sup> Private money can be used as a means of payment in substitution for state money. Examples include scrip (or company issued coins) and cryptocurrencies, such as Bitcoin or Ether. In contrast, the store of value and unit of account functions are more difficult for private parties to substitute. The reason for this is that the value of privately issued notes fluctuates, not just with demand and supply, but with the money's credibility to retain its nominal value in economic downturns and during financial turbulences, which is a precondition for serving as a reliable store of value and unit of account. It is not difficult to see why this is the case. Private money issuers face a binding survival constraint, whereas states do not. In the last instance, this renders them incapable of backstopping their money in times of crisis. Knowing this, investors will head for the exit when they see the writing on the wall. In contrast, sovereign states can unilaterally pledge the future productivity of their economies, thereby ensuring their own survival, and back the money they issue.

Not all states are equally monetarily sovereign, however, and their pledges therefore are not equally credible. Only states that issue their own currencies and incur their own debt in that currency are true monetary sovereigns: they can create the money they need to pay their debt without having to rely on others.742 Compare this to states that relinquished their currencies and/or issue their debt in foreign currencies. They face the prospect of default. Unlike private entities, they may not be liquidated, but they can lose access to international lending markets and might face political opposition when resorting to austerity measures to make ends meet. The euro area occupies a special place in the landscape of moneys. The euro area Member States have delegated their monetary policies to an institution, the European Central Bank (ECB), which exercises monetary sovereignty on their behalf.<sup>743</sup> Unlike most national central banks, the ECB has, at times, behaved more like a private creditor than a sovereign money issuer, trying to discipline Member States by withholding liquidity rather than signalling unconditional support (and when it did, it got sued).

<sup>&</sup>lt;sup>741</sup> Sissoko (2019); Desan (2015); Ricks (2016); and Menand (2020).

<sup>&</sup>lt;sup>742</sup> Pistor (2017).

<sup>&</sup>lt;sup>743</sup> Kapadia (2013).

Private entities create money by lending. They simultaneously create a liability on behalf of the borrower and a claim against said borrower for repayment. In this way, they expand their balance sheet while ensuring that their assets match their liabilities. Lending is not only an accounting practice but also a legal relationship. The debt contract stipulates the conditions on which the creditor extends credit and the obligations the borrower accepts, including a payment schedule, interest rates, penalties and margin calls. To mitigate the borrower's default risk, creditors often require additional protection, such as a personal guarantee by a creditworthy third party, or collateral - an asset that serves as a backstop in the event that the debtor defaults on the loan. Repurchase contracts (repos) are the functional equivalent of collaterals, with the important difference that repos can be reused by the creditor to secure its own funding needs, a feature called "rehypothesisation".<sup>744</sup> The use of repos fuels credit expansion in good times, as there is seemingly infinite availability of good collateral, but will trigger liquidity shocks in times of distress when the holders of the collateral realise that rehypothesisation means that in fact they have only an unsecured claim against the debtor. When central banks issue money, they also book liabilities, but this does not mean that they lend or borrow on equal terms as private parties. Unlike private parties, they control the money supply and can always issue more money to match their liabilities. For central banks (or more generally for sovereigns) the balance sheet representation should therefore not be taken literally.745

Default risk is not the only risk that is associated with the practice of lending. Other risks include the possibility that interest rates might change or that financial markets deteriorate forcing creditors as well as debtors to rebalance their assets and liabilities. In addition, there is liquidity risk, which tends to be ignored in good times, but can make or break market participants, even entire markets - as was vividly demonstrated by the 2008 global financial crisis when liquidity risks quickly morphed into insolvency. Liquidity is often understood as the capacity to meet one's obligations as they become due. In this context, liquidity is distinguished from insolvency as the temporary, rather than lasting, inability to serve one's debt. In financial markets, liquidity is also the ability to realise the value of an asset by converting it into a safer one, preferably into stateissued money. Assets that can quickly be converted without loss in value are deemed liquid. Assets that cannot be easily sold or sold only at the price of a substantial haircut are illiquid. The only asset that is always liquid is state-issued money, which is why its investors try to convert private assets into state money in times of crisis.746

Law is the foundation for lending relations and the trading of financial assets at scale. Law is often defined as the formal rules of the game<sup>747</sup>, in contrast to informal rules that rely on social norms and practices. For the

<sup>744</sup> Sissoko (2019).

<sup>745</sup> Hellwig (2015).

<sup>&</sup>lt;sup>746</sup> Ricks (2016).

<sup>&</sup>lt;sup>747</sup> North (1990).

operation of financial markets, the form of the rules is arguably less important than whether they assure access to the coercive means of enforcement. Only rules that have already or are likely to be recognised by a legal authority as binding give legal certainty that the asset will in fact benefit from legal enforceability. Market practices, however, often ignore the fine print. The more parties are willing to accept and trade in legally innovative financial instruments, the more likely it is that others will follow. In the end, it is up to the courts (especially bankruptcy courts) to vindicate these practices or not. Yet, few courts dare to strike down contracts that are widely used and might be recognised as customary law. Thus, the greater the update of innovative financial instruments, the higher the probability that courts will sanction them as binding.

The prospect of legal enforceability helps mitigate the default risk, but it does not eliminate it. If the debtor does not have enough assets left to satisfy all borrowers, or if the value of the debtor's own assets deteriorates, having an enforceable claim is not worth much. The underlying weaknesses of assets – the legal uncertainty associated with novel instruments and the creeping default risk as markets turn – is widely ignored in good times, but comes into its own in the form of liquidity squeezes or even "sudden stops"<sup>748</sup> when markets decline.

#### 2 Money systems without limits

Money systems are the most expansive social systems. The amount of money, including physical money and checking and savings accounts, currently stands at USD 40 trillion, and if investments, derivatives, and cryptocurrencies are included, it has reached at least USD 1.3 quadrillion - and there is no end in sight.749 The 2008 crisis, and even more so the COVID-19 crisis, has demonstrated that trillions of dollars or euros in new money can be created by the stroke of a pen. This does not mean that they can expand forever. After all, social systems operate within a bounded biological system. Still, money's capacity to expand, even as investments stagnate and economic growth slows or declines (as during the COVID-19 pandemic), warrants explanation. The rapid expansion of domestic and global money systems could be ascribed to the skill and sophistication of market participants or to changes in technology, including information technology that lowered transaction and information costs and accelerated the pace of financial transactions, making it easier to hedge against or diversify risk through options and other derivatives. Instead, I attribute the growth of money to its intangible nature. Money owes its existence to law and as a social construct does not have built-in hard caps.

<sup>&</sup>lt;sup>748</sup> Claessens, Dell'Ariccia, Igan and Laeven (2010).

<sup>&</sup>lt;sup>749</sup> See RandRed, August 28, 2021, "How much money is there in the world?". By comparison, total global GDP is about USD 84 trillion (data available on www. statistica.com).

#### 2.1 Money made in law

The amount of private or public money that can be issued does not have a binding constraint – and never has. The ballooning of private money harkens back to the era of metallic standards for public money. Metal itself was, of course, rarely used in transactions for being physically too bulky. In its stead, promises to pay in gold or silver circulated – and the amounts pledged in this fashion soon exceeded the metallic reserves without affecting the peg. For 19th century England it has been shown that the total money supply increased from GBP 50 million to GBP 1264 million, or by 2528%, even as the peg held firm.<sup>750</sup> Of course, there is a danger of credit bubbles when private money exceeds some threshold, or inflation when public money exceeds some threshold, but nobody knows beforehand when these thresholds might be crossed. There is no reliable underlying theory for credit bubbles or inflation.

The private supply of money can be kept in check by reserve requirements or capital adequacy rules, but only up to a point, and only if all suppliers of private money are subject to the same rules. Absent this, the sky is the limit. Self-restraint worked perhaps when creditors risked their own equity - as the goldsmiths did in the early days of financial market development<sup>751</sup> - but weakened when they made bets on other people's money. The shift to corporations in banking in the 19th and in investment banking in the late 20th century has effectively eliminated this constraint. In addition, a new form of banking emerged over the course of the 20th century, which is sometimes dubbed "shadow banking", but might better be described as "parallel banking"<sup>752</sup>. Whereas, in the past, deposit taking, lending, and investing were in-house operations of organisations designated as banks, these activities now take place along a chain of legal transactions and are intermediated by actors that do not necessarily qualify as banks. A central feature of parallel banking is the reliance on financial assets as security in lieu of reserves held at central banks or deposits and deposit insurance as a liquidity guarantee for bank customers.753

Prior to the 2008 crisis, the argument that asset backing would be at least as safe, if not safer than conventional prudential banking practices might have had some merit. The crisis revealed, however, that private assets are only as safe as their ability to retain at least their nominal value in times of crisis, which they don't and can't for the reasons explained above.<sup>754</sup> In fact, Sissoko has shown that relative to banking, safeguarded by prudential regulations and practices, asset-backed financing is more, not less risky.<sup>755</sup> This, however, has not diminished its appeal. After a dramatic decline in shadow banking during the 2008 crisis, most markets have recovered and

<sup>&</sup>lt;sup>750</sup> Knafo (2006).

<sup>751</sup> Quinn (1994).

<sup>&</sup>lt;sup>752</sup> Pozsar, Adrian, Ashcraft and Boesky (2010); Mehrling, Pözsar, Sweeney and Neilson (2013).

<sup>&</sup>lt;sup>753</sup> Adrian and Shin (2009); Sissoko (2009); and Sissoko (2019).

<sup>&</sup>lt;sup>754</sup> Ricks (2016).

<sup>&</sup>lt;sup>755</sup> Sissoko (2019).

the practice of parallel banking has found new applications in the growth of collateral loan obligations and the restructuring of the finances of non-financial firms.<sup>756</sup>

The appeal of parallel banking is easy to see. Banks can and do create money out of thin air, but the amount of money they create is, more or less, contained by prudential regulation. Like conventional banking, parallel banking also creates money out of thin air. In the absence of regulatory constraints, however, the only limitation is the amount of assets that can be used as available collateral. This not a binding constraint because these assets can be produced through legal coding and, in the case of repos, be reused as well. Outside crises, there is not even a need to worry about demand, because the money business is sufficiently lucrative to render demand insatiable. The only constraint is credibility; when it evaporates, the market crashes – as it almost did in 2008.

#### 2.2 The legal foundations of private money

The ability of private actors to expand private money can be traced to the foundations of its legal structure, including the principle of private autonomy, the malleability of private law and the implicit, and at times explicit, guarantee by monetary authorities to back private money and protect its continuous creation, thereby socialising the risk of the public-private money system.

Private autonomy stands for the notion that private actors should be allowed to organise their affairs. It does not stand for a law-free zone. Rather, it assumes private actors' use of private law and facilitates their transactions in backing the promise of enforceability, as long as they do not intentionally violate the law. The concept of private autonomy is a product of legal theory and doctrine that places the individual and individual rationality at the centre of normative reasoning.<sup>757</sup> It assumes that actors will avail themselves of the collectivised means of coercion only for rational, or perhaps responsible, endeavours. The state furnishes the law and the coercive means of enforcement with minimal scrutiny of the ends for which these tools are mobilised.

In the context of money systems, private autonomy operates as a shield for private parties who use private law to expand the private money supply – even as this puts financial stability at risk. It creates a presumption in their favour, as long as the legislature does not authorise specific interventions to safeguard the public interest. This presumption even extends to legal strategies aimed at circumventing regulatory intervention. Outright violation of the law is not tolerated and might trigger enforcement actions against the violator. In contrast, taking advantage of ambiguities and gaps in the law is

<sup>&</sup>lt;sup>756</sup> Casey (2015).

<sup>&</sup>lt;sup>757</sup> Michaels and Jansen (2006); Menke (2015).

not only tolerated, but the shield of private autonomy actively encourages it.

If law was a set of unbending rules that were enforced by an independent umpire, the ability of private parties to expand the supply of private moneys would be rather limited. There would be little room for them to engage in legal innovation. Private law does not work like that. In this corner of the legal system, the players themselves rewrite the rules of the game. There is no umpire to continuously monitor the game, who might call a penalty when violations have occurred. Instead, it is left to the players to enforce the rules by threatening or actually filing a lawsuit; without their initiative, no umpire takes action. Of course, not all players have the resources to carefully monitor the game or call on the umpire to enforce the rules, which translates into a powerful first move advantage for players hoping to benefit from strategies that promise them gains.

Legal innovation can take different forms, including repurposing legal rules for different applications, pushing the boundaries of existing interpretations or blurring the boundaries between different legal institutions.<sup>758</sup> Blurring the line between contracts and property has been one of the most successful strategies for creating new financial assets from the cloth of existing law. Contract law is designed to leave most decisions in the hands of the parties to the contract - as long as they meet the basic requirements for an enforceable legal agreement. In contrast, property rights are, at least in theory, governed by the enumeration principle.759 Only interests that are explicitly recognised in law as a property right are supposed to enjoy third party effects against strangers who might not know of the right and yet will have to yield to it. The common law trust is one of the most ingenious institutions ever invented, because it allows an owner to transfer formal title over an asset to a trustee and the economic benefits to a beneficiary without complying with the formal requirements of property law, such as the need to physically transfer the asset or register title.<sup>760</sup> It only takes a deed that is drawn up by a solicitor in his own office and pulled out when claims against the asset in guestion are made. Not surprisingly, to this day the trust is the go-to legal device for shielding assets from tax authorities or from their (previous) owners' creditors, as in securitisation structures that have to be *bankruptcy remote* to achieve their financial ends.<sup>761</sup> Some legal scholars have pointed out that securitisation techniques with the purpose of circumventing mandatory bankruptcy law should have rendered these structures null and void.<sup>762</sup> Yet, nobody challenged them. On the contrary, lawyers did their best to modify other rules that stood in the way of using securitising techniques as the *alchemy* of shadow money.<sup>763</sup> The purpose of these legal strategies is to make contractual claims more money-like and thus fungible by adding legal protections that insulate the asset from too

<sup>&</sup>lt;sup>758</sup> Streeck and Thelen (2005); Hacker, Pierson and Thelen (2014).

<sup>&</sup>lt;sup>759</sup> Merrill and Smith (2000).

<sup>&</sup>lt;sup>760</sup> Cotterrell (1987); and Anderson (2010).

<sup>&</sup>lt;sup>761</sup> Levitin (2013).

<sup>&</sup>lt;sup>762</sup> Kettering (2008).

<sup>&</sup>lt;sup>763</sup> Schwarcz (1994); and Schwarcz (1999).

many different claimants. Earlier examples that followed similar patterns include the bill of exchange<sup>764</sup>, the legal treatment of bank deposits, the tradability of debt, the treatment of money market funds as deposit accounts and so forth. They show that private parties can fashion new interests that offer protection akin to property rights and thereby dilute the enumeration principle. Jongchul Kim has labelled this process "propertization".<sup>765</sup>

The capacity of private players to expand the private money supply with the help of the law lies at the heart of the history of banking, including parallel banking. Over time, the sophistication of private players and, of course their lawyers, has increased. Private parties themselves have little incentive to rein in these practices. For a while at least, most benefit from the expansion of credit: creditors because they can earn interest or make gains by trading or lending debt instruments, and borrowers because they benefit from low-cost access to credit.

All credit cycles, however, must come to an end eventually.<sup>766</sup> A rising number of defaults, a lower take-up or supply of new credit or growing difficulties to refinance existing debt are tell-tale signs of credit cycles slowing if not reversing. Left to itself, a contraction is likely to end in a financial crisis. Faced with this prospect, public officials will try to halt the downward trend by offering liquidity support to entities such as banks, money market funds and other systemic players (for example AIG), or, in the alternative, they put a floor underneath the private money by taking it onto their own balance sheet. They insert themselves as lender or dealer of last resort.<sup>767</sup>

The dynamic interrelation of private money creation and public backstopping is emblematic of the nature of the money systems that evolved in the West and that now dominate the globe. They are neither public nor private but essentially hybrid.768 In the public discourse about central banking this structural feature of money systems is largely still met with denial. Markets continue to be described as natural phenomena that exist outside the state, its laws and its monetary policies. It may very well be that money existed in distant history in purely private form sustained by communal trust relations, as the Austrians would have it. However, these markets would not have had the capacity to evolve into large anonymous markets. The recent development of cryptocurrencies is an interesting natural experiment about the fallacy of purely private money. As the valuation of Bitcoin, as expressed in dollar (the relevant unit of account), continues to rollercoaster, market participants in search of a store of value have turned to *stablecoins*. The reason for their relative stability is simple: they are backed, or at least pretend to be, by state-issued or state-backed

<sup>&</sup>lt;sup>764</sup> Rogers (1995).

<sup>&</sup>lt;sup>765</sup> Kim (2014).

<sup>&</sup>lt;sup>766</sup> Minsky (1986).

<sup>767</sup> Mehrling (2011).

<sup>&</sup>lt;sup>768</sup> Mehrling (2013).

assets, including Treasury bills, bank deposits or cash.<sup>769</sup> The US Securities and Exchange Commission recently forced the issuers of Tether, Circle and other stablecoins to disclose the composition of their reserves. It turned out that the composition did not match the representations that had been made to the public. Still, the fact that these companies alleged full backing by the dollar or dollar-like assets to attain stability proves the point.

#### 3 Central bank independence

The hybrid money system is sustained not only by private autonomy but also by central bank independence. They operate jointly to keep the government out of the money supply and its governance. At times, legislatures have sought to design independent banks that would operate as effective regulators of banks and, more generally, of the private money supply - as the US Congress did when it adopted the 1913 Federal Reserve Act, which established the US Federal Reserve System.<sup>770</sup> Yet. this design was ignored by central bankers who refashioned them along monetarist theories. Such mission creep is difficult to control given the insulation of central banks from political oversight. Whether independence should have ever been used to protect central banks from legislative control rather than from manipulations by the executive is, of course, another matter. In practice, central banks have sought to demonstrate the existence of sufficient distance between both branches of government to avoid their own politicisation. This leaves them with markets as the only guide. Not surprisingly, central bankers have had to buy into the myth of natural markets.

The extraordinary measures the leading central banks took in the global financial crisis of 2008, the decades that followed it and again during the COVID-19 crisis – all of which have gone hand in hand with the further rise of inequality – have raised concerns about the distributional effects of these policies. The governors of central banks have been grilled by legislatures, and the ECB has been sued for interventions in financial markets on the grounds that these violated its mandate and eroded the budgetary sovereignty of Member States (Germany).<sup>771</sup> So far, central banks have been able to protect their independence, but the creeping politicisation of their operation, at least in the perception of the public, is difficult to ignore.

Yue and Handagama, "What We Know – and Don't Know – About Stable Coins' Dollar Backing", August 10, 2021 (updated October 31), available on www.coindesk.com

<sup>770</sup> Menand (2021).

<sup>&</sup>lt;sup>771</sup> The German Federal Constitutional Court (*Bundesverfassungsgericht*, *BVerfG*) submitted a request for a preliminary ruling to the CJEU, which ruled in December of 2017 that the ECB had acted within its mandate. See Judgment of 11 December 2018, *Weiss and Others*, C-493/17, EU:C:2018:1000). The BVerfG in turn questioned this result, arguing that the CJEU had violated EU law by not requiring a careful proportionality analysis (Decision of 5 May 2020).

#### 3.1 A quixotic dance

In his seminal book *The New Lombard Street*<sup>772</sup>, Perry Mehrling uses the term "quixotic dance" to describe the Federal Reserve's attempt to mimic markets in the run up to the 2008 crisis. The dancers pretend that they operate in autonomous spheres, each with its own logic and purpose – monetary policy in the case of the Federal Reserve, and the efficient allocation of scarce resources in the case of markets. The Federal Reserve's targeted interventions were portrayed as unidirectional and selective, without affecting the natural movements of market participants. And yet, both parties necessarily dance to the same music and their steps reinforce one another.

The intellectual underpinning of the quixotic move is the cognitive separation of finance from money and of markets from law and the institutionalised levers of power. In a recent speech, Isabel Schnabel, Member of the Executive Board of the ECB, discussed the distributional effects of central bank policy – a sensitive issue that most central bankers have shied away from discussing in public.<sup>773</sup> Not surprisingly, she chose to stick to the schematic division of labour between government and central banks, law and monetary policy. And yet, this division of labour is at odds with how markets affect central banking (and vice versa), and how both affect the policy space for governments.

Most inequality, Schnabel suggests, can be attributed to structural forces, such as technological change, globalisation, the decline of workers' bargaining power or the inequities in educational systems, especially primary schooling. These issues, she argues, fall within the jurisdiction of policymakers and require fiscal, not monetary interventions.

Maintaining a division of labour between governments and central banking is, of course, important, if only to avoid further politicising central banks. Yet, the organisation of the money systems does affect these structural factors, and vice versa. As the American sociologist Greta Krippner has shown in the case of the US, since the late 1960s many critical social issues have been solved by financialising them.<sup>774</sup> The answer to the burning cities of the 1960s was not the provisioning of housing, but access to credit to buy a home - for lower income families and later even for middle income families with the backing of Government Sponsored Entities (GSEs).775 Securitising mortgages was the strategy by which to avoid outright state guarantees for housing, which Fannie Mae had done for the first several decades of its existence. Indeed, GSEs actively encouraged private sector participation, which since the 1980s had led to the privatisation of the securitisation market and diminished GSEs to funding these markets by buying senior tranches in private securitisation structures. Critically, as Krippner shows, the financialisation of social problems in this

<sup>772</sup> Mehrling (2021).

<sup>773</sup> Schnabel (2021)

<sup>774</sup> Krippner (2011).

<sup>775</sup> Hyman (2011).

fashion undermined the political capacity to solve social problems by other means. The debilitation of politics was unfortunate because financialisation proved to offer only short-term solutions while creating new problems by fuelling household indebtedness.

In short, while "mitigating the effects of these structural trends on inequality is the responsibility of elected governments"<sup>776</sup> is a statement that might make sense in theory, it fails to recognise how deeply these trends are intertwined with the evolution of money systems, including the role that central banks play in them. In addition, when they resort to financialised solutions, politicians relinquish critical policy tools by transferring monetary policies to independent central banks. Some have argued that this has pushed governments to adopt microeconomic solutions, which favour market-based solutions over social politics, further deepening inequality.<sup>777</sup> Market actors were encouraged to push for private solutions and to use private law mechanisms to this end – shielded from government intervention by a strong bias in favour of private autonomy.

Central bankers are not alone in the belief that structural problems are best left to governments; market actors share this belief, and both conveniently ignore the effects their actions have on the policy space left for governments. The fear of capital flight made possible by a borderless world for capital (though not for labour) keeps governments at bay and ensures that labour and debtor protections are kept in check.778 In fact, globalisation does not occur in a law-free, state-free or even central-bank-free sphere either. The conditions for globalisation are set in law.<sup>779</sup> For global capital markets to emerge, capital controls had to be lifted, which is another way of saying that laws were changed to allow private actors to invest financial capital, not only in real assets or production, but also in financial instruments. This in turn spurred the search for new choice of law rules, the mechanisms by which law is made portable, for these financial instruments.780 Further, regulators had to learn how to police actors and assets they were unfamiliar with, and central banks had to adapt their policies to global, not just domestic capital flows. Indeed, the attempt by the newly-appointed Federal Reserve chair, Paul Volcker, to rein in inflation by ratcheting up interest rates was muted by the Treasury's opening of borders to capital inflows.<sup>781</sup> Private money creation filled the gap left by public money creation. The East Asian financial crisis of 1997/98 offered the first warning shot for the capacity of private money flows to undermine monetary policy.782 Instead, the blame for this crisis was placed on emerging markets. They were deemed victims of crony capitalism and responsible for the failure to develop their institutions to cope with global capital flows. Only a decade later, a new financial crisis broke out, this time

<sup>776</sup> Schnabel (2021)

<sup>777</sup> Aklin, Kern and Negre (2021).

<sup>778</sup> Pepinsky (2014).

<sup>&</sup>lt;sup>779</sup> Chandrasekhar (2005).

<sup>&</sup>lt;sup>780</sup> Crawford (2003).

<sup>&</sup>lt;sup>781</sup> Krippner (2011).

<sup>782</sup> Jomo (2000).

in the US, the core of the global financial system and the model for the institutional reforms the International Monetary Fund (IMF) and others had imposed on emerging markets. A massive intervention by governments and central banks was needed to avoid the implosion of the global financial system.<sup>783</sup> The major beneficiaries of these interventions, however, were asset holders – the same actors that had previously benefited from the expansion of the private money supply. Alternative strategies that would have helped homeowners rather than banks were not even under discussion.<sup>784</sup> Such is the power of finance over politics and central banks.<sup>785</sup>

#### 3.2 A dealer of last resort

The most profound transformation of central banks since the 2008 crisis has been the normalisation of their role as dealers of last resort whenever financial markets catch a cold – quite a contrast to the reluctant lenders of last resort in earlier periods. This mimics the shift from traditional to parallel banking and the transformation of credit from banking to market-based systems. Consequently, central banks have become much more deeply entangled with financial markets. As the decade following the 2008 crisis has amply demonstrated, they have shied away from withdrawing liquidity support every time they confront a negative market reaction. Asset support has become a constant of monetary policy and asset holders have benefited from this change disproportionately.

Together with unusually low interest rates for decades on end, this has also contributed to the "assetization"<sup>786</sup> of new resources as investors want the cake and want to eat it too: high yields plus full liquidity support by central banks. The same techniques that had been used to securitise mortgages in the run-up to the 2008 crisis are now employed for rental housing and the securitisation of internal cash flows among non-financial firms. Against this background, the new research findings by the IMF and the ECB showing that "unconventional policy measures, such as asset purchases, are likely to have a significantly larger impact on house prices than changes in short-term policy rates" are not surprising.<sup>787</sup> The coding of new assets is where the money is and therefore the action must be.

Importantly, the blame for this money system, its distributional implications and inherent fragility, cannot be placed on the shoulders of central banks alone. Equally blameworthy are market participants: the suppliers of new private money. Legislatures, regulators, and courts have played along as well – another reason for doubts over whether they will take up the call for structural remedies. Legislatures not only endorsed the securitisation of mortgages, but also aided and abetted the privatisation of mortgage-

<sup>783</sup> Obstfeld, Shambaugh and Taylor (2009).

<sup>&</sup>lt;sup>784</sup> Hunsberger, Borras, Franco and Wang (2014).

<sup>785</sup> Summers (2014).

<sup>&</sup>lt;sup>786</sup> Birch and Muniesa (2020).

<sup>787</sup> Schnabel (2021)
backed securities markets and the extension of securitisation techniques to new asset classes. Indeed, they changed the tax code to ensure that securitisation structures were tax exempt<sup>788</sup> and created bankruptcy safe harbour status for an ever-expanding list of assets, which were exempted from the ordinary rules of bankruptcy law even as others continued to be bound by them<sup>789</sup>. Last, but not least, they deregulated financial markets, which made it easier for non-banks to enter, simultaneously reduced the regulatory costs for banks and, in the meanwhile, lifted long established legal guards against financial speculation – the principle that wagers were unenforceable.<sup>790</sup> The EU played along as well. Not wanting to be a bystander in the globalisation of finance, it listened to Boston Consulting Group and other advisors and adopted directives, such as the Financial Collateral Directive, that made the EU and its Member States fit for securitisation.<sup>791</sup> The ECB was regularly asked to comment on these regulatory moves, which it supported without exception or critiqued for not going far enough. As reactive law enforcers, courts had little to say as long as the market boomed and nobody litigated the new assets. Yet, even after the crash, few dared to raise fundamental legal questions about the legal coding strategies that had become standard in financial practice.792

The above analysis suggests that the separation of money and finance from the rest of the economy, and from law, hides features that are critical for understanding the dynamic interaction of these areas. Monetary policy does not stand above the legal and economic structures. Indeed it helps shape them, as does the action of private parties.

### 4 The political economy of money

Examining contemporary money systems through the lens of the law sheds light on the political economy of money and its governance. In contrast to modern finance and monetarist theories, money and finance are not separate but deeply intertwined and both affect the real economy as well as the scope of politics. Law provides the tools for public and private money creation, and for its governance. It is a social resource, the means by which complex social systems govern themselves. The use of law for social ends, however, has been dwarfed as private players are encouraged to employ the law towards expanding the supply of private money with the backing of the implicit, and in times of crisis quite explicit, backstopping capacity of central banks.

<sup>&</sup>lt;sup>788</sup> Borden and Reiss (2014).

<sup>&</sup>lt;sup>789</sup> Edwards and Morrison (2005).

<sup>&</sup>lt;sup>790</sup> Stout (2011).

<sup>&</sup>lt;sup>791</sup> Gullifer (2012).

<sup>792</sup> Braithwaite (2014).

# 4.1 Legal (bottom up) empowerment versus top-down regulation

Private law empowers. It has evolved to give private parties off the shelf privileges, such as legal personality, limited liability, priority rights or exemptions from otherwise mandatory law. In contrast, regulatory law constrains. Because it is freedom-constraining, it is designed to focus on specific activities or actors, creating ample legal arbitrage opportunities for the use of private law to circumvent regulatory constraints. The bottom-up empowering function of private law is widely viewed as sacrosanct – in part because few appreciate its power outside the field of law and in part because ideologically it may be more convenient to stick to the notion of natural markets and ignore law's contribution to the creation of private wealth.<sup>793</sup> In effect, this leaves the tools for legal arbitrage in the hands of these actors. Indeed, some regulatory goals might be better achieved by tinkering with private law or by reducing the legal certainty for private actors than relying exclusively on public, or regulatory, law.

Consider the use of the corporate form to shield shareholders and managers from liability. Until the second half of the 19th century banks operated as unincorporated organisations<sup>794</sup>, as did large investment banks in the US until the 1990s.<sup>795</sup> This exposed the partners of these entities to liability for their actions – the ordinary risk associated with any business undertaking, before it became common to shield some from liability, if not to end liability altogether.<sup>796</sup> Following the 2008 crisis, the Dodd Frank Act mandated entities to have *skin in the game*, that is, to hold some of the risky assets they issued on their own balance sheet. However, this is at best a weak simulation of the liability they would incur as partners and thus continued to protect their shareholders from recourse. More generally, the techniques for structured finance, the foundation of the parallel banking system, remained untouched and were quickly retooled to turn sticky assets liquid.

### 4.2 Banking on liquidity

In *The Code of Capital*<sup>797</sup> I show that capital is coded in law in legal modules, such as property, collateral, trust, corporate, bankruptcy and contract law, that afford the holders of capital superior protection relative to other claims. The main attributes of capital are priority, durability, convertibility and universality. Priority secures the holder of the relevant asset the right to enforce against an asset before anyone else can and universality ensures that this right operates not only against contractual parties, but against the world. Future cash flows are made durable by

<sup>&</sup>lt;sup>793</sup> Pistor (2019).

<sup>&</sup>lt;sup>794</sup> Tilly (1967).

<sup>&</sup>lt;sup>795</sup> Endlich (1999).

<sup>&</sup>lt;sup>796</sup> LoPucki (1996).

<sup>&</sup>lt;sup>797</sup> Pistor (2019).

shielding them against too many creditors (including tax authorities). Lastly, financial assets benefit from convertibility – the option to swap them against safer assets on demand. It is the way in which financial assets attain wealth protection. Convertibility can be built into contracts among private parties that give one party a put option to convert an asset into cash. Margin and collateral calls offer insurance in the event that asset prices decline below a previously agreed threshold. In addition, private actors may agree to roll over the debt of a counterparty, accepting their debt instruments for cash at a discount. Still, private actors can only offer so much. They have a binding survival constraint<sup>798</sup> and will stop converting the assets of others for cash once their own survival is on the line.

When this happens the next stop in the hierarchy of finance is the central bank. Unlike private counterparties, it has unlimited capacity to offer liquidity support - subject only to legal constraints on the types of assets it might accept in return for cash. Examples include the real bills doctrine under the original Federal Reserve Act of 1913, which the Federal Reserve observed to a fault in the early 1930s when it stood by as the financial system collapsed around it. In the European Union (EU), the Maastricht Treaty's prohibition on the ECB acquiring sovereign debt of euro area Member States, at least in primary markets, is another example - and has arquably helped deepen the euro crisis. Ben Bernanke. Chair of the Federal Reserve's board of governors during the 2008 crisis, vowed that this would not happen again under his leadership - and spearheaded the establishment of new liquidity facilities that reached well beyond the conventional remit of monetary policy.799 Similarly, ECB President Draghi pledged in the summer of 2012 to "do whatever it takes" to save the euro a promise he did not have to implement as markets took him at his word.

The legality of these moves, however, remained hotly contested and, at least in the case of the EU, were challenged in court. In the end, the Court of Justice of the European Union (CJEU) sanctioned the ECB's policies. It was pushed to adopt a tough line, however, because the German Constitutional Court threatened to disavow the CJEU's prerogative over the interpretation of EU law, including the law governing the ECB.

Legal constraints, it turns out, matter, at least in crises. When central banks make binding legal constraints elastic they may avoid a crisis. But they also, perhaps inadvertently, set the stage for market actors to bank on their liquidity support in the future as well – and so far, central banks have been unable to extract themselves from this expectation.

Central banks have raised expectations for liquidity support not only by their rescue actions. They have also adapted their policies to the changing structure of financial markets, as evidenced by collateral guidelines, the rules that central banks give themselves regarding the types of assets they are willing to accept in exchange for cash and on what conditions. Some central banks accept safe assets only, foremost among them sovereign

<sup>&</sup>lt;sup>798</sup> Minsky (1986).

<sup>&</sup>lt;sup>799</sup> Bernanke (2013).

debt (Treasury bills) or quasi-government debt (agency bonds). Safety in this context denotes the ability of the issuer to make good on a claim under all circumstances. The central banks of the United States, the United Kingdom and Canada, for example, have historically excluded private assets altogether<sup>800</sup>, a position they reversed only in the context of the 2008 crisis. In the countries that now belong to the euro area, Belgium and Luxembourg took a similar position. In these countries, only government securities and trade bills (private bills of exchange with effective guarantees by a chain of endorsers) were central bank eligible.<sup>801</sup>

The Maastricht Treaty ruled out this approach for the euro area for fear that relying on sovereign debt would provide a backdoor for financing fiscally compromised Member States. The ECB may not acquire sovereign debt in primary markets and, moreover, is tasked to treat private and sovereign assets on equal terms. Some prospective euro area Member States were more *liberal* than the safety-first countries mentioned above. The Dutch central bank, for example, accepted government securities, central bank certificates of deposit, certain private loans, bonds listed on the Amsterdam stock exchange (AMSX), equities listed on the AMSX and certain foreign government bonds. Similarly, the Austrian central bank accepted government securities, ponds listed on the Austrian stock exchange, gold, bills of exchange, promissory notes, foreign bills, foreign exchange as well as warehouse warrants.

The shift to a common currency under the rules established by the Maastricht Treaty required a compromise. Having no government security at its disposal, the ECB decided to employ collateralised private loans with short maturities to signal its monetary goals.<sup>802</sup> Over time, the ECB's collateral guidelines evolved into critical tools both to conduct monetary policy and to manage the elasticity of lending in private markets.<sup>803</sup> Not surprisingly, the ECB accepted a wide range of private assets as collateral in ordinary open market operations. To ensure that it would reach financial intermediation throughout the entire euro area, it also opened its doors to many more banks than other central banks. Whereas the US Federal Reserve transacts only with 21 primary dealers, over 1,700 banks have access to the ECB's regular tender operations and over 1,900 to its marginal lending facilities.<sup>804</sup>

This could not but have an impact on market structure and the behaviour of market actors.

As Cheun et al. put it, "[a]Il other things being equal, the larger the volume of central bank temporary operations relative to the size of the domestic government bond market, the greater the need to expand the eligibility of

<sup>&</sup>lt;sup>800</sup> Papadia and Välimäki (2011).

<sup>&</sup>lt;sup>801</sup> ibid.

<sup>&</sup>lt;sup>802</sup> Bindseil et al. (2017); Cheun, von Köppen-Mertes and Weller (2009).

<sup>&</sup>lt;sup>803</sup> Bindseil et al. (2017).

<sup>&</sup>lt;sup>804</sup> Bindseil et al. (2017), p. 19, Table 2.

collateral to private sector securities or non-marketable assets".<sup>805</sup> Put differently, the size of sovereign debt markets and the need for private collateral are inversely related. This had to have an impact on private markets, and it did.

The ECB's collateral framework was designed to accommodate different counterparties and situations. The first set of collateral guidelines, which have since been revised, was issued in 1999 and was sufficiently loose to allow national central banks (NCBs) to work gradually towards a more standardised framework. The ultimate goal was to gradually establish a single list of assets ranked by relative risk and to phase out assets that some central banks had used in the past but that should not be part of the ECB collateral framework in the long run. To this end, the 2004 guidelines distinguished between Tier-1 and Tier-2 collateral, where Tier-1 defines common collateral criteria and Tier-2 debt comprised debt that NCBs accepted at their own discretion.<sup>806</sup> Further, between 2005 and 2007, the ECB developed a single list of *marketable* assets that were deemed central bank eligible subject only to risk-adjusted *haircuts*. The two-tier system was finally phased out on 31 May 2008<sup>807</sup> – but soon afterwards replaced with a series of ad hoc decisions in response to the deepening financial crisis.

Market actors are, of course, not oblivious to what kinds of assets are deemed central bank eligible. The ability to convert assets on demand grants them the option to lock in past gains and provide a buffer against market downturns. Collateral guidelines thus have performative power<sup>806</sup> – they affect the structure of the market itself. There is little doubt, for example, that the ECB's equal treatment of different Members States' sovereign debt for the purpose of repos helped fuel market integration, but also exposed the European market to financial instability associated with the widespread use of private assets.

Market participants bank on liquidity. In good times, they may take liquidity for granted, but in times of distress they seek safety, which can come only from an issuer that is itself not subject to a binding survival constraint, i.e. from a state or its central bank.

### 5 Concluding comments

This paper has argued that lending and liquidity are both functions of and tied to each other by the law. This legal theory of finance has important

<sup>&</sup>lt;sup>805</sup> Cheun, von Köppen-Mertes and Weller (2009), p. 11.

<sup>&</sup>lt;sup>806</sup> See ECB (2004). Tier-1 assets comprised four asset categories with different haircuts applied to each: (central government debt and debt issued by central banks (Category 1); local and regional government debt, jumbo covered bonds (Pfandbriefe), agency and supra-national agency debt (Category 2); conventional covered bonds, bank bonds, corporate debt instruments (Category 3); and asset-backed securities (Category 4).

<sup>807</sup> Bindseil et al. (2017).

<sup>808</sup> Callon (2005) and MacKenzie (2006).

implications for analysing the scaling of financial markets as well as their vulnerability to crisis.

Lending is a risky undertaking because debtors may default or assets may decline in value, putting even debtors who seemed to be creditworthy at risk. Lending, however, can be "de-risked"<sup>809</sup>. As a general rule, safety is a one-sided quality. The same characteristics that make lending safe for the creditor, make it riskier for the debtor, and vice versa.<sup>810</sup> The way a legal system configures safety standards therefore invariably has distributional effects for the relative risks creditors and debtors face. The strengthening of creditor rights is often justified by arguing that protecting creditors lowers the cost of credit and that this also benefits debtors. But this is true only in good times; in bad times debtors tend to bear the brunt of the risk of lending.

For large scale debt markets, the relative strength of creditor and debtor rights might appear to be less of a problem because many financial intermediaries stand on both sides of lending relations. They borrow and lend and they also engage in lending and borrowing securities. This sounds like a wash, but in fact exposes these intermediaries to liquidity risks on both sides of their balance sheet. When markets turn their survival will be determined by their ability to access liquidity, and to do so quickly before the further deterioration of their asset value forces them into bankruptcy. Private counterparties might refinance the debt of financial intermediaries in distress – but only to a point. This leaves central banks as the liquidity provider of last resort.

Central banks have increasingly assumed the role of dealers of last resort in response to market needs, mostly without explicit statutory authorisation. They have used these powers primarily to protect entities and assets that were deemed central for the system's survival. Importantly, embracing the role of liquidity provider for private intermediaries is not neutral. It encourages intermediaries to structure assets so that they will benefit from liquidity support and thereby shift their risk from private actors to the public.

The bottom line is that money systems do not operate outside the law or independent of central banks. Private and public money are hybrids. Market expansion depends on the availability of liquidity support, which for reasons discussed, is necessarily public. As a result, enormous social resources – public money and private law – are devoted to the creation of private wealth, which is highly unevenly distributed.

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<sup>809</sup> Gabor (2021).

<sup>&</sup>lt;sup>810</sup> Sissoko (2019).

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# Reconsidering the EU's economic ideas on markets and law: towards greater effectiveness, accountability and democracy

By Vivien A. Schmidt\*

Since the COVID-19 crisis, the economic governance of the European Union (EU) has radically shifted course as a result of the ECB's massive increase in expansionary monetary policy, the Commission's suspension of the debt and deficit rules, the Council's agreement to shared debt through the Resilience and Recovery Fund, and the new European Semester focus on the green transition, the digital transformation and addressing social inequality. These changes effectively challenge longstanding ideas regarding how to govern the EU economy that are institutionally embedded in the Treaties and the laws of the EU. The most important question today is whether these changes will be lasting and involve a new set of guiding principles, or will merely constitute a temporary hiatus, with a return to pre-pandemic ideas and policies to be expected.

In order to answer this question about the future, we first need to return to the past to analyse the ideas underpinning EU economic governance. This requires consideration of how the deep-seated neo (and ordo) liberal philosophies embedded in discourses about the law (regarding the role of the state or public regulatory authorities) and its relationship with markets (related to the nature of capitalism) have affected EU institutions and legal practices, in particular central banking regulation and euro area fiscal policies and oversight procedures, as well as Member State political economies.

I argue that neoliberal ideas, as present in both ordoliberal discourses about monetary policy focused on stability and inflation-targeting and neoliberal discourses centred on a one-size-fits-all model of market economy, have failed to take into account the realities of Europe's very different varieties of capitalism, and would have benefited from better adapted, fine-tuned regulatory approaches. In this sense, the law as shaped by idealised views of how markets should work has effectively been imposed on "real" markets, to their detriment. Because the philosophical ideals underpinning these ordo and neoliberal discourses were constitutionalised in the EU Treaties and institutionalised in everyday rules, they imposed constraints on what EU actors could do even when confronted with deteriorating economic performance and rising citizen discontent, in particular during the euro area crisis. Indeed, the austerity

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and structural reform policies followed during that crisis only exacerbated existing problems for all countries, but especially those under conditionality. The obsession with "governing by rules and ruling by numbers", focused on low deficit and debts, meant that the EU suffered from slow growth, increasing economic divergences, and increased inequality and poverty. It is therefore not surprising that politics in response became increasingly Eurosceptic and volatile, with citizens' loss of trust and confidence in EU and national authorities reflected in the frequent turnover of incumbent governments and the rise of populist anti-system parties and movements (Schmidt 2020a).

Moreover, even though EU actors' actual practices departed more and more from discursive ordo/neoliberal ideals after the acute phase of the crisis, as they reinterpreted the rules to achieve better outcomes, little was done to resolve the continuing economic vulnerabilities of the euro area, let alone address the looming crises related to climate change and rising inequalities. Things changed only with the onset of the COVID-19 pandemic.

The EU's responses to the COVID-19 crisis have put a pause on neoliberalism, as new ideas centred on the green transition, the digital transformation, and addressing inequality, with a new role for the state in industrial strategy, appear to have sidelined the neoliberal agenda for the moment. The general recognition that the markets could not be counted on to respond to the challenges of the 21st century has revealed the flaws underlying the ordo/neoliberal orthodoxies, and the multilevel need for public authorities (the law) to guide the markets via public investment and industrial strategies better adapted to the different varieties of capitalism being practised in the various Member States.

However, it is by no means a certainty that these new ideas, focusing on sustainable and equitable development, have become the new liberal economic script, displacing neoliberalism. The problems not only come from divisions among key policymakers on what to do going forward but also from the rise of populism as a democratic backlash against the socioeconomic, sociocultural and political impact of neoliberal reforms.

The question is whether this will be a temporary response or a more permanent shift. Once the pandemic subsides, will the EU return to the status quo ante in which constitutionalised and institutionalised ordo/ neoliberal ideals return (the markets) to prominence, constraining public authorities (the law)? Or will the new goals of greening the economy, digitalising communities, and addressing inequalities given public authorities (the law) a continuing and more active role in guiding the future of the economy (the markets)? And in this context, could the EU find a way to democratise and decentralise its governance processes so as to combat populism while enabling the EU's many different varieties of capitalism to flourish through more bottom-up macroeconomic governance and industrial strategies?

This paper begins by examining the resilience of ordoliberal and neoliberal ideas with regard to euro area governance over time (law), then considers the impact of such ideas on European economies (markets) and democracy, in particular with regard to the populist democratic backlash. This is followed by discussion of the changes resulting from the COVID-19 response and pathways forward for the democratisation of the EU's economic governance that could ensure greater legitimacy.

### 1 Neoliberal ideas about how the state (law) should regulate markets in the context of European economic governance

Democratic capitalism has undergone dramatic changes since the late 1970s, when the post-war neo-Keynesian settlement in advanced industrialised democracies slowly began to be dismantled by policymakers who had adopted a new economic philosophy loosely called "neoliberalism" (see, e.g., Harvey 2005; Miroski and Plehwe 2009; Peck 2010). Neoliberal economic ideas focused on freeing the markets from active state interventionism had been circulating since the 1930s, but had remained largely marginalised throughout the post-war period (with the exception of German ordoliberalism), until they came to prominence during the economic crisis of the 1970s, to become the predominant guiding economic philosophy from the 1980s almost to this day. Since then, neoliberalism has been amazingly resilient over time, with its core ideas highly adaptable and mutable, seemingly able to bounce back regardless of its failures, winning in debates against all alternatives as it served the interests of the powerful while being embedded in institutional rules (Schmidt and Thatcher 2013a). That resilience can be seen in the ways in which neoliberalism itself has evolved, first taking hold at national level with the conservative "roll-back" of the state to free up markets, followed by the social democratic "roll-out" of the state to enhance markets, culminating with the "ramp-up" of state-like capacities in the international arena and the EU (Peck 2010; Schmidt and Woll 2013).

### 1.1 Defining neoliberalism

Neoliberalism refers to a core set of ideas about markets and the state's role, and accordingly encompasses views on the ideal way to govern not only the economy but also the polity. Generally defined, neoliberals believe that markets should be as "free" as possible, meaning that they are governed by competition and open across borders, while the state should play a limited political economic role in creating and preserving the institutional framework that secures property rights, guarantees competition and promotes free trade. The watchwords for neoliberalism have been liberalisation, privatisation, deregulation and delegation to non-majoritarian institutions such as "independent" regulatory agencies and central banks, plus individual responsibility, competition and enterprise, backed up by a pro-market, limited state that promotes labour market flexibility and seeks

to reduce welfare dependence while marketising the provision of public goods (Schmidt and Thatcher 2013, pp. 4-6).

Two different strands of neoliberal thought come under this general definition of neoliberalism. The first strand was inspired by thinkers like Friedrich von Hayek (1944) and Milton Friedman (1962) and came to the fore following the oil shocks of the 1970s and the perceived failure of neo-Keynesianism to solve the ensuing economic crises. It was first taken up and popularised by conservative leaders like Thatcher and Reagan in the 1980s. The second strand is known as ordoliberalism, which is a subset of the more general category of neoliberalism, and embraces a more active, rules-based state, with greater social obligations. This strand was largely developed in Germany in the 1930s by thinkers like Walter Eucken and the Freiburg School, and took hold in the 1950s in Germany through the "stability culture" of macroeconomic policy (even though it was combined in that country with social democratic elements to constitute the "social market economy") (Foucault 2004; Ptak 2009; Gamble 2013; Howarth and Rommerskirchen 2013). It later migrated to the EU, coming to dominate monetary policy largely because ordoliberalism was baked into the rules of European Economic and Monetary Union.

Neoliberalism is not just a philosophy of political economy, however; it is also a philosophy of political democracy and the role of the state. It conceives of the polity as made up of the individual first, the community second, with legitimate state action being very limited with regard to community-based demands on the individual. Because neoliberalism places individual freedom ahead of anything else, it sees state intervention as imposing collective judgments on individuals' freedom to choose (see, e.g., Harvey 2005; Gamble 2013). This has, however, led to a selfcontradictory guandary, since while its central message is to have "less state", its limiting of state intervention means that it requires "more state", and a strong state at that, in order to accomplish its goals (Schmidt and Woll 2013). But whatever neoliberalism's philosophical guandaries related to the role of the state in the markets, neoliberal ideas have remained resilient over time as they have increasingly driven the move towards bringing in more and more state (law) to liberalise the European economy (market).

# 1.2 The resilience of neoliberal ideas from the 1970s to the 2000s

Neoliberal ideas focused on freeing the markets from active state intervention came to the fore after the 1970s, with the perceived failure of neo-Keynesianism to solve the economic crises brought on by the end of the Bretton Woods system of exchange rates fixed to the dollar and by the two oil shocks. With the exception of Germany, where neoliberalism was introduced in the 1950s in an ordoliberal compromise with social democracy, neoliberal ideas began in the early 1980s with a highly ideological "roll-back" of the state by conservative governments intent on making the markets as free as possible from state regulation. But they did it differently, given differences in national varieties of capitalism and the relative strength of political opposition.

The UK was the pathbreaker. Prime Minister Margaret Thatcher pushed through her neoliberal agenda guoting Havek as she insisted that the free market would not only release the "spirit of enterprise" but also that it would guarantee liberty; that the welfare state was an encroachment on individual liberty, while government attempts to reduce inequalities created a dependency culture; and that public services should in the main be taken into the private sector, with what remained subject to competition (Tribe 2009; Schmidt 2000, 2002, pp. 260-261). Other countries, followed suit, including the Netherlands, where Prime Minister Ruud Lubbers managed to extract agreements to increase labour market flexibility while giving capital a greater share of profits by threatening that the government "is here to govern" with or without its social partners. Furthermore, in the Netherlands the government dovetailed neoliberal policy ideas with pre-existing social democratic arrangements, while emphasising that it had to "cut the welfare state in order to save it" (Schmidt 2000, 2003). France under Mitterrand, in contrast, initially took an alternative route, with a socialist policy programme involving expansionary neo-Keynesian macroeconomic policy along with massive nationalisation and industrial restructuring plus a more generous welfare state. This was short-lived, however, as Mitterrand made the "great U-turn" to budgetary austerity while talking of the "modernisation" of the French economy, followed by major privatisations beginning under Prime Minister Chirac (Schmidt 1996: Gualmini and Schmidt 2013a).

From the early 1990s onwards, moreover, all the Central and Eastern European Countries (CEECs) undertook radical reforms to shift their national economies from a communist approach to that of neoliberal capitalism, albeit with significant differences among countries (Lane and Myant 2007). The architect of Poland's radical "shock therapy", Leszek Balcerowicz, was an ideological entrepreneur of the purest kind. But although Vaclav Klaus of Czechoslovakia was similarly ideological, he did not engineer the same kind of rapid, radical liberalisation (Frye 2010). Only Germany during this same time period did little with regard to neoliberal reform because it had little need for adjustment, having followed ordoliberal monetary policy and instituted austerity policies to which the social partners had adapted after a brief interlude in the 1970s (Scharpf 2000).

While the rhetoric of all such neoliberal governments in the 1980s maintained that the state would be best replaced by the efficiency, rigour and discipline of the free market, the reality was that their initiatives produced all manner of inefficiencies and problems. In a second step, to solve these problems, neoliberal governments moved from seeing the state as its main target of attack, to be rolled back by getting the state out of the markets, to seeing it as their primary tool of attack and to be rolled out to enhance the markets.

Starting in the mid to late 1990s, this renewal of neoliberalism was the brainchild of more pragmatic social democratic leaders. In the UK, Prime Minister Tony Blair's "New Labour" sought to create a "third way" that

adopted many of the fundamental premises of Thatcherite neoliberalism while insisting that this incorporated the main goals of social democracy. This involved, for example, completing Thatcher's "revolution" with regard to the welfare state through reforms such as workfare on the grounds that it would create equal opportunities, by making welfare "not a hammock but a trampoline", not a "hand out but a hand up" (Schmidt 2002, p. 269). The dovetailing of social democratic ideas with neoliberalism also came to France with Prime Minister Jospin, who avoided neoliberal discourse as he pledged that the Socialists' reforms were not just economically efficient but also promoted social equity, and that privatisation sought to secure investment as well as guarantee jobs while involving the unions in negotiation (Schmidt 2002). In Germany, neoliberal roll-out accompanied by social democratic flair came later than in France or the UK, with Chancellor Gerhard Schröder waiting until the recommendations of the Hartz IV Commission in the early to mid-2000s to implement changes to the labour markets and the pension system, despite plummeting popularity ratings and public discontent. In Italy in the 1990s, moreover, the pragmatic technocratic leadership of Prime Ministers Amato, Ciampi, and Dini, along with that of the social democrat Prodi, promoted neoliberal ideas that emphasised the necessity of privatisation and pension cuts in view of the crisis and to enable the country to join the euro, while arguing for its appropriateness in terms of national pride (Gualmini and Schmidt 2013b).

By the late 1990s, neoliberal ideas also gained increasing traction at international level, with the "Washington Consensus", as well as at EU level, as technocratic actors ramped up their supranational state-like activities while pushing for the rolling back of national state activity to free up the markets. And this only intensified with the financial crisis when, after an initial burst of neo-Keynesian stimulus, international organisations like the IMF and the EU ramped up neoliberalism in response to the financial crisis and then the euro area crisis, with austerity and structural reforms the watchwords (Blyth 2013; Clift 2018; Schmidt 2020a).

#### 1.3 The resilience of neoliberal ideas in the euro area crisis

At the onset of the euro area crisis, ordo and neoliberalism remained resilient. Rather than adopting bold new ideas that would have resolved the crisis quickly, EU actors doubled down on the rules, claiming that moral hazard was the main danger and austerity the answer, and imposing harsh austerity conditions and structural reform on countries in trouble. Because the crisis was framed as resulting from public profligacy (based on Greece) rather than private excess (the case of all other countries forced to bail out their banks), the causes were diagnosed as behavioural (Member States not following the rules) rather than structural (linked to the euro's design) (Schmidt 2020a, Chapter 9). In consequence, EU leaders saw little need initially to fix the euro or to moderate the effects of the crisis. Instead, they chose to reinforce the rules enshrined in the treaties, based on convergence criteria toward low deficits, debt, and inflation rates. And they agreed to provide loan bailouts for countries under market pressure in exchange for rapid fiscal consolidation and structural reforms focused on

deregulating labour markets and cutting social welfare costs. Moreover, they brought in the IMF which, having softened its approach for advanced industrialised countries, now found the Washington consensus reimposed by the EU (Lütz and Kranke 2014), first for the CEECs following the 2008 crisis (when the Commission was a junior partner in the bailouts), and then for euro area Member States in the sovereign debt crisis (as part of the Troika) (Clift 2018).

These measures did little to solve the underlying problems, as country after country attacked by the markets entered conditionality programmes: after Greece came Ireland, then Portugal, and even later Cyprus. By July 2012, however, once the markets went after Spain and Italy, two countries that were too big to bail out, the ECB finally threw down the gauntlet with ECB President Draghi's famous pledge to "do whatever it takes" to save the euro. This stopped market attacks dead in their tracks. And as the crisis slowed, European leaders and officials began to change euro area governance slowly and incrementally. They did this by reinterpreting the rules and recalibrating the numbers, albeit mainly by stealth, without admitting it publicly or even, often, to one another (Schmidt 2020). The Commission became more and more flexible in its application of the rules in the European Semester (as evidenced, for example in the derogations provided for Italy and France based on their having primary surpluses). despite continuing its harsh discourse focused on austerity and structural reform. The ECB in the meantime reinterpreted its mandate more and more expansively, even as it hid the truth in plain view as it claimed to remain true to its Charter, deploying guantitative easing (QE) by 2015, and coming ever closer to becoming a lender of last resort. Finally, the Council also began to change its tune. Along with innovative instruments of deeper integration such as the Banking Union and the European Stability Mechanism came acceptance in the Council of the need for growth "and stability" by 2012; for flexibility "within the stability rules" by 2014; and for investment in 2015.

In other words, in recognition of the problems caused by the reinforcement of neoliberal rules (law) to EU Member States' economies (market), EU actors informally and tacitly loosened those rules. But in so doing, these actors generated significant contestation regarding their legitimacy, as ordoliberals in particular accused others of a lack of accountability (procedural legitimacy), by exceeding their mandates or not doing their jobs. The decisive factors regarding legitimacy can be seen in the practices that were followed: whereas the Council and Commission slowly rolled back their restrictive reinforcement of the Stability and Growth Pact (SGP) rules, suggesting that they themselves recognised their lack of policy effectiveness (output legitimacy) and their deleterious political consequences (input legitimacy), the ECB normalised its expansionary monetary policies because they were both effective and generally politically accepted (Schmidt 2021).

Things got better as a result. But fundamental flaws persisted, with suboptimal rules hampering economic growth and feeding populism, as citizens punished mainstream parties while anti-system parties prospered.

### 2 The impact of neoliberal policy ideas (law) on European political economy (markets)

These resilient neoliberal ideas have informed the transformation of capitalist markets as states liberalised finance, deregulated business. weakened labour, marketised public services, and rationalised welfare states. They drove globalisation, as capital mobility grew while manufacturing moved offshore and labour markets dualised, split between high paying jobs in financial services and low paid, low skill jobs in low-end services, which were often temporary or part-time (Emmeneger et al. 2021; Howell and Baccaro 2017). They promoted Europeanisation, as the single market and the single currency reduced states' room for manoeuvre in macroeconomic policy through the low deficit and debt rules of the SGP, and in microeconomic policy through state aid and competition policy. Moreover, welfare states were rationalised through cuts in social assistance and means-testing of benefits and reformed through "welfare to work" programmes and labour market activation policies (Hermerijck 2013). At the same time, taxes were reduced and made less progressive, leading to the skyrocketing of inequality, with the top 1% holding an increasingly large proportion of overall wealth (Piketty 2014). And the model of the state that spurred all these transformations itself changed, moving from the post-war administrative state that played an active role in managing capitalism to the "regulatory state" (Majone 1997) that played an active role in creating freer markets along with more rules (Vogel 1996, 2018).

In this context, post-war national varieties of capitalism which, despite maintaining distinctive characteristics in terms of business conduct, labour relations and state action, were nonetheless transformed through the "translation" of the neoliberal script into national practices (Schmidt 2002, 2009; Ban 2016; Vail 2018). Post-war liberal market economies, in which capital came from the financial markets, business practices were competitive and contractual, labour relations fragmented and the government's role hands-off (mainly in the Anglosphere), became radically more liberal (Hall and Soskice 2001; King and Wood 1999; Schmidt 2002). Post-war coordinated market economies, characterised by strong labourmanagement coordination, cooperative firm-based interactions and bank-based financing, all facilitated by an "enabling" state (mainly in Northern Europe), also liberalised, albeit more slowly, while maintaining their basic profiles (Hall and Soskice 2001; Streeck 1997; Schmidt 2002; Vail 2018). Post-war state-influenced market economies characterised by an "interventionist" state organising inter-firm collaboration, directing business investment, and imposing management/labour cooperation (mainly France and Southern Europe) reversed course. The interventionist post-war *dirigiste* state became a pale shadow of its former self, leaving the state less able to enhance markets (especially France) while still able to hinder them (e.g. Italy and Greece) (Schmidt 1996, 2002, 2009; Gualmini and Schmidt 2013a; Vail 2018). Finally, a "fourth" variety of market capitalism emerged in the CEECs after the fall of the Berlin Wall: "dependent market economies" largely driven by outside forces, mainly capital coming from global as much as European sources (Nölke and

Vliegenthart 2009), although we could add to this regulation coming from the EU, despite significant differences between these countries along the lines of liberal or coordinated market economies (Drahokoupil and Myant 2010; Bohle and Greskovits 2012).

The financial crisis of 2008 and the sovereign debt crisis of 2010 only intensified these differences. While the financial crisis largely affected the CEECs, sending them to the IMF for a bailout (with the EU a junior partner), the euro area crisis impacted all EU Member States, as austerity became the watchword for all (Blyth 2013), along with rapid fiscal consolidation and "structural reforms" concentrating on crushing labour unions and cutting the welfare state for countries at risk of violating the rules (Schmidt 2020). The focus on labour market reform, in particular, was based on the neoliberal belief that labour market "rigidities" had contributed to countries' lack of competitiveness and failure to recover quickly after the crisis, thus ignoring the structural issues relating to the euro and the sudden brake placed on market finance. Equally importantly, the neoliberal assumption that all national political economies required the same remedies imposed special burdens on countries that differed from the ideal.

That ideal, focused on export-oriented, manufacturing-based growth, requires organised labour markets and other institutions able to repress wages and hold down domestic demand, which fits the coordinated market economies of Northern Europe perfectly. It did not fit as well for countries with either liberal market economies or state-influenced market economies, because they tended to have less organised labour markets and to be more reliant on demand-led growth (based on allowing wages and credit to expand to fuel consumption) (Baccaro and Pontusson 2016; Iversen and Soskice 2018). The coordinated market economy ideal embedded in the SGP rules certainly negatively affected countries which also had strong export sectors (e.g. France and Italy, which were losing market share to Germany in large part because of the latter's price edge on exports, due to its wage restraint). But it was even worse for Southern European Member States that lacked strong export sectors, since they were unable to offset the worst effects of austerity and wage devaluation on domestic demand, and thus found it difficult to generate growth (Baccaro and Pontusson 2016; Schmidt 2020, pp. 250-254). The problems experienced by countries under conditionality, such as Spain and Portugal, were added to by the structural reforms imposed, which radically decentralised labour markets (Perez and Matsanganis 2018). Pushing for more flexible labour markets without considering the overall industrial landscape of the country in guestion left those Member States subject to structural reform diktats at a disadvantage with regard to competition with Northern Europe and vulnerable to competition from developing countries with lower wage levels and potentially more highly skilled workers (Storm and Naastepad 2015; Schmidt 2020, p. 253). Euro area deficit and debt requirements that served to limit state investment and macroeconomic stabilisation capabilities also led to an even greater reduction in the state's role. This has been particularly problematic for state-influenced market economies such as France and Italy where the state has traditionally served as an engine for growth (via planning or investment). In these countries, given the fiscal

restraints, governments were also unable to invest (or even had to make cuts) in growth-enhancing areas, such as education and training, infrastructure, renewable energy and research and development (Schmidt 2020, pp. 251-252).

Finally, the general effects on all EU political economies of the ordoliberal obsession with low deficits and debt must be considered along with the differential impact on national varieties of capitalism, as countries that lacked "fiscal space" (read Southern European Member States) could not invest while those that had "fiscal space" did not (Northern European Member States). The lack of investment in physical, digital and social infrastructure contributed to the appearance of crumbling bridges and flooded plains even before the pandemic, while doing little to address climate change or the digital divides.

### 3 The democratic backlash against the impact of neoliberal transformations

These neoliberal transformations of national political economies have had a major impact on the socioeconomic, sociocultural, and political concerns of citizens. And these concerns have in turn contributed to the democratic backlash generally known as "populism" (see, e.g., Müller 2016; Mansbridge and Macedo 2019; Urbinati 2019; Pappas 2019). This is what Wendy Brown (2018, pp. 61-62) has termed neoliberalism's "Frankenstein", as the "logics and effect of neoliberal reason", which "economizes every sphere and human endeavor", have contributed to the populist revolt.

Certainly, a major source of the democratic backlash is socioeconomic (Rodrik 2018). The structural forces of neoliberal globalisation and Europeanisation have created a wide range of "losers" in deindustrialised areas, with a "race to the bottom" for lower skilled groups and rising insecurity for blue collar workers who lost good jobs to automation and offshoring (Hopkin 2020, chapter 2). Neoliberal institutions and policies have also driven the rise of inequality and poverty due to regressive taxation plans and cost cutting of the welfare state, including lower pensions and less life security (Hemerijck 2013).

These socioeconomic issues are themselves closely linked to sociocultural ones, as worries about loss of jobs combine with fears of loss of status (Gidron and Hall 2017; Hopkin 2020). Such fears have often morphed into concerns about migration, in particular by once-predominant sectors of the population who increasingly see increasing flows of immigrants and local demographic decline as challenges to national identity and sovereignty (Berezin 2009). These are often the very same people who are troubled by intergenerational shifts to post-materialist values such as cosmopolitanism and multiculturalism (Norris and Inglehart 2019). Additionally, they may favour a generous welfare state, but only for "their own", engendering a form of welfare chauvinism (Afonso and Rennwald 2018).

The democratic backlash is also political, and not just because the socioeconomic and sociocultural discontents find expression in loss of trust in political institutions. It stems equally from the failure of mainstream parties and political institutions to respond to economic and social discontents (Berman 2021). Party politics itself is partially to blame for the problem, going all the way back to the 1960s, as parties slowly moved away from being mass parties towards being cartel parties while increasingly losing direct connections with voters (Hopkin 2020). But citizens' rejection of technocracy, which has increasingly encroached on all aspects of "the political", by taking more and more issues outside the realm of political debate and decision-making, constitutes a crucial added element (Flinders and Wood 2014). Concern over the hollowing out of democracy at the hands of transnational bureaucrats is a particularly relevant issue in the EU, where multi-level governance puts great strain on Member State democracies (Schmidt 2006; Mair 2013).

This, in short, is the milieu in which populist anti-system messengers circulate their anti-elite, anti-liberal (political as well as economic) messages via the medium of social and traditional media in ways that got them votes, seats in parliament and, in some cases, governing power (Schmidt, forthcoming). And with the genie now out of the bottle, the question is whether it can be put back in, even if there were to be a lasting shift away from neoliberalism. To achieve this, the EU needs to build back legitimacy not only through more effective economic policies leading to better performance (output legitimacy) with better procedural accountability, transparency, inclusiveness and openness (throughput legitimacy) via more decentralised and democratised interactions (Schmidt 2020a).

# 4 What next? How to improve EU economic governance

Only in 2020 was there a major reversal in the neoliberal script, as the EU responded to the COVID-19 health pandemic in ways that represent a promising beginning with regard to tackling some of the EU's most pressing problems. After initial hesitation, it seemed that the EU had learned the lessons of the euro area crisis by responding much more proactively to the COVID-19 crisis. Suspension of the SGP rules and numerical targets was accompanied by massive national bailouts and the creation at EU level of an unprecedented European recovery fund focused on greening economies, digitalising societies, and addressing inequalities. Legitimacy, so much at risk during the euro area crisis, as evidenced by the poor political economic outcomes, the questionable quality of the governance, and the populist revolt, seems to have improved as a result of this new EU-level solidarity. But will it last?

To ensure a brighter future for the European economy, much more needs to be done. The EU needs to rethink European economic governance beyond the old neoliberal ideas, to repair the damage wrought by euro crisis management. New ideas call for an enhanced role both for EU and Member State bodies as public entrepreneurs to promote growth and provide investment to meet the challenges of the green transition and the digital transformation while ensuring greater social equity. However, this cannot be done solely as a technocratic fix, nor as a top-down process, even though both the Commission and the ECB have significant roles to play. Such decision-making needs to be both decentralised and democratised, with more bottom-up involvement of social partners and citizens at local, national, as well as EU levels, and greater roles for both national parliaments and the European Parliament (EP).

### 4.1 ECB monetary policy and macroeconomic coordination

There are many new ideas about what the ECB could do to further enhance the EU's economic prospects through its role in monetary policy and macroeconomic coordination. In the pandemic, it has already gone very far through its pandemic emergency purchase programme, but many more initiatives are possible, most of which are currently under discussion. Foremost among these would be for the ECB to move from an almost exclusive focus on the primary objectives set out in its Charter to the secondary objectives. This could mean giving itself a target of full employment on a par with fighting inflation; ending "neutral" bond-buying (meaning bringing to an end the buying the bonds of polluting industries); creating green bonds for the environment; or even providing so-called "helicopter money" to offer direct support to households in need. Finally, it would be extremely useful to create an EU safe asset while solving the problem of national debt overhang (since debt restructuring by country is not feasible) by having the European Stability Mechanism buy a proportion of the sovereign bonds held by the ECB (Avgouleas and Micossi 2020; Micossi 2021).

Importantly, in making any such moves, the ECB would benefit by enhancing its accountability and transparency while democratising the process. But how to do this? Amending the Treaties is a non-starter: it is perilous, and unnecessary since the ECB has the power to move forward with many such initiatives within its existing mandate. How then, however, does the ECB ensure that it has legitimacy in respect of its choice of secondary goals, not just in terms of policy effectiveness, but also with regard to procedural "accountability" (meaning that it can be held to account by relevant EU-level forums)? This is especially important in the light of German Constitutional Court decisions that have questioned its bond purchasing programs on grounds of democratic legitimacy. The issue is, therefore, what modalities could provide the ECB with guidance that would respect its independence while increasing its accountability along with the effectiveness of monetary policy in ensuring the euro area's optimal performance?

One such modality could be to increase ECB accountability to the EP, to which it is already formally accountable. This could be done, for example, through more structured ECB-EP dialogues or other means of facilitating

deliberation on ECB secondary objectives (Bères et al. 2020). Another way forward would be for the Council to make non-binding recommendations. perhaps in consultation with the EP. Better yet would be to create venues for more democratic debate and deliberation on EU macroeconomic governance. Let's call it the "Great Macroeconomic Dialogue" (Schmidt 2020b), with an annual or biannual conference to outline the grand economic strategies for the coming year, making for a space for dialogue between the ECB and other actors, including not only the EP but also the Commission and the Council as well as representatives of industry, labour, and civil society from across Europe. This would not need to focus on the ECB's monetary policy per se (for which it alone has jurisdiction) but on all aspects of its secondary objectives and even, arguably, the level of its primary objective (inflation). In other words, it could be the venue for considering the general targets for the euro area on an ongoing basis, as a substitute for relying on the currently suspended SGP rules and numbers. Naturally, the ECB would retain its Charter-based independence to pursue the policies it deemed most appropriate but it would at least be able to legitimate any bolder actions with reference to the "political guidance" offered through the Great Macroeconomic Dialogue. Such a process would arguably provide more of the kind of legitimacy afforded to national central banks, which operate in the shadow of national politics, by putting the ECB more clearly in the shadow of EU level politics. And it would certainly make the ECB more accountable and EU economic policymaking more transparent as well as more democratically legitimate and effective.

### 4.2 Commission industrial strategy and the European Semester

The EU has made a great leap forward through the Next Generation EU (NGEU) recovery plan, which focuses on investing in the green transition, the digital transformation, and social equity, together with the temporary Resilience and Recovery Facility (RRF) targeted at Member States most in need. However, this kind of industrial strategy needs to be reinforced through the development of permanent EU level debt that could provide investment funds for all Member States on a regular basis. Think of a permanent RRF as an EU wealth fund, akin to national sovereign wealth funds, which issues debt on the global markets to use to invest through grants to the Member States for education, training, and income support; to help green the economy and digitally connect society; for big physical infrastructure projects (Lonergan and Blyth 2018, pp. 132-141); or even in the form of innovative funds focused on refugee and migrant integration, unemployment and poverty reduction.

The euro area's SGP rules, reinforced during the euro area crisis, also require revision. The numbers alone are now completely out of whack, given the levels of Member State debt, which stand on average at over 100% of GDP, and government deficits way above previous levels. However, it would be better simply to jettison the rules and numbers than to readjust them. If that is not possible (as is likely to be the case), they should be replaced, say, by a set of fiscal standards to assess sustainability

in context (Blanchard et al. 2021). If this is not feasible, then a much more flexible set of rules needs to be developed, focused on countercyclical economic policy, with more fine-tuned assessments of where individual Member States sit in the business cycle in relation to deficits and debt as well as growth outlook and prospects of meeting investment targets. Flexibility needs to be the watchword, and sustainable and equitable growth the objective.

Moreover, national level public investments, beyond those that are part of the NGEU, are deemed to benefit the next generation because enhancing sustainable growth should not be counted toward deficits or debt (known as the golden rule for public investment). Growth-enhancing "golden rule" investments cover such areas as education and training, greening the economy and digitalising society, as well as improving the physical infrastructure. In fact, public debt itself can be ignored if it is sustainable, meaning that the government can borrow at a rate lower that the average rate of growth of GDP – otherwise, raise taxes (Lonergan and Blyth 2018). Why continue to punish countries with higher debt to GDP ratios by way of expenditure rules? One of the lessons of the past decade is that you cannot cut your way out of public debt through austerity: the only way out is through growth. In this vein, eliminating the debt brake from national constitutional legislation would be another valuable initiative. As noted above, this was a hindrance not only for those that lacked "fiscal space", who could not invest, but also for those who had it and did not invest.

# 4.3 Decentralising and democratising EU economic governance

In the light of the pandemic and NGEU, European Semester procedures have been reimagined and the Commission's mission transformed. It has largely left behind its roles of enforcer and then moderator in the euro area crisis to promoter of the new industrial strategy initiatives through the National Resilience and Recovery Plans (NRRPs), with sustainable and equitable growth as the new economic philosophy. In so doing, the Commission has also significantly shifted the EU's state-like capacities away from neoliberal regulatory state to the "catalytic state" it had been seeking to become since the 2010s (Prontera and Quitzow 2021). Nonetheless, the Semester remains a highly technocratic exercise largely carried out within the executive branches of national governments in coordination with the Commission. Our question here is as to the best way to coordinate oversight while decentralising and democratising the process.

In terms of overall grand strategy, indeed, in view of the aim of building strategic autonomy for the EU in the economic arena, a "Great Industrial Strategy Dialogue" with all the stakeholders would be ideal for democratising purposes (although it could also be part of the Great Macroeconomic Dialogue). It could be tasked with recommending overall targets and goals, say, for greener investing, more society-driven digitalisation, and addressing social inequalities, in addition to whatever other issues were of relevance at any given time. However, it would be of equal importance to decentralise the planning process for NRRPs to regional and local levels while democratising it by bringing in social partners, civil society actors and elected officials. This kind of vast decentralised consultation may be likened to the French "Plan" of the post-war period, which succeeded remarkably well not only because it had clear objectives for targeted funding but also because it engaged actors from civil society, with widespread consultation ensuring the creation of a common cause along with the circulation of ideas and information (Schmidt 1996). Moreover, while national governments should submit their plans to their national parliaments for approval, the EU should involve the EP much more at various stages of the European Semester (in particular because of the redistributive function of the RRF). And finally, the European Semester needs to be fully linked to the Social Dialogues in the context of the European Pillar of Social Rights.

Such a bottom-up approach is likely not only to promote better economic performance but also much greater political legitimacy at national level. This is because it would put the responsibility for each country's economics back in the hands of its national government, ensuring real ownership at national level. This in turn could help counter the populist drift in many countries, as political parties of the mainstream right and left could begin again to differentiate their policies from one another, with proposals for different pathways to economic health and the public good. This could help combat the form of populism that claims to be the only alternative to EU-led technocratic rule.

### 5 Conclusion

The EU faces many possible obstacles and stumbling blocks with regard to implementing many of these new ideas. Political divisions persist within the European Council, in particular between the "Frugal Four Plus", which insisted that the RRF be temporary, and opposed the making of any grants at all. If the RRF fails to deliver on growth or if the extra investment is not used wisely in the main countries targeted (Italy and Spain), enthusiasm will wane, and the likelihood of creating a permanent fund will diminish. Moreover, if rule of law issues emerge in the CEECs, with money going to the cronies of illiberal government leaders (especially in Hungary and Poland), concerns about the use of the funds will rise. In addition, the neoliberal austerity hawks are likely to be back, in particular once the pandemic is over and some form of "new normal" is established. If the rules are not changed, or at least relaxed, the exit from the "escape clause" of the SGP will have deleterious consequences for those countries that still need time to grow their way out of deficits and debt.

In large part because of these economic, political and institutional obstacles and stumbling blocks, EU institutional actors need to be open to new ideas not only with regard to the future euro area economic governance but also in terms of the future of the EU itself. Euro area governance requires an ECB that benefits from political guidance via a Great Macroeconomic Dialogue with regard to targeting secondary objectives focused on employment and greening the economy. The euro area demands a Commission able to deploy a permanent fund to invest in the key areas required for sustainable, equitable growth, while coordinating Member State efforts via flexible rules or standards with differentiated evaluations of Member States' economies established through industrial strategy dialogues. Furthermore, in addition to having permanent funds to steer toward sustainable, equitable development, EU governance also needs greater bottom-up decentralisation and democratisation, which could in itself help combat the deteriorating politics in which citizens vote for populists out of frustration for their lack of voice and choice.

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### Deconstitutionalising the Economic and Monetary Union

By Marco Dani\*

### 1 Introduction

Can European Union (EU) economic norms be reconciled with the democratic and social constitutional state (DSCS)? The very fact that the issue of alignment between the EU and national constitutional orders is raised is somehow revealing. First, it reveals the existence of doubts as to whether that alignment can be really taken for granted or attained, as assumed by large part of European constitutional scholarship. Second, it also reveals that at least a certain degree of alignment of EU economic norms with the DSCS is perceived as necessary and even desirable to secure the legitimacy and, as a reflection, the stability of European economic governance.

This paper explores the issue of alignment in the light of the dialectic relationship between openness and purposiveness. It argues that an inverse correlation can be identified between those two rival claims and, on that basis, it puts forward two distinct types of constitutional orders: prevailingly open constitutions and prevailingly purposive constitutions (Section 2). Against this theoretical background, the paper notes that, from their post-war foundation to the Maastricht Treaty, both national constitutional orders, in the form of DSCS, and the European Economic Communities have privileged openness over purposiveness (Section 3). The DSCSs relied on prevailingly open constitutional frameworks as a means of institutionalising the social question and the conflicts existing between the political forces involved in the new constitutional beginning. Accordingly, the pursuit of the bold transformative goals enshrined in national constitutional documents was viewed as an essentially political undertaking exposed to and not shielded from political conflict. Emblematical of this approach was the DSCS's commitment to activist government, which, depending on actual political preferences, was amenable both to Keynesian and ordoliberal legislative renderings.

Up to the entry into force of the Treaty of Maastricht, the legal framework of the European Economic Community also favoured openness over purposiveness. Designed to accommodate the tension between advocates of a multilateral framework enabling activist government and supporters of a laissez-faire international economic order, the founding Treaties provided a set of market principles amenable to remarkably different readings. While for a long period of time European institutions relied on interpretive and

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regulatory solutions reconciling market integration and activist national policies, since the end of the 1970s economic integration started to deviate from the DSCS. The latter development gained foothold throughout the 1980s, when market principles and Community policies were increasingly used as devices constraining and even subverting national activist policies.

This course of political economy was consolidated with the institution of the Economic and Monetary Union (EMU) by the Maastricht Treaty. As neoliberal principles and institutional arrangements were entrenched as a matter of constitutional law, the pursuit of alternative courses of political economy became exceedingly difficult for all EU Member States (Section 4). Since then, however, the EU has held unflinchingly to this neoliberal agenda and, if possible, has, throughout the economic and financial crisis that started in 2008, strengthened its commitment thereto. While the policy outcomes of this strategy are questionable at the least, its constitutional shortcomings are evident. First, by committing in the Treaties to a specific set of economic rules coherent with a particular political economy agenda the EU has encountered serious difficulties in using alternative policy tools when forced to by unexpected economic and political circumstances. Those policies were ultimately put in place by stretching the interpretation of key Treaty norms, but their actual viability rests on precarious legal grounds. Second, the same set of constitutional rules have de facto disenfranchised alternative courses of political economy, with the result of antagonising their followers who increasingly regard the EMU, and, as a reflection, the EU, as a toxic project to be overthrown.

Against this background, the paper concludes by contending that if the EU is keen on realigning with the DSCS, it should return to operating as a prevailingly open institutional framework (Section 5). This would entail redressing its neoliberal bias and reviving its original vocation of enabling national activist government within a context of intensive economic and political interdependence. In order to advance in that direction, the *deconstitutionalisation* of the EMU arises as one of the most pressing issues. As the EU tries to recover from the COVID-19 pandemic and the ensuing economic crisis with a series of policy measures gesturing towards a realignment with the DSCS, the idea of a major treaty amendment in the direction of reopening EU policymaking to political competition appears increasingly compelling. In this perspective, the EU Treaties and, in particular, the EMU legal framework should be pruned of all policy prescriptions, leaving to its political institutions and democratic competition the task of determining the purposes of its policies.

### 2 Modern constitutions: open and/or purposive?

Modern constitutions are normative documents aimed at the regulation of ordinary lawmaking, state-society relationships and, in certain cases, also the relationships between private legal and natural persons. Their regulatory capacity may be viewed as a function of two variables<sup>811</sup>: the formal status of constitutional norms and their substantive content.<sup>812</sup> The formal status of constitutional norms refers to their quality of being higher order laws and, therefore, it results from their level of entrenchment and the institutional arrangements predisposed to secure their legally binding character. Once a certain degree of rigidity is accorded and, as a reflection, a clear hierarchy between constitutional and ordinary law is established, the regulatory capacity of constitutions depends on their substantive content, namely on the level of determinacy of their norms and the corresponding degree of political freedom or discretion the authorities entrusted with their implementation and interpretation are recognised as having.<sup>813</sup>

In this regard, two distinct ideal types of constitutions may be identified. Purposive constitutions include detailed substantive norms embodying a particular political, economic or religious doctrine assumed as uncontested truth.<sup>814</sup> Similar constitutional orders presuppose a high degree of political homogeneity, promoted by a predominant constituent subject or resulting from a broad convergence of ideas among the governed individuals. They offer the vision of a perfect and reconciled society and, on that basis, they mobilise the political unity of the state for the realisation of the corresponding regulatory project. As thick systems of high order law, purposive constitutions exert a remarkable shaping capacity in relation to all legitimate political activity. This may reveal itself as a desirable feature, in particular for those constitutional orders in need of profound purification from the residues of previous constitutional experiences.<sup>815</sup> But this stark regulatory capacity may also turn out to be a liability. Owing to their determinacy, purposive constitutions are scarcely adaptable to changing social and political circumstances. Of course, even detailed norms may be subject to different readings, but if the answer to an emerging social problem lies outside their narrow interpretive scope, the only solutions are formal or informal constitutional amendments<sup>816</sup> or the temporary suspension of constitutional norms. Moreover, in terms of political pluralism purposive constitutions may be found wanting. A constitutional order elevating a particular worldview to the status of dogma creates a regime in which politics is reduced to the managerial execution of constitutional programmes, whilst alternative courses of political action are discredited as heresies to be marginalised or destroyed.817

A more accommodating approach to political pluralism is visible in open constitutions: constitutional documents that include open-textured substantive norms embodying a conflictual consensus among people of

<sup>&</sup>lt;sup>811</sup> The capacity of a constitution to shape legal and political reality also presupposes its effectiveness. If political, economic or social conditions prevent its application, the constitution is nominal, see Grimm (2012), p. 107.

<sup>&</sup>lt;sup>812</sup> For a similar discussion, see de Witte (2009), p. 36.

<sup>&</sup>lt;sup>813</sup> Loughlin (2018), p. 922.

<sup>&</sup>lt;sup>814</sup> Grimm (2012), pp. 110-113.

<sup>&</sup>lt;sup>815</sup> Somek (2014), pp. 97-100.

<sup>&</sup>lt;sup>816</sup> Hesse (2014), p. 79; Ackerman (2007), pp. 1737-1812.

<sup>&</sup>lt;sup>817</sup> Burdeau (1964), p. 143.

fundamentally differing views.818 Here, constitutional frameworks presuppose and accept a higher degree of pluralism, reflecting the existence of conflicting political, social and cultural groups. Absent the possibility to impose or agree on a single overriding constitutional project, open constitutions offer a framework for politics, not the blueprint for all political decisions.<sup>819</sup> Their defining features are procedures favouring the mediation of conflicts and substantive commitments marked by a considerable degree of ambiguity.<sup>820</sup> As a consequence, the state of irresolution of the latter invites continuous constitutional reinterpretation and a broad range of political renderings visible at policy level. Clearly, in similar constitutional frameworks, policy directions are more easily reversible and constitutional norms can adapt to evolving political and social developments, so much so that only in extreme circumstances is their amendment really necessary. At the same time, open constitutions emerge as thin systems of high order law exerting a limited regulatory capacity, which, in the absence of solid constitutional allegiances on the part of political actors, may struggle to secure their authority and risk being overwhelmed by endemic conflict.821

However, in the real world constitution makers are not faced with a blunt choice between openness or purposiveness. This is not only because a certain degree of interpretive discretion or purposiveness inheres in every constitutional norm. But, most importantly, because, in designing actual constitutional settings, constitution makers tend to combine purposive and open elements in an attempt to strike a difficult balance between transformation and inclusiveness. Indeed, in those efforts they have to come to terms with the inverse correlation existing between those claims: the starker the purpose of a constitutional order, the weaker its inclusive potential; the wider the semantic scope of its norms, the looser its transformative capacity.

If this is the real dilemma in constitutional design, it may make sense to develop more accurate modelling that incorporates awareness of the hybridisation of ideal types. So, we can surmise that there are constitutions that are prevailingly purposive. Therein constitutional norms define a blueprint for politics but, in doing so, they also acknowledge a limited degree of operational discretion for policymakers or a certain level of flexibility for adjudicators. Accordingly, policymakers are allowed to opt for their favourite means to pursue the predefined constitutional objectives, while adjudicators can decide whether and how to fine-tune the rigour of enforcement. Only up to those limits may purposive constitutions be loosened to expand the scope for pluralism and increase the adaptability of their norms. But if even these devices reveal themselves to be insufficient in coping with evolving factual circumstances or with the claims of emerging political forces, constitutional amendments or the temporary

<sup>&</sup>lt;sup>818</sup> See *Lochner v. New York*, 198 U.S. 45 (1905), dissenting opinion of Oliver Wendell Holmes. See also Zagrebelsky (2008), pp. 131-157.

<sup>&</sup>lt;sup>819</sup> Grimm (2015), p. 464.

<sup>&</sup>lt;sup>820</sup> Loughlin (2018), pp. 925-930.

<sup>821</sup> Hesse (2014), p. 66.

suspension of constitutional norms remain necessary to adjust the transformative commitments and secure their authority.

Similarly, constitutions that are prevailingly open can also be imagined. Therein constitutional norms establish an open framework for politics through a mix of procedural norms and irresolute substantive commitments. Yet, the openness of constitutional frameworks is not indiscriminate. There are issues on which the constitution expresses more definite choices with a view to increase their stability and subtract them from permanent political negotiation. There are other issues in respect of which constitutional norms may emphasise certain goals in order to provide general direction to policymaking. In both circumstances the regulatory capacity of the open constitution may be strengthened, but not to the point of replacing politics with constitutional decisions. Indeed, if constitutional norms systematically prioritise the aspirations and interests of a particular constituent subject, the open nature of the constitutional order is fatally compromised.<sup>822</sup>

### 3 The age of openness

# 3.1 The post-war European democratic and social constitutional state

The image of the prevailingly open constitution is reflected in the structure of the DSCS, the constitutional order predominant in Europe in the aftermath of the Second World War. The constitutions approved in this period were documents symbolising a new beginning, but they were also one of several tools employed to restore political consensus on state governing structures and foster social integration. This was particularly evident in countries such as France, Italy and Germany, where the newly enacted constitutions reflected a drastic realignment of political parties, with the dominant forces – Christian Democracy and the parties of the Left – assuming the role of predominant constitutional subjects.

Aware of their profoundly different aspirations, interests and policy agendas, those political parties learned quickly that constitutional politics was no longer the terrain for political struggles aimed at imposing a particular political agenda. Constitutions ceased to be instruments of government of the predominant social classes and turned into pacts stating the basic terms for their peaceful coexistence.<sup>823</sup> To write this type of constitution, ordinary political disagreements had to be bracketed and efforts were directed towards choices of constitutional design commanding broad support in the political system and in the country at large. This ethos of mutual recognition and compromise shaped post-war constitutional politics: constituent subjects strove to agree, if not on a fundamental ideology, then at least on a set of substantive commitments and institutions

<sup>&</sup>lt;sup>822</sup> Mortati (1962), p. 185.

<sup>823</sup> Zagrebelsky (2008), pp. 133-135.
contributing to social cohesion and enabling democratic political competition.<sup>824</sup>

Constitutional politics played out in a consensual mode by political parties harbouring conflicting political aspirations resulted in prevailingly open constitutions.<sup>825</sup> Their openness was visible in their aspiration to govern the social question through democratic means.<sup>826</sup> This capacity to legitimate and contain conflicts, and to transform them from factors of disintegration into potential civic resources was created first of all by agreeing on a set of procedures and institutions establishing a relatively even-handed institutional framework for the acting out of political and socio-economic conflicts.

The emerging constitutional culture, however, was by no means satisfied with a shared procedural framework enabling political competition. Open constitutions were not neutral constitutions, that is, they could not admit whatever political development resulting from majority rule. Meaningful democratic competition presupposed respect for a set of requirements concerning the emancipation of persons and their equal participation in collective goods. Thus, to establish their authority, it was also regarded as necessary for a range of substantive normative commitments to be included within constitutions.827 The constitutions, therefore, also expressed a set of purposive fundamental norms penetrating all the social relations situated within the state domain<sup>828</sup> and exerting their effects primarily through the activity of legislatures and constitutional adjudicators.829 However, their transformative aspirations were not superimposed on society; on the contrary, their pursuit was viewed as an eminently political undertaking, attainable through democratic competition and legislative deliberation. In other words, the transformative goals of the DSCS were exposed to and not shielded from political conflict.

If no one could elevate their particular convictions and policy solutions to the status of dogma, in principle all political opinions deserved to have access to the constitutional arena and be treated with equal respect.<sup>830</sup> Besides inspiring the design of political institutions, this concept was promptly acknowledged in the interpretation of constitutional texts. In 1954, for instance, the German Federal Constitutional Court was adamant in declaring that the Basic Law did not establish a particular economic system, but laid down only a more open framework of core protections and principles.<sup>831</sup> Likewise, the Italian Constitutional Court refrained from constraining legislative activity on the basis of the more or less biased reconstruction of the economic constitutional order resulting from unilateral

<sup>828</sup> D'Albergo (1991), p. 220; Dossetti (2014), pp. 45-46.

<sup>824</sup> Grimm (2012), p. 144.

<sup>825</sup> Onida (1997), pp. 97-98.

<sup>826</sup> Bin (2007), p. 11.

<sup>&</sup>lt;sup>827</sup> Emphasis on the substantive dimension of the constitution is evident, see for instance the *Elfes* case (1957), 6 BVerfGE 32.

<sup>829</sup> Fioravanti (2014), p. 295.

<sup>830</sup> Burdeau (1964), p. 126.

<sup>&</sup>lt;sup>831</sup> See the *Investment Aid* case (1954), 4 BVerfGE 7.

interpretations of constitutional principles.<sup>832</sup> National constitutions did not subscribe to any exclusive and predefined economic theory and remained open to alternative legislative renderings of their constitutional commitments. To be sure, the most extreme versions of collectivism and laissez-faire were discarded but, besides that, broad room was left to political freedom and a great deal of discretion was accorded to legislatures in the actual use of a wide range of policy instruments. The open constitution was amenable to a variety of economic material orders.<sup>833</sup>

The wide scope for policymaking available in the DSCS can be appreciated by looking at the material economic orders developed during "Les Trente Glorieuses".<sup>834</sup> Following the United States' lead, in many European countries the promotion of employment and the modernisation of the economy became the focal point of all political economy, even at the cost of potentially negative repercussions on price stability.835 Keynesian economics emerged as the favourite course of political economy, particularly in the countries more exposed to the risk of a communist ascent, or as a moderate alternative to planning.836 To influence overall levels of economic growth and employment governments were in charge of the countercyclical management of aggregate demand. Accordingly, in times of economic recession, they were expected to boost aggregate demand through increases in public expenditure or lowered taxation, even at the cost of incurring budget deficits and inflation. In the event of aggregate demand exceeding supply, governments were expected to run a budget surplus and adopt a restrictive monetary policy.837

Within a similar framework, monetary policy was viewed as contributing to this comprehensive macroeconomic effort.<sup>838</sup> In this perspective, central banks could be endowed with a certain degree of operational autonomy, but their activity was expected to complement the economic policy devised by democratic institutions. As a result, fiscal policy concerns came to dominate monetary policy. Once abhorred as a symptom of an undisciplined economic policy, money creation under the instructions of national government and the last resort purchase of public bonds with a view to controlling their price and constrain financial speculation became common practices for central banks.<sup>839</sup>

This notion of monetary policy had clear institutional implications. If monetary policy were to contribute to general economic policy, it could not remain disconnected from fiscal policy and insulated from the ordinary democratic circuit. It is therefore not surprising that the era of the DSCS opens almost everywhere with the approval or the completion of the

<sup>832</sup> See judgment n. 14/1964.

<sup>&</sup>lt;sup>833</sup> Saitto (2018), pp. 132-133.

<sup>834</sup> Fourastié (1979).

<sup>&</sup>lt;sup>835</sup> Rosanvallon (1989), pp. 183-193.

<sup>&</sup>lt;sup>836</sup> See Weir (1989), pp. 74-81; De Cecco (1989), pp. 219-220.

<sup>837</sup> Hall (1989), pp. 6-7.

<sup>838</sup> Chessa (2016), p. 277.

<sup>&</sup>lt;sup>839</sup> ibid., pp. 256-262.

nationalisation of central banks.<sup>840</sup> Interestingly, the newly adopted constitutions omitted almost entirely to discipline the monetary system and central banks, a decision that facilitated the subordination of the latter to national democratic institutions. Widespread was therefore the choice to regulate central banks through legislation, thus leaving to governments the responsibility for the formulation of the monetary policy vis-à-vis parliaments. In these statutes monetary objectives were no longer defined with an exclusive view to price stability as central banks' mandates were extended to cover a broader range of goals.<sup>841</sup>

Not in all European countries were Keynesianism and the idea that money creation could depart from the rule of rigid convertibility into gold perceived as coherent with the ongoing effort of the DSCS to transform the structures of European states in a more democratic and social direction. Even among the ranks of those committed to social justice and attracted by activist government, the idea of financing public budgets through monetary emissions was frowned upon. Particularly in Germany the ordoliberal notion that the central bank should be entrusted with a narrow mandate centred on price stability and a broad degree of operational independence remained dominant<sup>842</sup>, to the extent of justifying a derogation from the otherwise unflinching commitment of the Basic Law to ministerial accountability and representative democracy.<sup>843</sup>

Keynesian ideas were therefore pre-empted by another set of policies oriented toward the supply side and social market economy. This set of policies found ideological legitimation in ordoliberalism, with its commitment to the primacy of monetary policy guaranteed by a strong and independent central bank, an open international economy to favour exports, limited state intervention and increased market competition.844 As noted above, a similar economic model was not entrenched at a constitutional level. Indeed, the Basic Law did not conceive the federal budget as a tool for the stabilisation of the economy, but neither did it impose the obligation to run balanced budgets.<sup>845</sup> Within the same constitutional framework, ordoliberal policies could therefore be challenged, as witnessed by the rise of Keynesianism at the end of the 1960s. The reforms of the Finanzverfassung opened the door to countercyclical management of demand and, therefore, to an economic order based on price stability, economic growth, full employment and macroeconomic equilibrium. In this context, public debt was accepted as an ordinary instrument for financing public investments.846

These forays into Keynesianism were brief and qualified due to the close surveillance and influence exerted by the Deutsche Bundesbank.<sup>847</sup> Even in this regard West Germany could appear as a prominent outlier. Since its

<sup>&</sup>lt;sup>840</sup> Amtenbrink (1999), pp. 64-65 and 104-105.

<sup>&</sup>lt;sup>841</sup> ibid., p. 192.

<sup>842</sup> Chessa (2016), pp. 278-294.

<sup>&</sup>lt;sup>843</sup> Amtenbrink (1999), pp. 217-219.

<sup>&</sup>lt;sup>844</sup> Allen (1989), p. 281.

<sup>&</sup>lt;sup>845</sup> Saitto (2016), pp. 161-164.

<sup>&</sup>lt;sup>846</sup> ibid.

<sup>&</sup>lt;sup>847</sup> Allen (1989), pp. 277-278.

establishment in 1957, the Deutsche Bundesbank had been designed as independent. Although the Basic Law expressly provided for a federal central bank, its independence from government instructions had been set out at legislative level, a choice that did not entirely exclude parliamentary control, but fixed it on a long-term perspective as the frustration of expectations could lead to legislative backlash by the parliament.<sup>848</sup> The monetary target was defined with a prevailing view to price stability, although in a number of circumstances other economic objectives justified deviations.<sup>849</sup> Within a similar legal framework, however, monetary policy was consistently conceived as a means by which to encourage investment and an export-led growth, while the possibility to finance government expenditure was strictly constrained, also in circumstances in which the goal of economic reconstruction could have justified expansive monetary measures.<sup>850</sup> On the whole, however, the standing of the Deutsche Bundesbank benefited from similar legislative decisions, contributing to its affirmation in the constitutional system as an independent fourth branch of government.

#### 3.2 The ambivalent European Economic Communities

Openness was also the prevailing trait of the original institutional framework of the European Economic Communities. As in the DSCS, this feature reflected divergences among the political forces sustaining the European integration project. Here, reference is made not so much to the tensions between the supporters of a pan-European political community and the proponents of a more modest intergovernmental form of cooperation. Far more crucial was in fact the divide between the forces willing to reaffirm at supranational level the commitments inspiring the DSCS and those aiming at their rebuttal.<sup>851</sup> Indeed, following a trend initiated in the late New Deal<sup>852</sup>, Christian Democrats and Social Democrats conceived of supranational agencies as key components of a new world order enabling their commitment to activist government. At the same time, Conservatives and Liberals imagined the multilateral framework in the making as a suitable vehicle to reinstate the principles of the laissez-faire economic order defeated at national level.<sup>853</sup>

Against a similar background, the ambivalence of the European Economic Communities should not come as a surprise. Although the making of a Common Market expressed a certain purposive orientation, it was not clear whether the goal of the founding Treaties was simply to counter the autarchic tendencies of the nation state or to rescue the economic freedoms and property rights from their downgrade under the DSCS. The founding Treaties established a peculiar form of economic integration

<sup>&</sup>lt;sup>848</sup> Amtenbrink (1999), p. 219.

<sup>&</sup>lt;sup>849</sup> ibid., pp. 195-196.

<sup>&</sup>lt;sup>850</sup> Holtfrerich (1988), p. 122.

<sup>&</sup>lt;sup>851</sup> Menéndez (2013), pp. 472-473.

<sup>852</sup> Burley (1993).

<sup>&</sup>lt;sup>853</sup> Hayek (1949), pp. 255-273.

based on the free movement of productive factors, the harmonisation of competitive conditions and the coordination of macroeconomic policies. Free movement was pursued through a set of regulatory principles and specific legal bases. The former included both prohibitions of discrimination based on nationality and the commitment to remove hindrances to market access. The latter foreshadowed a process of gradual liberalisation to be attained by Community institutions through the approval of measures of secondary law. As for the harmonisation of competitive conditions, the Treaties enabled regulatory interventions by Community institutions, on the assumption that this goal could not be left entirely to the operation of market forces, but required regulatory competition.<sup>854</sup> As to macroeconomic coordination<sup>855</sup>, Member States were encouraged to conceive their economic policies as matters of common concern, avoid trade imbalances, secure price stability and promote a high level of employment.

On these bases, there were several regulatory strategies available for Community policymakers. From the early 1960s to the mid-1970s, the material economic order that was actually implemented was predominantly congenial to the consolidation of the DSCS.<sup>856</sup> Accordingly, free movement of productive factors was mainly pursued through a decentralised regulatory strategy.<sup>857</sup> This entailed a rather deferential enforcement of market principles by the Court of Justice of the European Union (CJEU): by primarily targeting direct and indirect discriminations the CJEU left largely unaffected the possibility to attain economic and social goals at national level. As for the harmonisation of competitive conditions, the regulatory interventions by Community institutions were inspired by the notion of a regulatory level playing field, on the assumption that the type of competition fostered by the Common Market in the making was to enhance firms' efficiency and innovation rather than regulatory or tax competition among the Member States.<sup>858</sup> In principle, such a sweeping harmonisation could rely on the legal bases enshrined in the Treaty of Rome; the CJEU also seemed to endorse their potentially limitless remit on several occasions. Yet, after the empty chair crisis and the ensuing Luxembourg compromise, the notion of widespread harmonisation appeared illusory, leaving broad room to national policy initiatives.

Deference towards states' economic and social policies was also the strategy inspiring macroeconomic coordination in this period. The goals of containing currency fluctuations and tackling trade imbalances were pursued in accordance with the tenets of the Bretton Woods system. The semi-pegged exchange rates therein established, if coupled with capital mobility, could threaten Member States' autonomy in fiscal and monetary

<sup>&</sup>lt;sup>854</sup> Kaupa (2018), pp. 61-63.

<sup>855</sup> See Articles 103-105 of the EEC Treaty.

<sup>&</sup>lt;sup>856</sup> Ruggie (1982).

<sup>&</sup>lt;sup>857</sup> Maduro (1998), pp. 143-149.

<sup>\*\*\* &</sup>quot;Memorandum of the Commission on the Action Programme of the Community for the Second Stage" COM(62)300 final, 24 October 1962. See also Kaupa (2018), pp. 52-53.

matters. Yet, for a rather long period, that scenario did not materialise. In the 1960s the implementation of Article 67 of the Treaty establishing the European Economic Community (EEC Treaty) on free movement of capital had been pursued on the basis of two directives specifying that a set of capital movements were not liberalised.<sup>859</sup> Other capital controls were liberalised but, in case of an adverse impact on national economic policies, they could be reinstated. Similarly, the case-law of the CJEU reflected a cautious approach. Up until the 1980s, the Court was perfectly aware of the fact that complete freedom of capital movement could undermine the economic policies of the Member States or destabilise their balance of payments.<sup>860</sup> Accordingly, unlike the other free movement provisions, Article 67 of the EEC Treaty was not considered as having direct effect, with the result that the free movement of capital was mainly conceived of as authorising the payments necessary for the exercise of other economic freedoms.<sup>861</sup>

In a similar context, European macroeconomic coordination secured favourable conditions for Member States' activist plans.<sup>862</sup> To be sure, this implied that the full economic benefits of the Common Market would not be reaped. But in that political and economic environment, the Common Market was still imagined as complementing and, therefore, aligning with the DSCS. A similar institutional arrangement made the fortune of the European nation states by contributing to their economic success in Les Trente Glorieuses.<sup>863</sup> Nevertheless, the oil crises of the 1970s, the end of the Bretton Woods system and the gradual abolition of its attendant capital controls led to a reorientation of the European integration process and the establishment of a new material economic order. In this new rendering, the ambivalences of the Treaty of Rome were resolved in a neoliberal direction, thereby marking the beginning of an increasing misalignment with the DSCS and, notably, its more Keynesian rendering.

The redefinition of the material economic order was carried out first of all in the field of free movement. Therein the goal of completing the Single Market entailed a gradual shift, from the decentralised model of economic constitution experimented in the foundational period to an economic constitution combining elements of both the competitive and centralised models.<sup>864</sup> The focal point of that shift was mutual recognition, the notion inspiring *Cassis de Dijon*<sup>865</sup>, the judgment that transformed the prohibition of measures having equivalent effects to quantitative restrictions into an economic due process clause of sorts favouring judicial challenges to

<sup>&</sup>lt;sup>859</sup> First Directive for the implementation of Article 67 of the Treaty (OJ 43, 12.7.1960, p. 921); Second Council 63/21/EEC Directive of 18 December 1962 adding to and amending the First Directive for the implementation of Article 67 of the Treaty (OJ 9, 22.1.1963, p. 62).

<sup>&</sup>lt;sup>860</sup> *Casati*, C-203/80, EU:C:1981:261.

<sup>&</sup>lt;sup>861</sup> See Article 106 of the EEC Treaty.

<sup>&</sup>lt;sup>862</sup> Kaupa (2018), pp. 76-83.

<sup>863</sup> Milward (1999).

<sup>&</sup>lt;sup>864</sup> Maduro (1998), pp. 110-143.

<sup>&</sup>lt;sup>865</sup> *Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein*, C-120/78, EU:C:1979:42.

broad swathes of domestic regulation. Although judgments conforming to the *Cassis De Dijon* doctrine did not necessarily displace domestic regulations or unleash regulatory competition<sup>866</sup>, they did increase the overall pressure on national governments, all the more when judicial mutual recognition was generalised to all productive factors.

The neoliberal rendering of the Treaty of Rome did not rest only on an increased emphasis on negative integration. Cassis de Dijon was immediately synchronised with the Commission's legislative agenda targeting Member State measures, justified in the light of the mandatory requirements doctrine for harmonisation purposes.<sup>867</sup> The implementation of this re-regulatory strategy became a realistic prospect in the mid-1980s when the Single European Act provided a suitable legal basis to overcome national vetoes through qualified majority voting.868 The increased political capacity of the Community seemed to enable a new stage in the building of the Single Market, in which supranational political institutions were finally in the position to approve uniform rules responding to both the facilitative and protective concerns implied in market regulation. However, the success of this strategy was only partial. First, the appeal of gualified majority voting also led to the adoption of legislative measures in fields not immediately related to the regulation of markets, which had the result of extending market rationality to areas such as the environment, health and culture. Second, gualified majority voting did not apply to the harmonisation of fiscal provisions, free movement of persons and the rights and interests of employed persons<sup>869</sup>. leaving those fields exposed to the vagaries of judicial politics. Third, the shift to gualified majority voting favoured the adoption of Directive 88/361/EEC<sup>870</sup>, the legislative act which abolished the restrictions on capital movements within the Community, thereby undermining the keystone of the system of macroeconomic coordination which had previously enabled state interventionism.

Admittedly, capital mobility does not necessarily entail the sacrifice of national political autonomy, notably if exchange rates are left free to float. Yet, the adoption of Directive 88/361/EEC took place in an entirely different context. To cope with the macroeconomic instability following the collapse of the Bretton Woods system, European countries had significantly reconsidered their exchange rate system. Approximately at the same time as *Cassis de Dijon* was being decided, the European Monetary System (EMS) was established in an attempt to constrain currency fluctuations.<sup>871</sup> The EMS required the definition of an official central exchange rate for all currencies, which were left to float within bands determined for distinct

<sup>&</sup>lt;sup>866</sup> Kaupa (2018), pp. 117-120.

<sup>&</sup>lt;sup>867</sup> Communication from the Commission concerning the consequences of the judgment given by the Court of Justice on 20 February 1979 in case 120/78 ("Cassis de Dijon") (OJ C 256, 3.10.1980, pp. 2-3).

<sup>868</sup> See Article 100 A of the EEC Treaty.

<sup>&</sup>lt;sup>869</sup> See Article 100A, para. 2 of the EEC Treaty.

<sup>&</sup>lt;sup>870</sup> Council Directive 88/361/EEC of 24 June for the implementation of Article 67 of the Treaty (OJ L 178/5, 8.7.1988, p. 5).

<sup>&</sup>lt;sup>871</sup> Council Regulation (EEC) No 3181/78 of 18 December 1978 relating to the European monetary system (OJ L 379, 30.12.1978, p. 2).

groups of countries. When a currency reached the limits of the band, participating countries were expected either to intervene via their central banks or to negotiate a change of the parity rates. As a consequence, also within a similar system, capital controls were the *conditio sine qua non* of national fiscal and monetary policies. Absent those restrictions, not only would the margins for national autonomy be depleted, but also the weakest national currencies would end up being exposed to speculative attacks.<sup>872</sup>

# 4 The age of purposiveness

#### 4.1 The entrenchment of neoliberalism

The way out from the fragility of a semi-pegged exchange rate regime was moving to a monetary union. In this regard the plans designed in the 1970s and 1980s recognised that, to achieve a full monetary union, a sizeable supranational budget ought to be established to support the regions in difficulty and facilitate the modernisation of their economies.<sup>873</sup> Thus, far from evoking the destabilisation of the DSCS, the monetary union nourished the idea of its pan-European restatement, in line with further institutional developments taking place in the same period such as the expansion of supranational legislative competences and the improvement of the liberal and democratic credentials of the Communities with, respectively, a judge-made bill of rights and a popularly elected European Parliament. Against a similar background, the neoliberal turn of the late 1970s and 1980s could appear only as the avant garde of a process that would soon be rebalanced with the addition of more robust democratic and social components.

To be sure, a similar scenario implied a good dose of optimism about the capacity of the Community to produce the social, political and economic preconditions required to create a full monetary union and a pan-European constitutional democracy. And even more optimism was needed to imagine that, in a general political and intellectual climate marked by the rise of rampant neoliberalism, a similar plan could actually be accomplished. Thus, it is not surprising that the economic constitution conceived at Maastricht was remarkably different from those earlier ideas. To a considerable extent, its contents developed and consolidated the neoliberal trend ushered in by Cassis de Dijon, the EMS and Directive 88/361/EEC. But whilst those decisions were not set in stone, the Treaty of Maastricht made them de facto irreversible by entrenching their underlying motifs as the new economic constitution of the euro area. From then on, it could no longer be claimed that the EU institutional framework had been made for people of fundamentally differing views. Indeed, economic norms and institutions were conceived to further a particular economic model and, as a reflection, to prompt the neoliberal transformation of the DSCS. Thus, by

<sup>&</sup>lt;sup>872</sup> De Grauwe (2018), pp. 104-105.

<sup>&</sup>lt;sup>873</sup> See, e.g., the 1977 McDougall Report and the 1987 Padoa-Schioppa Report.

elevating a particular economic paradigm to the status of uncontested truth, the Treaty of Maastricht turned the Community legal framework into a prevailingly purposive constitutional order.

The neoliberal purposive inclination of the Treaty of Maastricht emerged first of all in its uncompromising commitment to free movement of capital. The Treaty of Maastricht reframed the relevant Treaty principle in purely obstacle-based terms in accordance with Directive 88/361/EEC.874 Its scope of application was also extended to third countries, thereby amplifying the disciplinary potential of international financial markets.875 This move was reinforced by key judgments of the European Court of Justice overruling earlier more cautious case-law: the newly introduced Treaty provision was endowed with direct effect<sup>876</sup> and the notion that the general financial interests of a Member State could justify the retention of capital controls was also overridden.877 This more assertive judicial orientation reinforced the idea already hinted at in Cassis de Dijon: considering market principles as judicially enforceable constitutional rights.<sup>878</sup> But whereas in the case of product requirements the deregulatory potential of market principles could be contained through positive harmonisation, in the case of taxation or industrial relations the Treaty of Maastricht simply lacked adequate legal bases to counter deregulation.

The same neoliberal inclination was visible in the structure of the new competences introduced in the Treaty. In expanding the scope for EU policymaking to fields normally associated with state activist government, the new legal bases often came with specific policy directions pre-empting key democratic choices by means of neoliberal guidelines.<sup>879</sup> Thus, the goal of price stability was prioritised in monetary policy<sup>880</sup>, workers' adaptability in employment policy<sup>881</sup> and competitiveness in industrial policy.<sup>882</sup> Admittedly, the same legal bases also included textual references to other policy objectives which, in later Treaty revisions, would further be enriched with more ambitious substantive goals and horizontal clauses.<sup>883</sup> Yet, those textual gestures could only cloak with a pluralist veneer the actual post-political structure of an overabundant<sup>884</sup> and potentially asphyxiating<sup>885</sup> constitutional framework. The latter did establish a clear hierarchy among those goals, leaving to political institutions only the decision on how to attain neoliberal targets while maximising competing interests.

<sup>&</sup>lt;sup>874</sup> See Article 63 TFEU.

<sup>&</sup>lt;sup>875</sup> Menéndez (2013), p. 467.

<sup>&</sup>lt;sup>876</sup> Bordessa and Others, Joined Cases C-358/93 and C-416/93, EU:C:1995:54; Sanz de Lera and Others, Joined Cases C-163/94, C-165/94 and C-250/94, EU:C:1995:451.

<sup>877</sup> See, e.g., Commission v Portugal, C-367/98, EU:2002:326.

<sup>&</sup>lt;sup>878</sup> Scharpf (2017), pp. 317-321.

<sup>&</sup>lt;sup>879</sup> Davies (2015), pp. 2 and 14.

<sup>880</sup> See Article 127 TFEU.

<sup>&</sup>lt;sup>881</sup> See Article 145 TFEU.<sup>882</sup> See Article 173 TFEU.

<sup>&</sup>lt;sup>883</sup> See respectively Articles 3 TEU and 9 TFEU.

<sup>&</sup>lt;sup>884</sup> de Witte (2009), p. 35.

<sup>&</sup>lt;sup>885</sup> Fossum and Menéndez (2005), p. 409.

The entrenchment of the neoliberal policy agenda in the EU constitutional order found its ultimate manifestation in the architecture of the EMU. First, the list of goals inspiring economic and monetary policy mentioned price stability, sound public finances and monetary conditions and a sustainable balance of payments, but, tellingly, eschewed full employment.

Second, short of the requisite degree of political and social legitimacy to sustain a robust supranational fiscal policy, the EU opted for an asymmetric institutional arrangement decoupling monetary and economic policy. The need to reap the full benefits of capital mobility and overcome the fragilities of a semi-pegged exchange rate regime favoured the creation of an incomplete monetary union: that is, a monetary union without a sizeable budget.<sup>886</sup> Thus, monetary policy was federalised and depoliticised<sup>887</sup>, whilst economic and fiscal policy were retained by the Member States as national constitutional prerogatives subject only to intergovernmental macroeconomic coordination. This disconnect of monetary and economic policy was by no means innocuous as it implied the weakening of the macroeconomic steering capacities of euro area Member States. In particular in countries with a more ingrained Keynesian tradition, a single and allegedly neutral federal monetary policy could not be synchronised with the needs of several fiscal policies and, more broadly, of highly heterogeneous national economic systems.

Third, the disconnect between monetary and fiscal policy and, as a reflection, the de facto neutralisation of Keynesian courses of national economic policy were accentuated by the particular form assigned to EU monetary policy. In this regard, the German experience of the Deutsche Bundesbank was taken as a model and generalised for the rest of the euro area in a radicalised form. As noted, up until the Treaty of Maastricht, the narrow mandate and the independence of the Deutsche Bundesbank had been established through legislation, thus they were formally reversible by an ordinary political majority. In the design of the European Central Bank (ECB), the Treaty of Maastricht upgraded those choices to the status of constitutional norms.888 Indeed, monetary policy was framed as the quintessential purposive competence. In a context still reminiscent of the high inflation of the 1970s, the ECB was entrusted with a narrow mandate centred on price stability as its primary goal, with support for general economic policies only a secondary objective. The Treaty left it open to the ECB to define the content of price stability, but foreclosed the pursuit of other objectives to the detriment of the main goal.889 Ironically, the preference for a narrow mandate for the ECB was defended on democratic grounds. Monetary policy was presented as an area requiring a level of expertise, temporal consistency and policy credibility unattainable by ordinary political institutions.<sup>890</sup> In other words, the protection of the value of

<sup>&</sup>lt;sup>886</sup> De Grauwe (2018), p. 111.

<sup>&</sup>lt;sup>887</sup> Menéndez (2013), p. 487.

<sup>&</sup>lt;sup>888</sup> See Articles 127 and 131 TFEU. The same approach emerges also in the amended version of Article 88 of the German Basic Law.

<sup>&</sup>lt;sup>889</sup> Ioannidis, Hláskova Murphy, Zilioli (2021), p. 8.

<sup>&</sup>lt;sup>890</sup> Herdegen (1998), p. 290.

money could justify a restriction on democracy and the delegation of regulatory powers to an ad hoc institution.<sup>891</sup> Yet, democratic concerns imposed the requirement that the mandate of the latter be limited in scope, hence the prescription of price stability. Other considerations could lead to a more critical assessment of how monetary policy was being shaped. The prioritisation of price stability was questionable in terms of political freedom, since within the new institutional landscape the prospects of implementing the Keynesian version of the DSCS appeared dim. Moreover, the exclusive definition of price stability on the part of the ECB implied the depoliticisation of key decisions concerning macroeconomic magnitudes with clear redistributive implications.

Finally, the decision in favour of entrenchment also encompassed the independence requirements concerning the ECB. Not satisfied by merely having set up the central bank as an independent fourth branch of government, the Treaty of Maastricht reinforced its insulation with the express constitutional prohibition of monetary financing.<sup>892</sup> Again, this choice also made perfect sense within an institutional framework conceived to enhance the disciplinary power of international financial markets and constrain the deficit bias of democratic decision-making. At the same time, the prohibition of monetary financing gave the kiss of death to any possibility to pursue courses of political economy other than that presupposed by the Treaty.

The neoliberal structure of the monetary union also influenced the direction and the structure of the macroeconomic coordination of national economic policies. The combination of a single currency and capital mobility entailed conducive national economic policies to avoid negative externalities. In particular, excessive borrowing by national governments could engender inflationary pressures and, in the most dramatic cases, even defaults whose repercussions could also be felt beyond national borders. To cope with these risks, the Treaty set up a more intense managerial system of coordination comprising both positive targets to steer economic policy and negative limits to prevent externalities.

The positive dimension was the weakest: macroeconomic coordination was expected to ensure the broad range of goals included in Article 3 TEU but, critically, national economic policies should be conducted in accordance with the principle of an open market economy with free competition.<sup>893</sup> To achieve the general goals, a soft law system of coordination was established relying on broad guidelines and a mechanism of multilateral surveillance centred on the Council and the Commission.<sup>894</sup> The resulting institutional framework was in principle more open than that observed in monetary policy because the constraints of the Treaty objectives, and the surveillance procedure were definitely less penetrating. The neoliberal

<sup>&</sup>lt;sup>891</sup> Brunner and others, Cases 2 BvR 2134/92 & 2159/92, paras 95-96. See also Zilioli and Selmayr (2007), p. 361.

<sup>&</sup>lt;sup>892</sup> See Article 123 TFEU.

<sup>&</sup>lt;sup>893</sup> See Article 119(1) TFEU.

<sup>&</sup>lt;sup>894</sup> See Article 121 TFEU.

leaning of macroeconomic coordination emerged more clearly in its negative dimension. Even in this regard Treaty norms were not confined to core issues but entrenched a particular vision of economic policy relying on governance arrangements and the disciplinary force of financial markets. A general ban on excessive deficits was established<sup>895</sup>, with quantitative limits on government deficits and public debt spelled out at guasi-constitutional level<sup>896</sup>. Those reference values were reinforced by a no-bailout clause.<sup>897</sup> On the whole, therefore, fiscal rules expressed a certain scepticism towards borrowing and, as a reflection, towards the economic theories regarding it as an ordinary tool of economic policy.<sup>898</sup> No consideration was given to the reasons justifying borrowing, for instance by distinguishing between the debts incurred for public investments and those funding current spending. No equivalent attention was devoted to private indebtedness and macroeconomic imbalances, and the tools relating to economic and financial shocks were equally insufficient. So, also in this regard the Treaty drafters preferred to populate the constitutional framework with their more or less questionable economic doctrines. transforming it into an instrument of government. In moving in this direction, they overlooked the downsides of a prevailingly purposive constitutional framework – an issue of which they would become aware on the occasion of the economic and financial crisis that began in 2007.

#### 4.2 Increased purposiveness and its downsides

As elsewhere, in the euro area the impact of the economic and financial crisis was also extremely serious. But unlike other advanced economies, the EMU lacked adequate institutions and tools to cope with it. A crisis of this magnitude could have been the catalyst for a transformative process leading to a full monetary union and, under the pressure of the crisis, some of the key aspects of the euro area architecture did in fact change. Nevertheless, the transformation made was in essence preservationist. The imperative of saving the euro area did not trigger the creation of a sizeable EU budget to endow the EMU with fiscal capacity. The euro area that was saved remained the asymmetric creature conceived at Maastricht, supplemented by a complex set of measures radicalising and, simultaneously, adapting the original neoliberal paradigm. Accordingly, Member States experiencing difficulties in servicing their debt in financial markets received financial assistance, although subject to strict conditionality. A set of legislative and constitutional reforms were approved to improve the credibility of the commitment to sound finances of all the Member States. And, eventually, also in Europe quantitative easing programmes were adopted to counter deflation and economic stagnation. On the whole, these reforms increased the purposiveness of the EU

<sup>&</sup>lt;sup>895</sup> See Article 126 TFEU.

Article 1 of the Protocol on the excessive deficit procedure. Reference values can be modified by the Council voting unanimously on the basis of a special legislative procedure (Article 126(14) TFEU).

<sup>&</sup>lt;sup>897</sup> See Article 125 TFEU.

<sup>898</sup> Mostacci (2020), p. 1068.

constitutional order, with the result of aggravating its detrimental impact on political pluralism and its difficulties in adapting to changing economic and political circumstances.

The first responses to the crisis by the EU were conceived on the assumption that the neoliberal model established at Maastricht was valid and what had not worked in the run-up to the crisis was its implementation. With this mindset in place, EU institutions embarked on a series of legislative reforms to intensify macroeconomic coordination with a view to fostering budgetary discipline.<sup>899</sup> This approach inspired the conditionality attached to the first vehicles of financial assistance engineered to respond to the emergency in the most affected countries and led to the hardening of the Stability and Growth Pact for all.<sup>900</sup> The wisdom of constraining public investments and, more generally, of depriving national economies of meaningful fiscal support in an adverse economic cycle was questionable on policy grounds. But as long as those measures were incorporated in legislative acts, they remained exposed to EU democratic competition and open to relatively easy reversal.

Legislative reforms, however, did not seem to assuage the concerns as to the fiscal credibility of EU Member States. But instead of reconsidering their contents, EU institutions and Member States opted for their constitutional entrenchment. The first move in that direction was the insertion in the Treaty of a provision permitting the euro area countries to establish a stability mechanism granting financial assistance subject to strict conditionality.<sup>901</sup> At first glance, this new constitutional provision might appear to abandon the categorical wording of the no-bailout clause or, at least, to introduce a qualification to its clear-cut prohibition.<sup>902</sup> Yet, the qualification was not meant to open up the institutional framework to alternative courses of political economy. As the CJEU was ready to admit, the strict conditionality attached to financial assistance was conducive to the goal of the no-bailout clause, namely fostering budgetary discipline and maintaining financial stability within the EMU.<sup>903</sup>

Budgetary discipline and financial stability were also the goals that inspired the second constitutional reform: the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG). The strategy therein pursued was the entrenchment of the highly ambitious fiscal targets set out in the reformed Stability and Growth Pact and, critically, their incorporation in national constitutional settings. Thus, the TSCG required the budgetary position of the Member States to be in balance or surplus.<sup>904</sup> Member States were also expected to insert budget balancing rules in their constitutions as well as to adopt automatic correction mechanisms to be

<sup>&</sup>lt;sup>899</sup> See the set of regulations and directive making up the Six-Pack and Two-Pack.

<sup>900</sup> Mostacci (2020), p. 1027.

<sup>&</sup>lt;sup>901</sup> See Article 136(3) TFEU, introduced by European Council Decision 2011/199/EU.

<sup>&</sup>lt;sup>902</sup> Chalmers, Davies, Monti (2019), p. 679.

<sup>&</sup>lt;sup>903</sup> *Pringle*, C-370/12, EU:C:2012:756, paras. 135 and 137.

Article 3 of the TSCG. More specifically, this norm requires that across the cycle there should not be a deficit lower than 0.5% of GDP (1% for countries with public debt significantly below 60% of GDP).

activated in case of significant deviations from their specific fiscal targets. A duty to drastically reduce public debt to reach the 60% threshold was also introduced<sup>905</sup> and Member States subject to the excessive deficit procedure were required to enter into economic partnership programmes, including structural reforms of their economies.<sup>906</sup>

Clearly, similar norms further stiffened the neoliberal profile of the EU constitutional order and, on that basis, envisaged alignment within national constitutional settings. As purposiveness escalated, it became increasingly evident that the euro area was no place for Keynesians.<sup>907</sup> The policies adopted at the behest of the EU and the closure of the institutional framework fuelled antagonism and resentment in both creditor and debtor countries.<sup>908</sup> No surprise then, that in a context of unmediated and suppressed political conflicts, the EMU and, by extension, the EU came to be regarded by significant parts of national electorates as toxic projects to be overthrown.

The deterioration of the EU institutional architecture entailed another phenomenon typical of prevailingly purposive constitutional orders. A few years after its adoption, the TSCG revealed all its rigidity and incapacity to deal effectively with the ongoing financial and economic crisis. Fiscal rules were repeatedly violated without sanctions by EU supervising authorities. From being conceived as categorical norms, fiscal rules were reinterpreted as indicative targets steering national economic policies. In place of rule enforcement, EU economic governance resorted to broad usage of discretionary flexibility to carve out some interstice for counter-cyclical fiscal policies.<sup>909</sup> But even if this relaxation of fiscal rules probably made much more economic sense than their strict application, it did not imply the abandonment of the persisting purposive orientation of the EU institutional setting.

A similarly elusive approach was also visible in the field of monetary policy. As the reform of fiscal rules and the vehicles of financial assistance revealed itself to be insufficient to appease financial markets, it was up to the ECB to step in as the ultimate institution ensuring macroeconomic stability. So, if at the beginning of the crisis the ECB seemed to keep within the confines of its modest role, it later started to operate as a lender of last resort for private financial institutions and sovereign states. This move was coherent with the programmes already implemented by other central banks outside the euro area, but sat uneasily with the original mandate defined in the Treaty. In particular the launch of programmes such as Outright Monetary Transactions (OMT)<sup>910</sup> and the public sector purchase

<sup>&</sup>lt;sup>905</sup> Article 4 of the TSCG.

<sup>&</sup>lt;sup>906</sup> Article 5 of the TSCG.

<sup>&</sup>lt;sup>907</sup> Chessa (2016), p. 414.

<sup>&</sup>lt;sup>908</sup> Chalmers (2012), p. 607.

<sup>&</sup>lt;sup>909</sup> See European Council Conclusions 27 June 2014 and Communication from the Commission, "Making the best use of the flexibility within the existing rules of the stability and growth pact" COM(2015)12 final.

<sup>&</sup>lt;sup>910</sup> Technical Features of Outright Monetary Transactions, available at www.ecb.europa.eu

programme (PSPP)<sup>911</sup> implied a generous construction of the boundaries of a monetary policy, primarily focused on price stability, as well as a lenient interpretation of the prohibition of monetary financing. Nonetheless, the ECB was essentially forced by circumstances to proceed in that direction, first to stabilise financial markets and then to contrast deflation and relaunch economic growth.

No matter how economically sound and effective those measures were, their constitutional implications were problematic for at least two interlinked reasons. First, the developments at issue raised justified concerns from a rule of law standpoint. Against the standard set by the original interpretation of the Treaties, those measures were rightly regarded as unconventional. As noted in relation to the no-bailout clause, in this respect judicial validation also required a considerable degree of deference and a number of qualifications on the part of the courts involved. Yet, unlike in the case of the no-bailout clause, the ECB programmes also entailed the systematic reconsideration of earlier judicial gualifications - a fact that, clearly, sits at odds with the EU's rule of law commitment.<sup>912</sup> Indeed, the OMT programme had been certified by both the CJEU and the German Federal Constitutional Court on the basis of its exceptional character and its coupling with the European Stability Mechanism's conditionality.<sup>913</sup> Those conditions were later challenged by the PSPP programme, framed as a regular monetary policy intervention and untied from any formal conditionality. In the review of this programme, both the CJEU<sup>914</sup> and its German counterpart<sup>915</sup> more or less agreed on a set of safeguards that guantitative easing programmes ought to respect to avoid infringing the prohibition of monetary financing. Yet, those limits were probably strained when, in the early phases of the COVID-19 pandemic, the ECB implemented its pandemic emergency purchase programme.916

The second troublesome implication of the ECB's unconventional programmes concerned democracy. Remember that the narrow scope of intervention originally assigned to the ECB was justified as a necessary and yet circumscribed derogation to the commitment of national constitutions to representative democracy. On these premises, expansion of the ECB's role would clearly create a void of democratic accountability.<sup>917</sup> No matter how justified by the need to fight deflation and economic stagnation<sup>918</sup>, the new ECB programmes were implemented in a context of

<sup>&</sup>lt;sup>911</sup> Decision (EU) 2015/774 of the European Central Bank of 4 March 2015 on a secondary markets public sector asset purchase programme (ECB/2015/10) (OJ L 121, 14.5.2015, p. 20).

<sup>&</sup>lt;sup>912</sup> Dani et al. (2021), pp. 323-324.

<sup>&</sup>lt;sup>913</sup> *Gauweiler*, C-62/14, EU:C:2015:400 and BVerfG, Judgment of the Second Senate of 21 June 2016 - 2 BvR 2728/13, DE:BVerfG:2016:rs20160621.2bvr272813.

<sup>&</sup>lt;sup>914</sup> Weiss, C-493/17, EU:C:2018:1000.

<sup>&</sup>lt;sup>915</sup> BVerfG, Judgment of the Second Senate of 5 May 2020 - 2 BvR 859/15, DE:BVerfG:2020:rs20200505.2bvr085915.

<sup>&</sup>lt;sup>916</sup> Decision (EU) 2020/440 of the European Central Bank of 24 March 2020 on a temporary pandemic emergency purchase programme (ECB/2020/17) (OJ L 91, 25.3.2020, p. 1).

<sup>&</sup>lt;sup>917</sup> Dani et al. (2021), p. 321.

<sup>&</sup>lt;sup>918</sup> Tooze (2020), p. 30.

precarious democratic authorisation and weak democratic controls<sup>919</sup>. The economic and financial crisis showed how remote and costly the possibility of reverting to the apparently cheerful days before the crisis was, in which the pretence of a distinction between economic and monetary policy could still appear credible. Unconventional monetary measures were there to stay and, if modifications were required at all, they should be targeted to their institutional framework.

#### 5 Deconstitutionalising the EMU

The upshot of the argument presented in this paper is that, because of its prevailingly purposive institutional setting, the EU is misaligned with the prevailingly open constitutional framework of the DSCS. If realignment appears desirable, there are two possible pathways to attain it: on the one hand, a top-down neoliberal realignment of the DSCS, based on the influence and ramifications of the EMU and the primacy of EU law: on the other, the bottom-up redressing of the EU neoliberal bias, based on the rehabilitation of the foundational commitments of the DSCS and, notably, of its open character. If the latter option is favoured (and this is a big *if*), the most obvious ways to realign the EU with the DSCS would be either the creation of a full monetary union or the replacement of the euro area with a more flexible institutional setting enabling Member States' different approaches to activist government. Clearly, both options entail momentous constitutional changes for which there seems to be scant appetite and, most importantly, no political force with the requisite mobilising capacity. This explains the realistic and yet uninspiring muddling through approach followed by the EU from the financial crisis up to the COVID-19 pandemic. This unpredictable shock has further shaken the EU institutional architecture, revealing once again the inadequacy of its institutional framework in coping with unexpected circumstances and their consequences. Tellingly, most of the key norms on which EU economic governance is grounded had to be suspended<sup>920</sup> (or their effects diluted)<sup>921</sup> to enable unprecedented borrowing and activist measures by national governments. After some initial hesitation, the ECB confirmed and broadened its unconventional monetary policy. Moreover, an unprecedented fiscal policy effort was put in place by the EU in an attempt to relaunch economic growth and, in the meanwhile, boost the green and digital transition of national economies.922

Admittedly, most of these developments have been made in exceptional circumstances to buy more time and to prevent the uncoordinated

<sup>&</sup>lt;sup>919</sup> De Boer and Van 'T Klooster (2020), pp. 1703 and 1710.

<sup>920</sup> Statement of EU ministers of finance on the Stability and Growth Pact in the light of the COVID-19 crisis, available at www.consilium.europa.eu

<sup>&</sup>lt;sup>921</sup> Communication from the Commission, 'Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak' (2020/C 91 I/01).

Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility (OJ L 57, 18.2.2021, p. 17).

unravelling of the euro area. Thus, no change of paradigm seems clearly in sight, a fact witnessed by the high degree of ambiguity marking all those policy initiatives. Indeed, EU fiscal rules are going to remain suspended until the end of 2022. In the meantime, a debate has started on their reform in an attempt to build consensus on norms capable to decrease public debt levels without stifling incipient economic growth. Even if these premises hint at a more sensible approach than that inspiring the EU response to the previous financial crisis, at the same time the debate unfolds essentially at a policy level, without any attempt to rethink more comprehensively European economic governance and, notably, its entrenched neoliberal bias. Similarly, the ECB remains well disposed towards operating as a lender of last resort with a view to relaunch and consolidate economic growth. Yet, all these initiatives continue to develop on precarious legal terrain and in the absence of meaningful mechanisms of democratic accountability. Finally, NextGenerationEU may also be the harbinger of an EU endowed with sizeable fiscal capacity to be employed in activist economic programmes. At least for the moment, however, the programme remains exceptional and the conditionality attached to its grants and loans is ominously reminiscent of the structural reforms inspiring the management of the previous financial crisis.

In brief, all these developments gesture towards a realignment with the DSCS, but they also reveal a good deal of path dependency on the part of EU political and institutional actors, and an incapacity to transcend their ingrained mindsets and neoliberal imprinting. In a similar context, the most realistic prediction is that in its post-pandemic new normal the EU will recalibrate the existing policies and institutions in a more sensible social and political direction, but not to the point of redressing its neoliberal purposive posture. As noted above, a similar scenario may mitigate some of the criticism against the EU, but would not entail a genuine realignment with the DSCS – a goal which can be accomplished neither through the mere humanisation of a neoliberal constitutional structures nor through its relaxation or suspension in case of emergencies.

The difference between the most recent developments and a genuine realignment emerges as soon as the latter is conceptualised. To imagine the EU and the DSCS realigned, one does not necessarily have to envisage extreme scenarios such as the completion of the EMU or its dissolution. The guiding idea for realignment should be reverting to an EU intergovernmental framework that facilitates the realisation of the DSCS foundational commitments. A first key step in this direction would be moving away from a prevailingly purposive constitutional order to a constitutional framework made for peoples and governments with fundamentally different views. A similar shift would require the drastic deconstitutionalisation of the Treaties and, correspondingly, the repoliticisation of EU competences.<sup>923</sup> In this perspective, EU institutional actors should return to thinking of the Treaties not as instruments of government but as institutional infrastructures open to democratic competition.

<sup>&</sup>lt;sup>923</sup> See also Grimm (2015), p. 473; Scharpf (2017), p. 321.

In view of its importance and ramifications, the EMU should be the focal point of this endeavour. While present political and economic circumstances make the asymmetry between a federalised monetary policy and decentralised national economic policies difficult to overcome, it seems nonetheless possible to think of significant Treaty changes including the consolidation of the ECB scope of intervention, its subjection to a democratic accountability mechanism and a more open and effective system of macroeconomic coordination of national policies.

Here is what an EMU realigned with the DSCS could look like:

- (a) The objective of full employment would be added to the list of the goals inspiring EU monetary and economic policy enshrined in Article 119(3) TFEU.
- (b) Monetary policy would be defined as a sector specific competence without any constitutional prioritisation of price stability (or any other policy goal). Both the goals and the scope of ECB action would be decided by the Council and the European Parliament on the basis of the ordinary legislative procedure after consulting the ECB.
- (c) The no-bailout clause and the prohibition of direct purchases of debt instruments should be replaced with legal bases enabling the Council and the European Parliament to specify the conditions for, respectively, debt mutualisation and direct and indirect purchases of debt instruments.
- (d) The EU framework for economic policies should be based on a clearer distinction between shared constitutional principles (e.g. the prohibition of excessive government deficits and excessive trade imbalances), to be retained in the Treaties, and more contingent fiscal targets, to be defined by the Council and the European Parliament through the ordinary legislative procedure.<sup>924</sup>
- (e) The focal point of fiscal surveillance by EU institutions should remain narrow (the size of government deficits and trade imbalances). In a context in which national demoi are entrenched and salient policy choices on economic and social affairs are taken at Member State level, EU institutions seem ill equipped to veto specific policy measures. In this respect, the Commission should be assigned a more general *ex ante* suspensive veto on national budgets, with the possibility for the Council to override it with a qualified majority vote.
- (f) Similarly, EU institutions also seem ill equipped to impose specific policy measures on Member States. To encourage the adoption of their preferred economic and social policies, they could provide incentives in the form of conditional spending programmes funded by the EU budget.

<sup>&</sup>lt;sup>924</sup> For a similar suggestion, see Blanchard et al. (2020), pp. 16-19.

# 6 Concluding remarks

Ever since the ratification of the Treaty of Lisbon, treaty amendment has become taboo in the EU. Not even the COVID-19 pandemic has motivated politicians to invest their (modest) political capital in an arduous adventure such as a sweeping treaty reform. So, why should anyone care to discuss proposals such as those sketched in this paper? There are at least two reasons that may justify some interest in them. First of all, the features of a deconstitutionalised EMU offer a vardstick against which to gauge recent and forthcoming European developments and, notably, to avoid the all too easy conclusion that a modicum of flexibility and social recalibration may do the trick of realigning the EU with the DSCS. Second, the horizon of a deconstitutionalised EMU may offer a meeting ground for the most enlightened of supporters of the current EU framework and its moderate critics, namely between that part of the EU establishment that has become aware of the precariousness of the institutional setting and outsiders who are not attracted by the prospect of throwing the baby out with the bathwater. In particular for the former, the prospect of a more inclusive and adaptable institutional framework should be reason enough to forego the structural advantage conferred on them by the EU amendment clause and undertake more daring high profile initiatives.

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Law and the markets – the role of international financial institutions between market participants and public policy: a practitioner's view

By Barbara Balke\*

The activities of international financing institutions (IFIs) provide an interesting practical example of the interplay between the law and the markets.

The law provides the framework within which the activities of market players have to be exercised. This is the case both for private sector players but also, and very much so, for public sector actors and for international organisations and IFIs whose entire *raison d'être* is defined by the legal framework establishing them. Keeping the balance between purposefully and constructively interpreting this legal framework and avoiding the risk of going beyond its boundaries – and ultimately risking a breach of the law – is a constant reality in the practice of the legal departments of such organisations.

This paper explores some examples drawn from the experience of the European Investment Bank (EIB) of how these boundaries between the strictures of the legal framework, on the one hand, and the economic and political realities driving the role of the institution, on the other hand, have been balanced in practice.

#### 1 Introduction

The EIB was created in 1958 by virtue of Articles 129 and 130 of the Treaty establishing the European Economic Community. Its Statute is attached to the Treaty on European Union (TEU) and the Treaty on the Functioning of the European Union (TFEU) as Protocol (No 5), and thus forms an integral part of both Treaties.

The EIB's Treaty based and statutory role is to "contribute, by having recourse to the capital market and utilising its own resources, to the balanced and steady development of the internal market in the interest of the Union". Under Article 209(3) TFEU the EIB also supports European Union (EU) cooperation programmes with developing countries.

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Law and the markets – the role of international financial institutions between market participants and public policy: a practitioner's view

Under the lighter procedure introduced by the Lisbon Treaty<sup>925</sup> in 2009, the EIB Statute can today be amended by the Council acting unanimously (at the request of the EIB or the European Commission and after consulting the European Parliament and the Commission, or the EIB, respectively). A formal Treaty change via the heavy procedure of an Intergovernmental Conference is therefore today no longer required to amend the legal framework governing the EIB's activities, which was the case for the first 50 years of its existence.

The Treaty provisions position the EIB between the markets on the one hand and a public mission to contribute to political objectives pursued by the EU and enshrined in the Treaties on the other hand (Article 309 TFEU).

Thus from its inception, the EIB was set up as an entity with a dual nature: it is an EU body closely involved in the pursuit of the general economic policy objectives of the EU, while it is also a market player active in capital markets. The dual nature of the EIB explains why this EU body has stood at the crossroads between the law and the markets and been able to negotiate its way in the face of an ever-shifting balance between those two fora: it is the EIB's independence and legal autonomy as a market player that allows it to finance itself in the capital markets in order to fund its financing activities. Conversely, the EIB's public policy mandate is to provide banking products (the Statute specifically mentions loans and guarantees) in sectors and geographies where markets and economic participants are not provided with sufficient financing, in order to create markets or to act as a catalyst for other forms of financing.<sup>926</sup> The EIB uses the same types of instruments as commercial banks - it provides loans, guarantees and other types of financing instruments including equity - and it finances its activities through bond issuances in the capital markets. However, it distinguishes itself from other banks in that it finances projects that might not come to life otherwise since neither public nor private players might be willing or capable by themselves of providing financing. This concept is often referred to as "providing additionality"927 and is a common feature of IFIs.

The purpose of this contribution is to provide a practitioner's view on how the primary law (the TFEU and the Statute) that governs the EIB captures the highlighted tension of being both a bank and an international financing institution. This contribution further illustrates the way in which one of these facets tends to triumph over the other depending on prevailing political views and economic circumstances. It also provides the EIB's perspective on bridging the gap between its two roles through its best banking practice (BBP) approach.

<sup>925</sup> Article 308(3) TFEU.

<sup>&</sup>lt;sup>926</sup> A guide to multilateral development banks, 2018, p. 8.

<sup>&</sup>lt;sup>927</sup> According to the Multilateral Development Banks' (MDBs') harmonized framework for additionality in private sector operations, p. 7: "Additionality refers to key financial and non-financial inputs brought by MDBs to a client and project to make the project or investment happen, make it happen much faster than it would otherwise, or improve its design and/or development impact."

# 2 The EIB and examples of the (re) constitutionalisation of EU law or the dynamic mandate of the EIB

Institutions like the EIB have it in their DNA to be constantly acting on the borderline between being a public institution and having to intervene in an environment determined by market forces. These two perspectives are not always easy to align. The following examples look into the main activities of the EIB – lending and borrowing – and analyse the evolution of the EIB's statutory powers for the deployment of these activities, both by means of interpretation and finally by means of a "(re)constitutionalisation" of the competences of the Bank in the Treaties.

#### 2.1 EIB lending activities

In its lending operations, an institution like the EIB is intended to "intervene" in the markets rather than to follow them. Therefore, by design, the Member States have chosen to create an instrument that – unlike credit institutions – is not merely subject to market forces but implements political choices where purely market driven operators would abstain from intervening, i.e. they would not finance a given project or would not finance it on the required terms.

This facet of the EIB also unveils the dynamic, ever-evolving nature of the mandates of the EIB and other IFIs. Whereas the EIB's mission is clear – to provide financing in economic sectors or geographic areas less well served by available market sources – the avenues taken to achieve it vary as financing needs change over time and intertwine with the economic and political priorities of society at any given point in time.

Against this backdrop, there have been various instances in the past where the governing bodies of the EIB have looked into solutions that go beyond a literal interpretation of the EIB's statutory framework, adopting instead a purposive or teleological approach to its interpretation.

(i) In the 1990s, the EIB was confronted with a growing need and mounting requests to lend to financially sound counterparties without such lending being backed by a Member State guarantee or other "adequate guarantees" as required at the time by the wording of the Statute. The governing bodies of the EIB considered that the statutory provision requiring a loan to be provided only if accompanied by an adequate guarantee could not be interpreted in a literal manner, as to mean that non-guaranteed borrowers were always barred from access to finance granted by the EIB. Such a restrictive interpretation would in practice lead to the exclusion of a number of otherwise creditworthy borrowers from financing, thus unduly affecting the EIB's fulfilment of its mandate. On that basis, the EIB started lending widely to borrowers without additional guarantees or security, based only on the analysis of their own financial strength and ability to repay the EIB loan.

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(ii) A second occasion on which the EIB had recourse to teleological interpretation of its Statute was to fulfil the Resolution of the European Council on growth and employment adopted in Amsterdam in 1997.<sup>928</sup> The Resolution<sup>929</sup> gave the EIB a pivotal role in creating employment through fostering investment opportunities in Europe, urging the EIB to promote investment projects consistent with sound banking principles and practices, in particular through the establishment of a facility for financing SMEs' high-technology projects, possibly making use of venture capital.

At the time, the Statute did not allow investments in equity, except when such financial instruments were acquired in the context of restructurings as a means to safeguard the rights of the EIB in ensuring recovery of funds lent. The EIB Board of Governors, its highest decision-making body, consisting of ministers designated by the EU Member States, unanimously endorsed the Resolution and in consequence the EIB expanded its catalogue of financial instruments offered to include venture capital instruments, making use of resources derived from its annual surplus. Since the Statute offered some leeway regarding the use of the surplus funds, it was interpreted to allow the use of such funds to the extent they remained under the EIB's control and would be dedicated to an EU objective compatible with its mission and ancillary or complementary to its regular activity. The Amsterdam Special Action Programme was thus born. What started as an exceptional measure planned to last between 1997 and 2000 was subsequently extended with the setup of the Structured Finance Facility, which remains active in the areas of transport and energy networks.

In view of the success and evident benefits for the economy and society at large arising from the enhanced financing toolkit available to the EIB, its Statute was eventually amended to incorporate both interpretations described above as permanent features of its catalogue of interventions. Since the entry into force of the Lisbon Treaty on 1 December 2009, the EIB's amended Statute has formalised both the acceptance of loans on the basis of the borrower's financial strength and equity participations as a means of EIB financing.

The above examples are prime illustrations of the EIB's ability to intervene on the markets while at the same time evidencing the limits of market logic as well. Investors tend to shy away from markets or investments characterised by high risk or low revenue expectations, hence innovation and social investments present investment gaps, which are frequently primarily addressed by policy driven investors.

<sup>&</sup>lt;sup>928</sup> Resolution of the European Council on growth and employment (OJ C 236, 2.8.1997, p. 3), also referred to as the "Amsterdam Pact". The Resolution was adopted at the same time as the negotiations that concluded the Treaty of Amsterdam and as a consequence of the enlarged powers of the EU in the field of social policy, including employment.

<sup>&</sup>lt;sup>929</sup> The Resolution was part of a wider package of reforms of EU governance introduced by the Treaty of Amsterdam.

Political actors (namely Member States as EIB shareholders) have legitimised the EIB's intervention in such markets through political decisions later constitutionalised at Treaty level. As a result, initially temporary measures prompted by policy reasons evolved into permanent responses that stretched beyond crisis periods, forming part of the *acquis communautaire*.

The cases described above testify to the IFIs' important political mission and the dynamic nature of promotional/development lending: once a market is created, which is to say once a certain level of maturity in the game of offer and demand is attained for a certain asset, it is time for the IFIs to reinvent themselves and find another "not so perfect" market. Examples can be found in the EIB's intervention in the aftermath of the 2007-2009 global financial crisis, the deployment of the European Fund for Strategic Investments, the response to the refugee crisis through the Resilience Fund and, very recently, action supporting the pandemic recovery with the European Guarantee Fund. In these examples, the focus on areas where pure market logic does not allow satisfactory deployment of private or other public means of finance is evident. The law that governs IFIs needs to be able to provide the necessary tools for them to up their game and rise to these challenges within appropriate timeframes, utilising adequate means and with reasonable legal certainty.

#### 2.2 EIB funding activities

Funding activities are at the core of IFIs' financial model, as capital markets constitute their almost sole source of resources.<sup>930</sup> Given their legal autonomy, IFIs are able to shape their funding programmes, independent of government mandates, to respond to their lending needs. The funding activities of the EIB also evidence the use of its political and economic weight to steer the investments of institutional investors, shifting those investments towards environmental, social and governance (ESG) goals. The EIB's precursor role in this context is clear: in 2007, it pioneered the green bonds market by issuing the world's first climate awareness bond. In 2014, green bond volumes tripled and the first iteration of the Green Bond Principles was published, with a substantial contribution from the EIB given the expertise it had acquired in this field. The EIB was the first institution to link individual green bonds with renewable energy and energy efficiency projects, in 2015.

In 2018, drawing on its experience and as an observer of the High-Level Expert Group on sustainable finance, the EIB supported the recommendation to establish an EU green bond standard (EU GBS). In 2019, as a member of the Technical Expert Group on sustainable finance, it

<sup>&</sup>lt;sup>930</sup> As distinct from credit institutions, IFIs do not take deposits and, apart from funds raised in the capital markets, they rely on the capital subscribed by their shareholders.

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provided detailed input on this subject in the recommendation for an EU GBS<sup>931</sup>.

Additionally, Sustainability Awareness Bonds (SABs) were launched in September 2018 with an initial focus on water projects. Their scope was extended to health and education projects in late 2019. In 2020, SAB health eligibilities have included the EIB's financing directly related to the fight against the COVID-19 pandemic. SABs support the implementation of the Commission Action Plan for Financing Sustainable Growth launched in March 2018 and contribute to the implementation of the 2030 Agenda and the Sustainable Development Goals.

SAB projects are expected to significantly contribute to the achievement of sustainability objectives.

The establishment of a unified classification system for sustainable activities (the "EU Taxonomy") is a key part of the Commission's Action Plan for Financing Sustainable Growth. The EIB has strongly supported this initiative, initially as a member of the HLEG and more recently as a member of the TEG. The EIB Group continues this support as a member of the Platform on Sustainable Finance directly appointed through Article 20 of the Taxonomy Regulation.

# The other side of the coin – banking regulation and its application to public policy driven banks

As a result of the Lisbon Treaty of 2009, the enlargement of the EIB's intervention tools, which endowed it with powers to enhance its action as an IFI, was complemented by a duty of the Audit Committee of the EIB to verify that the EIB's activities conform with BBP (Article 12(1) of the EIB Statute).932

Once more, the tension between the public policy and banking facets of the EIB's role came to the fore. Given the key role played by the EIB in the aftermath of the financial crisis and the expansion of its balance sheet because of the breadth of its support to the real economy, the 2009 amendment to the Statute tends to give equal prominence to the financial soundness of the institution.

Article 12(1) has been interpreted (by the EIB's governing bodies) as meaning adherence to prudential norms applicable to banks to ensure their

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<sup>&</sup>lt;sup>931</sup> TEG Report Proposal for an EU Green Bond Standard, June 2019, available at www. ec.europa.eu

<sup>&</sup>lt;sup>932</sup> Article 12 of the Statute reads as follows: "A Committee consisting of six members, appointed on the grounds of their competence by the Board of Governors, shall verify that the activities of the Bank conform to best banking practice and shall be responsible for the auditing of its accounts."

economic resilience.<sup>933</sup> This interpretation certainly raises the EIB's accountability towards its shareholders and the market at large. However, it may ultimately require the EIB to engage more and more in bank-like operations, thus begging the question as to the effective fulfilment of the political mission of IFIs as agents of change.

IFIs accomplish their mission by performing a banking function where credit is not available or not available under normal market conditions. However, it is also assumed that, given that they work as banks, considerations about loan repayment by borrowers will necessarily play a role in the decisionmaking processes of multilateral development banks (MDBs).<sup>934</sup> Furthermore, IFIs are able to finance their activities by borrowing in the capital markets on good terms. Investors often prefer to acquire liquid assets, on the basis that they can be easily monetised. Consequently, IFIs need to evidence their economic strength, the existence of a robust internal control framework and healthy governance practices. One could say that market discipline is as important for IFIs as for other market participants given the fact that their dependence upon capital markets is a feature by design, i.e. it is embedded in their organisational model. Hence, transparency about risk management processes and governance is key.

As an independent EU body, the EIB takes its own borrowing and lending decisions. Such independence comes at a price: the EIB needs to maintain a sound financial standing in order to borrow money on capital markets so that it may finance itself and lend on favourable terms to projects that support EU objectives. Moreover, the EIB needs to convince investors that buying the bonds it issues is an advantageous and prudent investment.

As EU primary law leaves open the determination of what constitutes BBP applicable to the EIB, it decided to proactively codify and align its BBP framework with the evolving regulatory requirements as a means to demonstrate its accountability towards its stakeholders (notably investors). To this end, the Bank's governing bodies have set out high level principles and related internal processes to assess the applicability to the EIB, on a voluntary basis, of regulatory requirements.<sup>935</sup>

# 4 Conclusion

These few considerations regarding the recent history and the business model of the EIB illustrate the evolving nature of IFIs and the outlook for

<sup>&</sup>lt;sup>933</sup> This is consistent with the methodology used by credit rating agencies to appraise MDBs, which is very much focused on aspects similar to those essential to banks. For a discussion about the drawbacks of such methodology, see Chris Humphrey, "Are Credit Rating Agencies Limiting the Operational Capacity of Multilateral Development Banks?", University of Zurich, available at http://www.g24.org/wp-content/ uploads/2016/01/Are-Credit-Rating-Agencies-Limiting-the-Operational.pdf

<sup>&</sup>lt;sup>834</sup> As noted by Ruth Ben-Artzi. See Ben Artzi, R. (2916), Regional Development Banks in Comparison: Banking Strategies versus Development Goals, Cambridge University Press.

<sup>&</sup>lt;sup>935</sup> Best Banking Practice Guiding Principles of the European Investment Bank, available at www.eib.org/attachments/general/best\_banking\_practice\_guiding\_principles\_en.pdf

their role: if an institution like the EIB is limited to filling gaps where other market players do not invest, how should those gaps be determined? Is the law unduly constraining the effectiveness of EU policy instruments such as the EIB if the concept of a "market gap" is viewed too narrowly rather than taking a more policy driven view of where the EU wants investments to happen in the first place? Where does the institution have a "pathfinder role", i.e. where do we want to use public instruments like the EIB to move markets in a direction that they are not taking by themselves?

By way of example, the EIB has acted as a pioneer in the field of green finance and climate finance by taking a leading role in developing products that markets were not offering. It was the first issuer to issue "green bonds", leading the way for a market that has boomed since.<sup>936</sup>

IFIs need to reflect on whether the standards their legal frameworks provide to appraise operations are fit for purpose in all jurisdictions and in all political and economic circumstances where they are asked to intervene. If they are not, consideration should be given to the question of which standards should be applicable and how far the legal framework defining the IFI's activity can be stretched. The response to these and other questions, on whether law should prevail over the markets or the other way round hangs on political decisions about the role of IFIs. This role is constantly developing and we may expect new developments in their mandates.

<sup>&</sup>lt;sup>936</sup> The European Commission, following the EIB's lead, aims to issue up to EUR 250 billion worth of green bonds under the Next Generation EU recovery plan over the coming five years, cementing Europe's position as the leading region for sustainable finance.



Panel 4: Digitalisation of finance: the challenges from a central bank and supervisory perspective

# Digital finance: emerging risks and policy responses

#### **By Fabio Panetta\***

Technological innovation has been a source of competitive advantage within the financial sector, traditionally at the forefront in the use of IT systems. Since the middle of the last century, banks and payment service providers have introduced innovative payment solutions that have marked important milestones in the evolution of financial services.<sup>937</sup>

But the pace of change has now accelerated. The digital transformation that has revolutionised the market for goods and services has renewed the payment landscape, where digital payment solutions have grown rapidly to accommodate the needs of ecommerce and offer convenient cashless and contactless payment options. The digital transformation of financial services is now entering a second stage with the growth of decentralised finance and the entry of Big Tech firms, which bring new risks.

The future shape of the financial sector will depend on market forces and consumer preferences, but also on the ability of policymakers to provide an appropriate policy response. This has two dimensions: (i) the regulatory response to market transformations, and (ii) central bank digital currencies to preserve the role of sovereign money as an anchor for payments also in the digital age. These two dimensions are discussed in turn.

# 1 Market transformations and the regulatory response

As more and more financial and non-financial players are looking for better ways of meeting consumers' needs, retail financial services are becoming more decentralised.

One example is the emergence of decentralised finance (DeFi), that is platforms in which financial products become available on a public decentralised blockchain network. These platforms are increasingly gaining ground. The size of DeFi globally grew sevenfold in just nine months: from USD 15 billion at the end of 2020 to about USD 110 billion as at September 2021.<sup>938</sup> While up to 2020, by far the most web traffic to DeFi protocols

<sup>\*</sup> Member of the Executive Board, European Central Bank.

<sup>&</sup>lt;sup>937</sup> See Panetta, F. (2017), "L'innovazione digitale nell'industria finanziaria italiana", Municipality of Milan - Ministry of Economy and Finance Inauguration of the Fintech District.

<sup>&</sup>lt;sup>938</sup> Size refers to the total value locked, or the total dollar value of all collateral deposited in DeFi platforms. See IMF (2021), "Global financial stability report: covid-19, crypto, and climate: navigating challenging transitions".

came from North America, Europe is now contributing a substantial and growing percentage to this market.

Moreover, the world of DeFi is increasingly turning towards speculation, through investment and arbitrage in digital assets such as crypto-assets and stablecoins, rather than towards the creation of services that are useful for the real economy.<sup>939</sup>

The value of crypto-assets is growing rapidly and currently stands at over USD 2,500 billion.<sup>940</sup> That is a large figure with the potential to generate significant risks to financial stability, especially where combined with leverage. For example, it exceeds the value of the securitised sub-prime mortgages that triggered the global financial crisis of 2007-2008.<sup>941</sup>

If we underestimate these developments, we may find ourselves in a situation where, when the bubble bursts, we suddenly realise the extent to which exposures and interlinkages have spread within the financial system. It should not take another financial crisis to regulate crypto-assets.

In spite of the substantial sums involved, there is no sign that crypto-assets have performed, or are performing, socially or economically useful functions. They are not generally used for retail or wholesale payments, they do not fund consumption or investment, and they play no part in combating climate change.

In fact, there is clear evidence that they do the exact opposite: cryptoassets can cause huge amounts of pollution and damage to the environment. And they are widely used for criminal and terrorist activities, or to hide income from the eyes of the tax authorities. It is estimated that over the course of 2019, USD 2.8 billion worth of Bitcoin was traded by criminal entities. According to other estimates, the volume of criminal business in 2020 reached over USD 3.5 billion.<sup>942</sup> Finally, they provide legitimate investors with no protection whatsoever against IT or cyber risks. On the whole, it is difficult to see a justification for the existence of crypto-assets in the financial landscape.

Stablecoins are also expanding fast. Since early 2020 the value of stablecoins in circulation has risen from USD 5 to USD 120 billion.<sup>943</sup> These are digital instruments whose value is linked to that of a portfolio of low-risk assets (reserve assets) such as currencies or securities. Without

<sup>&</sup>lt;sup>939</sup> See BIS (2021), "The risks of DeFi and the illusion of decentralization", *BIS Quarterly Review*, December 2021.

<sup>&</sup>lt;sup>940</sup> See Panetta, F. (2021a), "Stay safe at the intersection: the confluence of big techs and global stablecoins", speech at the conference on "Safe Openness in Global Trade and Finance" organised by the UK G7 Presidency and hosted by the Bank of England, October.

<sup>&</sup>lt;sup>941</sup> See Panetta, F. (2021b), "The present and future of money in the digital age". Lecture by Fabio Panetta, Member of the Executive Board of the ECB, December.

<sup>&</sup>lt;sup>942</sup> See Chainalysis (2020), "The 2020 State of Crypto Crime", January and Ciphertrace (2021). "Cryptocurrency crime and anti-money laundering report", February.

<sup>&</sup>lt;sup>943</sup> See Panetta, F. (2021a).
appropriate, rigorous regulation, stablecoins are also unfit to perform the functions of money: as they are low-risk but not risk-free, they are particularly vulnerable to possible runs in the event that holders experience a loss of faith.

Their dissemination could influence monetary policy implementation and undermine the efficiency of the securities markets.<sup>944</sup> For example, one of the most widespread stablecoins promises "stability" by investing in low-risk assets such as commercial paper, and holds a large proportion of the stock of these instruments in circulation. In a situation of stress, large-scale sales of assets in response to a sudden increase in redemptions could generate instability throughout the commercial paper market. This phenomenon could spread to other stablecoins and related sectors, eventually finding its way to the banks that hold the stablecoins' liquidity.

These risks could be amplified by a lack of transparency around the composition of reserve assets, by a lack of checks on conflicts of interest between issuers and holders of stablecoins, by cases of fraud or mismanagement, and by the link between stablecoins and crypto-assets.<sup>945</sup>

In sum, stablecoins are not therefore so "stable", and that's why I have previously referred to them as "unstable coins".<sup>946</sup> In fact, a third of stablecoin initiatives launched on the market in recent years have not survived.<sup>947</sup>

If they are kept within a framework of effective rules and checks, some privately issued digital finance instruments can increase the efficiency of payments, especially international payments. But they must be adequately regulated. Europe is at the forefront of regulation, supervision and oversight of digital finance.<sup>948</sup> In countries outside Europe calls for stricter controls are becoming louder. In the US, the Chair of the Commission for Securities and Exchanges<sup>949</sup> and the report prepared by the President's working group on financial markets clearly indicated the need for congressional action to regulate stablecoins.<sup>950</sup>

<sup>&</sup>lt;sup>944</sup> See Panetta, F. (2020), "The two sides of the (stable)coin", speech at II Salone dei Pagamenti, November.

<sup>945</sup> See Panetta, F. (2021b).

<sup>&</sup>lt;sup>946</sup> See Panetta, F. (2021), interview with the *Financial Times*, conducted by Martin Arnold, 20 June.

<sup>&</sup>lt;sup>947</sup> See Mizrach, B. (2021), "Stablecoins: Survivorship, Transactions Costs and Exchange Microstructure".

<sup>&</sup>lt;sup>948</sup> The European Commission recently introduced a Proposal for a Regulation on Markets in Crypto-assets (MiCA). The ECB has updated its Payment Instruments, Schemes and Arrangements (PISA) supervisory model for electronic payment products to include digital payment tokens such as stablecoins.

<sup>&</sup>lt;sup>949</sup> See Aspen Security Forum 3 August 2021, available at: www.sec.gov/news/ public-statement/gensler-aspen-security-forum-2021-08-03#\_ftn11

See the report prepared by the US President's Working Group on Financial Markets, jointly prepared by the Office of the Currency Controller (OCC) and the Federal Deposit Insurance Corporation (FDIC), "Report on Stablecoins", available at: www. home.treasury.gov/system/files/136/StableCoinReport\_Nov1\_508.pdf

At the same time, the proliferation of crypto-assets and stablecoins should not be seen in isolation. Big Tech<sup>951</sup> firms are also expanding their financial business<sup>952</sup>.

First, Big Tech firms are beginning to offer a broad range of financial services and are increasingly competing with incumbent financial institutions. The payment and wallet services offered by Big Tech firms are now part of everyday life: they allow users to pay at point-of-sale terminals and on e-commerce platforms and apps. In parallel, Big Tech firms are increasingly leveraging their free access to vast amounts of customer data that feed into artificial intelligence (AI) driven models to provide financial services. While their direct activity in this area is still limited at the global level, they may play a crucial role in the near future, especially in retail financial services.

Second, they have already become important players in global financial markets owing to their very large holdings of liquid assets, including marketable securities.<sup>953</sup> The aggregate liquid assets of GAFA has more than quadrupled since 2011, reaching USD 370 billion in 2020. This is larger than the high-quality liquid assets of five of the eight global systemically important banks headquartered in the euro area.

Third, and more importantly, Big Tech firms are also developing digital alternatives to traditional forms of money, namely global stablecoins.

The convergence of these two tendencies – the growth of stablecoins and Big Tech's expansion in the finance sector – could have a drastic impact on the functioning of financial markets and supplant traditional intermediation and payment services. Central banks all over the world have now recognised the need to address the financial stability issues arising from these trends.

At the same time, we should be mindful that if we want to be successful, we have to have solid legal foundations. We need to carefully reflect on the necessary changes to regulation that would ensure that digitalisation of finance promotes innovation and financial inclusion but does not undermine financial stability.

This means that over and beyond recent initiatives to regulate, supervise and oversee digital finance, we must strive to continuously identify

<sup>&</sup>lt;sup>951</sup> The term "Big Tech" refers to technological giants such as Google, Amazon, Facebook and Apple (GAFA).

<sup>952</sup> See Panetta (2021a).

<sup>&</sup>lt;sup>953</sup> The more than fourfold increase in liquid assets of GAFAs over the past ten years has mirrored the fivefold increase in their cumulative total assets during the same period, from USD 220 billion to USD 1,124 billion. On aggregate, as of 2020, marketable securities represent two-thirds of the total liquid assets of Google, Apple, Facebook and Amazon, and this proportion has been rather stable over the last ten years (with a low of 57% and a peak of 76%). Although there are some noticeable differences across the individual companies, US government securities and corporate debt securities are generally the largest components of their liquid asset holdings.

loopholes and close them. We will need to keep the regulatory framework under continuous review and make it as forward looking as possible. Legislators can contribute by providing the necessary flexibility in legislation so that regulators, supervisors and overseers can keep pace with technological change and market transformations. And cooperation with authorities in various fields – competition, investor protection, data protection, taxation, anti-money laundering, cybersecurity – will be increasingly needed. In other words, we need to transform regulation just as digital finance is transforming payments.

### 2 The case for a central bank digital currency

At the same time, we should acknowledge that regulation is a necessary, but insufficient, condition for tackling the concerns I just outlined. Without convertibility at par with digital sovereign money, digital payments would lack the anchor that has brought stability to payments and the financial system before the digital transformation.

Central banks will thus also need to go digital and the ECB has started the investigation phase of a retail central bank digital currency (CBDC), the digital euro.<sup>954</sup> CBDCs would provide an anchor of stability for the digital finance ecosystem at both the domestic and global level.

Confidence in savings held as private money is indeed largely determined by the strength of central bank money – the monetary anchor – and by the convertibility of private money into public money. Central bank money is a safe form of money that is guaranteed by the State, by its strength, its credibility and its authority. Other forms of money consist of private operators' liabilities; their value is based on the soundness of the issuer and is underpinned, in the last analysis, by the promise of one-to-one convertibility with risk-free central bank money.

In practice, many people are unaware of the differences between public and private money. This is what economists call "rational inattention".<sup>955</sup> However, people know that banknotes protect them from the consequences of intermediaries potentially defaulting and they make their payment and savings choices accordingly.

This does not mean that the safeguards put in place to protect savings – legislation and banking supervision, deposit insurance schemes, capital markets supervision – are not important. On the contrary. They must, however, be flanked by convertibility to ensure the orderly conduct of payments, the stability of the financial system and the soundness of the currency.

<sup>&</sup>lt;sup>954</sup> ECB (2021), "Eurosystem launches digital euro project", press release, 14 July.

<sup>&</sup>lt;sup>955</sup> See Sims, C. A. (2003), "Implications of rational inattention", *Journal of Monetary Economics*, 50(3), pp. 665-690.

Without the anchor of sovereign money, people would have to constantly monitor the safety of private money issuers in order to value each form of money. This would undermine the functioning of the payments system and confidence in savings.

Today, citizens hold central bank money in the form of banknotes. In the future – in a digitalised world – cash could however lose its central role. The way people make their purchases has been changing, especially since the start of the pandemic.<sup>956</sup>

Two trends are emerging.<sup>957</sup> The first is the tendency to use digital instruments, with the use of cards or apps on our mobile devices to make payments.<sup>958</sup> The second is online shopping. Consumers are buying goods and services – food, clothing, package holidays – not only in bricks and mortar local shops, but more and more on the internet.<sup>959</sup>

Cash is increasingly used as a store of value and decreasingly as a means of payment.<sup>960</sup> The cash stock has continued to increase, driven by the precautionary demand for cash. However, only about 20% of the stock is now used for payment transactions, down from 35% 15 years ago.

Cash purchases are therefore decreasing. If this trend were to continue, banknotes would eventually lose their central role and become a marginal means of payment. Even central banks' efforts to continue to supply banknotes would not be enough to preserve that role in the face of insufficient demand for cash as a means of payment. Citizens could therefore lose a simple, safe and reliable means of payment that is provided for free by the State and universally accepted.

This would create a need to introduce a public digital currency. Central banks must ensure that central bank money is fully usable and can retain its role as a payments anchor. That is the primary objective of the digital euro.

<sup>&</sup>lt;sup>956</sup> See Panetta, F. (2021), "Cash still king in times of COVID-19", keynote speech at the Deutsche Bundesbank's 5th International Cash Conference, Frankfurt am Main, June.

<sup>957</sup> See Panetta, F. (2021b).

<sup>&</sup>lt;sup>958</sup> If given the choice, almost half of euro area consumers would prefer to pay with cashless means of payment, such as cards. See ECB (2020), "Study on the payment attitudes of consumers in the euro area (SPACE)", December.

<sup>&</sup>lt;sup>959</sup> Internet sales in the euro area have doubled since 2015. In August 2021 the Eurostat index of retail sales via internet or mail order houses (seasonally and calendar adjusted, index 2015=100) stood at 206.

See Zamora-Pérez, A. (2021), "The paradox of banknotes: understanding the demand for cash beyond transactional use", Economic Bulletin, issue 2, ECB, Frankfurt am Main.

## 3 Conclusions

It took a major crisis to step up the regulation of banks and another to focus more deeply on risks from money market funds, investment funds and margining practices.

Policymakers around the world should not wait for another crisis to regulate increasingly digitalised finance with new global players. In fact, this regulatory effort must be continuous in order to keep pace with technology. Regulators and supervisors will need to be empowered accordingly.

The problem is how to do this. The session on "Digitalisation of finance: the challenges from a central bank and supervisory perspective" gave valuable advice that policymakers should incorporate into their policymaking.

## The EU Digital Finance Strategy – regulatory challenges and legal approaches

By Jan Ceyssens\*

## 1 Introduction

The digital transformation is changing our financial system at an increasingly rapid pace. Already before the COVID-19 pandemic, more and more Europeans were managing their banking and payments digitally; online brokers allowing retail investors easy access to capital markets had seen their client base and their valuations soar; and banks were increasingly making use of cloud service providers to manage their data – to give just a few examples.

Digital finance offers significant opportunities: it enables the development of new financial products for consumers, including for people currently unable to access financial services; it unlocks new ways of channelling funding to EU businesses, in particular, small and medium-sized enterprises (SMEs); and it offers new delivery mechanisms for existing financial services, thereby making it possible – given the right conditions are present – for firms to scale up much more easily.

Boosting digital finance would therefore support Europe's economic recovery strategy and broader economic transformation. It would open up new channels to mobilise funding in support of the European Green Deal and the New Industrial Strategy for Europe.

As digital finance cuts across borders, it also has the potential to enhance financial market integration in the Banking Union and the Capital Markets Union<sup>961</sup>, thereby strengthening Europe's economic and monetary union. Indeed, digital interaction tools allow financial services users to access a much broader set of financial products than local branches could offer them, including those offered in other European Union (EU) Member States. For financial services suppliers, many innovations can only be

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<sup>&</sup>lt;sup>961</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, A Capital Markets Union for people and businesses-new action plan, COM/2020/590 final of 20 September 2020.

developed and made profitable if financial institutions scale them up and market them across all 27 Member States.

Last but not least, a strong and vibrant European digital financial sector would strengthen Europe's ability to retain and reinforce our open strategic autonomy in financial services and, by extension, our capacity to regulate and supervise the financial system to protect Europe's financial stability and our values.

For these reasons, in September 2020, following on from a public consultation and a broad public outreach across Member States, in its Digital Finance Strategy<sup>962</sup> the European Commission proposed a strategic objective, namely for the EU to embrace digital finance and all the opportunities offered by the digital revolution, and to be the driving force behind it, with strong European market players in the lead, in order to make the benefits of digital finance available to European consumers and businesses. At the same time, the strategy also calls for the promotion by Europe of digital finance based on European values and the sound regulation of risks. The latter is particularly important since the digital transformation of the financial system will not change the fundamental nature of finance and the risks related to it. These risks have led legislators to regulate this sector much more tightly than other parts of the economy and to put it under the close supervision of central banks and financial supervisory authorities. Today, on account of the objectives to create a single market for financial services and, since 2007, to ensure a coherent common response to the financial crisis, a single rulebook common to all 27 EU Member States includes many key regulatory measures. An important element of the EU digital finance strategy and the measures it announced around a set of four priorities is therefore to adjust the regulatory system established by the EU and composed of dozens of detailed directives and, increasingly, regulations on the developments of the digital age in finance.

In the following sections, a number of regulatory challenges linked to the digital transformation will be examined, and the way in which the Digital Finance Strategy proposes to address them will be highlighted: Section 2 will examine how strong standards of market integrity and financial stability can be brought into new digital market segments; Section 3 will consider how the EU regulatory system can respond to the accelerated pace of change in the digital transformation; and Section 4 will consider how to respond to new actors and new value chains developing in the digital age of the financial system and the broader economy.

<sup>&</sup>lt;sup>962</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on a Digital Finance Strategy for the EU, COM/2020/591 final of 20 September 2020.

## 2 Ensuring safety and integrity in new digital finance market segments – the EU's legislative proposals on crypto-assets

One innovation with the potential to bring significant change to our financial system are crypto-assets - that is, assets based on blockchain or distributed ledger technologies. A key characteristic of these technologies is that they support the distributed recording of encrypted data across multiple entities. As also recognised in the Digital Finance Strategy, crypto-assets can bring significant opportunities in finance: potentially cheap and fast payments, especially for cross-border and international transactions; new funding possibilities for SMEs; and more efficient capital markets. Utility tokens can serve as enablers of decentralised blockchain networks and stablecoins can underpin machine-to-machine payments in mobility, energy and manufacturing sectors. However, they also involve risks, and should therefore be properly regulated and supervised. Indeed, in many instances, crypto-asset markets as they stand today are fraught with a lack of transparency and reliable information for investors about individual assets' risks - leading to a number of high profile cases of outright issuer fraud causing damage to thousands of purchasers. Cryptoassets are usually stored in dedicated wallets, but the absence of clear regulatory standards and their supervisory enforcement has allowed inadequately protected custodial wallets to be marketed to users and led to repeated thefts and losses of crypto-assets in custody. Additionally, at the exchanges, a lack of high operational resilience has led to several hacks over the years. Many crypto-assets that are backed by other assets (asset backed tokens or "stablecoins", that is) have turned out to have a far less solid backing than was promised by their issuers. And even though the immutability of the blockchain should normally make crypto-assets fully traceable, a lack of application and enforcement of anti-money laundering rules has led cyber criminals especially to use crypto-assets for criminal purposes, for example to ensure that ransom payments are made.

A proper regulation of crypto-assets markets therefore has a twofold objective: first, to ensure that financial stability and investors continue to be effectively protected as finance moves to the digital sphere; second, to support the sustainable development of crypto-asset markets, as it makes these asset categories more suitable for mainstream investors. This would also enable traditional financial firms to offer crypto-asset services, if they so wish. As common European rules are usually based on the principle of passporting, it would also facilitate cross-border operations in the EU, allowing firms authorised and supervised in one Member State for compliance with the common rules to market services across all 27 Member States.

The EU legislative proposals approach crypto-assets in a twofold manner. First, they clarify that assets that are based on distributed ledger technology but otherwise have the properties of financial instruments are and remain covered by existing EU legislation. The proposals amend the definition of financial instrument laid down in the Directive on Markets in Financial Instruments (MiFID).<sup>963</sup> The amendment clarifies and confirms the reading set out above based on the principle of technology neutrality.<sup>964</sup> The European Securities and Markets Authority (ESMA) is expected to carry out additional work to ensure supervisory convergence on the qualification of individual instruments on that basis. However, the proposals recognise that not all provisions of the existing rules on trading and settling financial instruments may be suitable for instruments based on distributed ledger technology. Therefore, the proposals include a new pilot regime under which financial supervisors can allow specific treatment of these instruments.<sup>965</sup> Second, for crypto-assets that are not covered by the definition of financial instruments, the Commission proposed a new regulation on Markets in Crypto-Assets (hereinafter "MiCA").<sup>966</sup>

#### 2.1 MiCA – Scope

The scope of MiCA was purposely made relatively wide; it covers any crypto-asset defined as a digital representation of value or rights that may be transferred and stored electronically, using distributed ledger technology or similar technology (Article 2 and Article 3(2)). MiCA covers only privately issued crypto-assets, which are distinct from central bank digital currencies.<sup>967</sup> The purpose of MiCA is to ensure the integrity of financial markets on which crypto-assets are traded. However, crypto-assets are inherently more easily tradable than physical assets, and, because of the nature of crypto-assets, markets can arise even for fungible tokens that may not initially have been created to be traded. To ensure a broad and common framework for crypto-asset markets, and to avoid regulatory arbitrage, the Commission therefore proposed that MiCA apply to all cryptoassets. This was also done to align the EU's definition of crypto-assets with that of the Financial Action Task Force as MiCA sets out definitions that are used by the recently proposed new European anti-money laundering framework. However, MiCA does contain several exemptions from the requirements to be fulfilled by issuers (Article 4(2)), for example for

<sup>&</sup>lt;sup>963</sup> Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (OJ L 173, 12.6.2014, p. 349).

<sup>&</sup>lt;sup>964</sup> Article 6(1) of the proposal for a directive of the European Parliament and the Council amending Directives 2006/43/EC, 2009/65/EC, 2009/138/EU, 2011/61/EU, EU/2013/36, 2014/65/EU, (EU) 2015/2366 and EU/2016/2341, COM/2020/596 final of 24 September 2020.

Proposal for a regulation of the European Parliament and the Council on a pilot regime for market infrastructures based on distributed ledger technology, COM/2020/594 final of 24 September 2020.

<sup>&</sup>lt;sup>966</sup> Proposal for a regulation of the European Parliament and the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937, COM/2020/593 final of 24 September 2020; see also, Zetzsche, D. A., Annunziata, F., Arner, D. W. and Buckley, R. P., "The Markets in Crypto-Assets regulation (MiCA) and the EU digital finance strategy", *Capital Markets Law Journal, Vol.16, No 2*, Oxford Publishing Limited (England), 2021, pp. 203-225; for additional views, see also Siadat, RdF 2021, 172 - Markets in Crypto Assets Regulation – Vertrieb von Kryptofinanzinstrumenten, as well as RdF 2021, 12 - Markets in Crypto Assets Regulation – erster Einblick mit Schwerpunktsetzung auf Finanzinstrumente.

<sup>&</sup>lt;sup>967</sup> See European Central Bank, report on a digital Euro, October 2020.

crypto-assets that are unique and non-fungible and cannot therefore be traded or used for payment purposes or other financial purposes; or for certain utility tokens or tokens that are only generated as part of the validation process for the underlying blockchain. The Council of Ministers has allowed MiCA to retain a relatively broad, if slightly narrowed, scope, covering all fungible crypto-assets.<sup>968</sup>

Based on the model of traditional financial markets regulation – and arguably lawmaking in general – MiCA applies only to financial intermediaries (identifiable persons) who engage in issuance or provide related services.<sup>969</sup>

MiCA does not establish a detailed taxonomy of crypto-assets; any taxonomy of crypto-assets is likely to become outdated very quickly in the light of technological developments. However, within the broad scope mentioned above, certain distinctions are made where diverging properties and risks require a different regulatory treatment as regards the issuers, in line with the principle of proportionality.

MiCA covers crypto-assets regardless of their purpose. Indeed, the function and purpose of a crypto-asset may not be easily ascertainable and may develop over time. However, MiCA includes dedicated rules for cryptoassets that, because of their specific objective features, are likely to become more widespread and could potentially be used as a means of payment (see below).

Crypto-asset markets value chains include numerous functions, including, among others, issuance, wallets for holding crypto-assets, trading, and other functions. As the integrity of crypto-assets markets can be affected by every part of the crypto-markets value chain, MiCA includes dedicated rules both for issuers of crypto-assets (Titles III and IV) and for crypto-asset service providers (Titles V and VI).

#### 2.2 Issuance of crypto-assets

To ensure that proper information is provided to investors, issuers of cryptoassets are required to provide a white paper detailing key information on the nature of the crypto-asset, the risks linked to it, and on the issuer (Article 5, for related liability see Article 14), and must abide by specific rules on marketing communications (Article 6), as well as requirements to act honestly, fairly and professionally to tackle conflicts of interest and

<sup>&</sup>lt;sup>968</sup> General Secretariat of the Council, proposal for a regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937, Mandate for negotiations with the European Parliament, Brussels, 19 November 2021, No 14067/21.

<sup>&</sup>lt;sup>969</sup> On the application of MiCA to "decentralised finance", see Machacek, "Europäische Zeitschrift für Wirtschaftsrecht", 2021, p. 923; on the challenges of decentralised finance for financial regulation, see e.g. Decentralized Finance, Zetzsche D. A., Arner D. W., Buckley R. P., "Author Notes", *Journal of Financial Regulation*, Vol. 6, No 2, 20 September 2020, pp. 172-203.

ensure a certain level of security (Article 13). To ensure proportionality, the crypto-asset white paper is modelled in broad terms on the prospectus issued for securities. Unlike a prospectus, it does not have to be approved in advance by the competent authorities; only a notification is required (Article 7). However, in line with EU consumer protection rules, for crypto-assets that are not admitted to trading on a trading platform, consumers have a right of withdrawal (Article 12 and recital 22).

Enhanced requirements are established for crypto-assets that purport to maintain a stable value by referring to the value of a single official currency (referred to as "e-money tokens" (EMTs)) and for crypto-assets that purport to maintain a stable value by referring to a combination of e-money tokens (referred to as "asset-referenced tokens" (ARTs)); both types of cryptoassets fall into the broader category of "stablecoins". These requirements reflect and implement the recommendations of the Financial Stability Board for global stablecoins<sup>970</sup>, and are to be considered against the background of a joint statement by the Council of Ministers and the Commission of 5 December 2019<sup>971</sup>, which highlighted the opportunities but also the risks inherent in such arrangements, and committed to putting in place measures to ensure appropriate standards of consumer protection and orderly monetary and financial conditions, and asked that no global stablecoin arrangement should begin operation in the EU until the legal, regulatory and oversight challenges and risks have been adequately identified and addressed. While for ARTs these requirements are fully newly established by MiCA, the requirements for EMTs build on and complement the requirements set in the E-Money Directive (EMD)972 to fully reflect the possibility for a token-based e-money to scale up much more easily than traditional e-money. Issuers of stablecoins and their crypto-asset white papers are subject to prior authorisation and a set of risk management and governance requirements (Articles 15 to 31 for ARTs; Articles 43 and 46 for EMTs). In particular, they must be clear about redemption rights for asset holders and establish a reserve of assets to back that right (Articles 32 to 35 for ARTs; Article 44 and related requirements in the EMD for EMTs). Issuers of significant ARTs and EMTs are subject to additional and more stringent requirements and will be supervised directly by the European Banking Authority (EBA) (Articles 39 to 41 for ARTs; Articles 50 to 52 for EMTs), while other issuers (ARTs and EMTs) remain under the supervision of national competent authorities. Since significant stablecoins may have implications for the smooth functioning of payments systems and for monetary policy mechanisms, the ECB has the power to issue opinions on

<sup>&</sup>lt;sup>970</sup> High-level recommendations for the regulation, supervision and oversight of "global stablecoin" arrangements of 13 October 2020.

<sup>&</sup>lt;sup>971</sup> Joint statement by the Council and the Commission on "stablecoins", available at www.consilium.europa.eu

<sup>&</sup>lt;sup>972</sup> Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC (Text with EEA relevance) (OJ L 267, 10.10.2009, p. 7).

them. Following the ECB's legal opinion on the MiCA proposal<sup>973</sup>, the ECB's role was further strengthened and expanded in the legislative procedure.<sup>974</sup> To ensure comprehensive supervision of the entire ecosystem of a significant stablecoin, direct EBA supervision of the issuer is complemented by a college of supervisors, which brings together the EBA and the relevant central banks and supervisors responsible for crypto-asset service providers (see below) in relation to the stablecoin. Lastly, it recognises the potential implications for monetary policy matters of certain crypto-assets by giving an important role to central banks.

The second important aim of MiCA is to provide a regulatory and supervisory framework for the different sets of service providers that are active in the custody, trading, exchange and advice concerning cryptoassets. Indeed, today these services are not covered by MiFID, and a number of Member States have adopted national rules in relation to some of these services.<sup>975</sup> Upon authorisation by a national authority on the basis of these rules, crypto-asset service providers are allowed to market their services across the EU ("passporting", see Articles 53 to 58). One objective of crypto-asset service regulation is to ensure investor protection, market integrity and financial stability (see recital 55 seg.). Key requirements include prior authorisation by national competent authorities, organisational and prudential requirements, and arrangements to safeguard the ownership rights of clients' holdings of crypto-assets (Articles 59 to 66), as well as dedicated requirements for each service (Articles 67 to 73). Finally, requirements to prevent market abuse and market manipulation are established (Articles 76 to 80). All these service providers will consequentially also be covered by EU anti-money laundering rules, based on the recent Commission proposals.976

Overall, MiCA is an attempt to provide a full regulatory framework to ensure consumer protection, market integrity and financial stability in crypto-asset markets, while maintaining a proportionate approach in this sector, which largely operates outside the regulatory sphere. MiCA is the first example of a holistic approach in an emerging digital finance sector that ensures cooperative regulation and supervision of all its elements. Taken together, the MiCA rules have the potential to significantly change the structure of crypto-asset markets, and address the manifold risks to market integrity

<sup>&</sup>lt;sup>973</sup> Opinion of the European Central Bank of 19 February 2021 on a proposal for a regulation on Markets in Crypto-assets, and amending Directive (EU) 2019/1937 (CON/2021/4) 2021/C 152/01 (OJ C 152, 29.4.2021, p. 1).

<sup>&</sup>lt;sup>974</sup> See also the revised Eurosystem oversight framework for electronic payment instruments, schemes and arrangements of November 2021.

<sup>&</sup>lt;sup>975</sup> For example, for France, Loi n° 2019-486 du 22 mai 2019 relative à la croissance et la transformation des entreprises, JORF n°0119 du 23 mai 2019 – "Loi pacte"; for Germany, Gesetz zur Umsetzung der Änderungsrichtlinie zur Vierten EU-Geldwäscherichtlinie (GwRLÄndG k.a.Abk.) G. v. 12.12.2019 BGBI. I S. 2602 (Nr. 50); and, for Malta, Virtual Financial Assets Act, 2018.

<sup>&</sup>lt;sup>976</sup> See proposal for a regulation of the European Parliament and of the Council on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing COM/2021/420 final of 20 July 20201 and proposal for a regulation of the European Parliament and the Council on information accompanying transfers of funds and certain crypto-assets (recast) COM/2021/422 final of 20 July 2021).

and investor protection, which are currently still present. At the same time, MiCA introduces prudent regulation and close European supervision for stablecoins, which will become significant in the EU, in order to ensure full protection of financial stability as well as monetary sovereignty.<sup>977</sup>

# 3 Digital finance and the challenge of regulating rapidly transforming markets

A second challenge of regulating digital finance is to keep pace with the increasing speed of technological and market development. While it is welcome and desirable that financial innovators in Europe stay in tune with their competitors and develop and deploy new technologies and new financial products at an increasingly fast pace, this places public authorities before of a well-known dilemma: lawmaking takes time, and it takes even longer in a democracy and in a complex governance system such as the EU. This is further accentuated by the fact that, in the EU, where direct common supervision is limited to a number of areas such as credit institutions or credit rating agencies, common rules on financial services ("the EU single rulebook") often need to be relatively detailed in order to ensure convergent supervisory practices across different supervisors and Member States. In an internal market based on the principle of home state supervision and passporting, leaving significant parts of financial regulation to the supervisors themselves - as is the case for example in the United States, where rulemaking by the agencies is the key source of financial regulation - may lead to divergences and to an increased risk of supervisory arbitrage. The changing world of digital finance therefore makes it even more important for the EU to approach lawmaking with a dynamic, rather than static, approach. Four elements can contribute to this objective.

First, wherever possible, technological changes should be addressed based on existing rules, and legislation should be designed to be open to technological development. For example, the Digital Operational Resilience Act (DORA) presented as part of the Digital Finance Strategy, is designed as a general framework requiring financial institutions to put in place the necessary governance measures to address cyber threats and other risks to their digital operational resilience (see Article 1). While technological developments will change the type of digital operational risks and therefore require firms to adapt their digital operational resilience measures, this would not require a change to the legislative measures. However, legislative changes may be necessary if technological and market developments lead to a change of the financial services value chain with new types of entities carrying out activities that are important for financial

<sup>&</sup>lt;sup>977</sup> Since the publication of the MiCA proposals, similar efforts to strengthen the regulatory framework for stablecoins have also been announced by other jurisdictions, and most recently by the United States. Presidential Working Group, Report on Stablecoins, November 2021, https://home.treasury.gov/system/files/136/ StableCoinReport\_Nov1\_508.pdf

supervisors to observe to fulfil their mandate of protecting financial stability and market integrity. Such changes make it necessary to extend the regulatory perimeter to new entities that are not covered by existing regulation. For example, DORA proposes the introduction of oversight over information and communications technology firms that provide critical services to the financial sector (see Article 28 seq.). Equipping financial supervisors with the necessary enforcement powers to implement such oversight clearly requires legislative change given that, so far, financial supervisors have had no direct powers over these entities.

Second, given the length of the legislative procedure<sup>978</sup>, the EU will sometimes need to take the global lead in proposing new rules. Indeed, viewed globally, it was the first jurisdiction to propose a legislative framework for stablecoins and crypto-assets (see above).

Third, in their drafting, legislative acts should be limited to setting out general requirements and provide financial supervisors with the necessary enforcement powers. Detailed requirements should be left to delegated or implementing acts adopted by the Commission, which can achieve the objective of supplementing or amending certain non-essential elements of the legislative act (Article 290 TFEU) or establishing uniform conditions for implementing legally binding EU acts (Article 291 TFEU). This builds on the longstanding tradition of the "Lamfalussy procedure" proposed by the Lamfalussy report in 2001 to improve the regulatory process in financial services in order to make it quicker and more effective.<sup>979</sup>

Fourth, with the DLT pilot, the EU will be testing not only new forms of DLT-based market infrastructures but also a new regulatory tool that allows some regulatory flexibility for a limited time period, subject to closer coordination by ESMA. This proposal recognises that while a significant share of DLT-based instruments qualify as financial instruments covered by EU legislation, EU financial services legislation was not designed with DLT and crypto-assets in mind, and there are provisions in existing EU financial services legislation that may preclude or limit the use of DLT in the issuance, trading and settlement of crypto-assets that gualify as financial instruments (recitals 3 to 5). For example, while financial services regulation is currently based on the principle of the separation of the trading of securities and the settlement of a trade, DLT could enable a full integration of trading a security and settling the trade in a single "atomic" transaction, leading to increased efficiencies and reduced settlement risk. At the same time, regulatory gaps exist due to legal, technological and operational specificities related to the use of DLT and crypto-assets that gualify as financial instruments. For instance, the underlying technology

<sup>&</sup>lt;sup>978</sup> To give an example, for the distributed ledger technology (DLT) pilot, which is relatively limited in scope, it took more than one year from adoption of the Commission proposal (proposal for a regulation of the European Parliament and the Council on a pilot regime for market infrastructures based on distributed ledger technology, COM/2020/594 final of 24 September 2020) to a final agreement in trilogues, European Commission, Daily news of 25 November 2021.

<sup>&</sup>lt;sup>979</sup> Final Report of the Committee of Wise Men on the regulation of European securities markets, Brussels 15 February 2001.

could also pose some novel forms of cyber risks that are not appropriately addressed by existing rules. However, given that there is limited experience as regards the trading and post-trading of transactions in crypto-assets that gualify as financial instruments, the proposal states that it is too early to bring significant modifications to the EU financial services legislation to enable the full deployment of such crypto-assets and their underlying technology. In order to allow for the development of DLT-based securities, the DLT pilot therefore allows national financial supervisors to temporarily exempt DLT market infrastructures from some specific requirements under the EU financial services legislation that could otherwise prevent them from developing solutions for the trading and settlement of transactions in crypto-assets, and allows them to adopt compensatory measures to ensure that these projects do not lead to a higher risk level, overall (Articles 4 to 6). To ensure the coherent application of this additional flexibility, national financial supervisors are required to notify ESMA of each application that is part of the DLT pilot to allow ESMA to adopt an opinion on it (Articles 7 and 8). Given its purpose of enabling testing of innovative projects, the DLT pilot is only available for certain types of securities and only for securities that are not liquid (Article 2 and recital 12), and its purpose may be established for five years only, after which experience with the pilot will be evaluated (Article 10). During the legislative procedure, the basic concept of the DLT pilot was endorsed by the co-legislators, while adjustments were introduced in particular to the scope and form of the DLT pilot and to the rules applicable to participants.

Overall, these examples highlight that the EU has a number of tools available to enable its regulatory environment to keep pace with financial innovation. However, policy makers and regulators need to continuously monitor market developments to ensure that financial regulation does not become outdated.

# 4 Regulating and supervising new actors and new value chains in digital finance

One development in financial markets and beyond that is associated with the digital transformation is the increasing transformation, not only of the technologies employed, but also of the structure of the financial services value chain and the financial system.

Financial institutions increasingly outsource their data management to cloud service providers. Payments are handled by an increasing number of payment service providers, processors and other firms. There are also more and more examples of financial institutions cooperating with technology firms, for example by integrating a "robo-advisor" provided by a technology firm into their investment advice offerings or enabling access to platforms connecting banks and depositors or other products. Financial institutions also offer their products on digital platforms operated by technology companies. On the other hand, technology companies are entering financial services and reaching end-users either directly or indirectly (e.g. via cooperation with financial service providers). While such firms now offer payments and related services, respondents to the Commission's public consultation and participants in the digital finance outreach activities carried out in spring 2020 expect the online provision of other financial services, such as loans, holding of client money, insurance, and asset management for consumers and businesses, to develop further.

For financial regulators and supervisors, these developments not only create the challenge of supervising new digital risks (see Section 3 above on DORA), but also raise the question of whether existing regulatory and supervisory arrangements are still fit for purpose to protect financial stability and market integrity in the new digital financial ecosystem, where entities currently subject to supervision may no longer account for most of the value chain and where risks may be spread over different entities supervised by different financial supervisors. Importantly, these developments raise the question of whether our regulatory system still ensures that the same activities giving rise to the same risks are also subject to the same rules<sup>980</sup>, and therefore ensure a level playing field. With regard to large technology companies ("Bigtechs"), particular issues arise in relation to the specific risks related to the integration of financial services with such large multi-activity firms.<sup>981</sup>

One element of response to these market developments and the increasing role of technology companies in finance is to cooperate closely with other authorities, including competition and data protection authorities. Indeed. financial stability and market integrity concerns about increased concentration risks posed by digital platforms seem to go in a similar direction as competition law concerns about possible abuses of dominant positions. The Commission has recently proposed a Digital Markets Act to further strengthen enforcement powers against large platforms acting as gatekeepers for other services.982 As access to a broad variety of consumer data is an important strategic asset of these platforms, enforcement actions by data protection authorities to ensure that data are only used upon consent of the data subject are equally relevant. One example of how to increase cooperation between different enforcement authorities is the association of the European Data Protection Board, the Commission services responsible for competition enforcement, and relevant national authorities beyond the financial sector with the work of the European Forum of Innovation Facilitators, which brings together national financial supervisors' innovation hubs and sandboxes, to discuss the challenges

<sup>&</sup>lt;sup>980</sup> Expert Group on Regulatory Obstacles to Financial Innovation (ROFIEG), Final Report to the European Commission December 2019 - Thirty Recommendations on Regulation, Innovation and Finance, available at www.europa.eu

<sup>&</sup>lt;sup>981</sup> See also FSB, BigTech in finance: Market developments and potential financial stability implications, 9 December 2019; Carstens, A., Claessens, S., Restoy F., and Shin, H. S., BIS Bulletin No 45, 2 August 2021.

<sup>&</sup>lt;sup>982</sup> Proposal for a Regulation of the European Parliament and the Council on contestable and fair markets in the digital sector (Digital Markets Act), COM/2020/842 final of 15 December 2020.

raised by innovative business models that combine financial and nonfinancial services.<sup>983</sup> At the same time, these authorities have different mandates and different working modalities, and such cooperation alone is unlikely to address shortcomings in financial supervisors' tools and powers to protect financial stability and market integrity.

Those involved in financial regulation and supervision will therefore also have to consider whether they are equipped with the right tools and powers to protect financial stability and market integrity in a changing environment. In order to examine this matter, the Commission has asked the European Supervisory Authorities to provide advice on market developments and possible need to adjust the EU framework in relation to four areas:<sup>994</sup>

- regulation and supervision of more fragmented or non-integrated value chains;
- · platforms and bundling of various financial services;
- · risks of groups combining different activities;
- non-bank lending and protection of client funds.

Feedback from the European supervisory authorities is expected to provide evidence on whether the current EU regulations remain fit for purpose in a financial system transformed by digitalisation or whether adjustments are necessary.

## 5 Conclusions

Digital finance provides important opportunities for a more efficient and more integrated financial system in the EU, in support of consumers and businesses. But these opportunities can only be harnessed without jeopardising financial stability and market integrity if the EU adapts its regulatory framework to technological innovation, to keep pace with the increasing pace of innovation and to adjust to changed market structures deriving from the digital transformation. As part of a broader agenda to make Europe fit for the digital age, the Digital Finance Strategy has set out some key initiatives and legal approaches in this regard. Going forward, it will be important for the EU and its Member States to understand market developments and adjust on a continuous basis, if it wants to maintain a stable and efficient financial system in the EU and secure an important role in finance globally.

<sup>&</sup>lt;sup>983</sup> Digital Finance Strategy, section 4.1.

<sup>&</sup>lt;sup>984</sup> European Commission, Request to EBA, EIOPA and ESMA for technical advice on digital finance and related issues, 2 February 2021.

## Central bank digital currency: Caribbean pathways

By Diana Wilson Patrick\* and Thandiwe Lyle\*

## 1 Introduction

Our world today has become more wireless and cloud-based resulting in changes in the way financial transactions occur. Technology and digitalisation have led to a shift away from cash to digital payments. The COVID-19 pandemic has accelerated this shift as the demand for contactless payments has increased exponentially and the use of cryptocurrencies and stablecoins have become more widespread. As finance becomes increasingly digital, central banks around the world are contemplating whether they need to fully embrace the digital era by issuing central bank digital currency (CBDC) or risk being left behind. The International Monetary Fund (IMF) has concluded that CBDC could be the next milestone in the evolution of money.985 Some central banks have already made the digital leap and have either launched their own CBDC or launched pilots. Central banks in the Caribbean region have been leading the charge, with the first CBDC in the world having been launched on 20 October 2020 by the Central Bank of The Bahamas (CBB). On 31 March 2021 the Eastern Caribbean Currency Union (ECCU) became the first currency union in the world to launch a CBDC pilot. This paper assesses CBDCs in the context of the progress made by the various CBDC projects in the Caribbean region. It discusses the legal and policy considerations underpinning the shift towards CBDCs by Caribbean central banks and evaluates whether there is a case for CBDCs in developing economies, particularly small, vulnerable economies (SVEs).

## 2 CBDC explained

While there is no widely accepted definition of CBDC<sup>986</sup>, it has been defined as a digital payment instrument, denominated in the national unit of account that is a direct liability of the central bank.<sup>987</sup> CBDC is envisioned by most to be a new form of central bank money, which serves both as a

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<sup>&</sup>lt;sup>985</sup> Mancini-Griffoli et al. (2018), p. 30.

<sup>&</sup>lt;sup>986</sup> Bossu et al. (2020), p. 6.

<sup>&</sup>lt;sup>987</sup> Bank for International Settlements (2020a), p. 3.

medium of exchange and a store of value.<sup>988</sup> Like cash, it is fiat money widely available to the residents of a country and potentially also to individuals and companies abroad. Unlike central bank reserves, it can be used easily for person-to-person, person-to-business and business-tobusiness transactions. In understanding what CBDC is, it is important to note what it is not. CBDC is not a cryptocurrency. A cryptocurrency is a digital asset designed to work as a medium of exchange using cryptography to secure transactions, to control the creation of additional value units and to verify the transfer of assets.<sup>989</sup> Importantly, cryptocurrencies are issued by the private sector and operate independently of central banks. They are maintained by decentralised systems and are not issued or backed by governments or by physical assets. Therefore, from a legal perspective, cryptocurrency cannot be considered *currency* which is the official means of payment of a state or monetary union recognised as such by monetary law.990 They are often referred to as crypto-assets and not cryptocurrencies. Additionally, CBDC is not a stablecoin. A stablecoin is a cryptocurrency which aims to maintain a stable value relative to a specified asset or a pool or basket of assets.991 Stablecoins are often pegged to fiat money to stabilise the price. However, while they may be peaged to currency, they are not currency. Since it is a direct claim on a central bank rather than a liability of a private financial institution, CBDC also differs from other forms of cashless payment instruments for users such as card payments, credit transfers, direct debits and e-money.<sup>992</sup> It is this feature of a riskless claim, i.e. direct liability of the central bank, that truly sets CBDCs apart from other digital assets and cashless payments.

#### 2.1 Types of CBDCs

CBDCs may have different operational and technological design features. They may be: (i) wholesale or retail; (ii) account-based or token-based; (iii) centralised or decentralised; or (iv) direct or indirect. The legal treatment of a CBDC depends on its design features.<sup>993</sup>

#### 2.1.1 Wholesale or retail

With regard to wholesale CBDCs, central banks issue digital currency only to their existing account holders and participants in their payment systems, which are other financial institutions and public bodies. This CBDC will be limited in circulation. Wholesale CBDCs are intended for the settlement of interbank transfers and related wholesale transactions, for example to

<sup>&</sup>lt;sup>988</sup> Committee on Payments and Market Infrastructure of the Bank for International Settlements (2018), p. 3.

<sup>&</sup>lt;sup>989</sup> Hardle et al. (2019), p. 3.

<sup>&</sup>lt;sup>990</sup> Bossu et al. (2020), p.8.

<sup>&</sup>lt;sup>991</sup> Financial Stability Board (2020). p. 4.

<sup>&</sup>lt;sup>992</sup> Boar and Wehrli (2021), p. 4.

<sup>&</sup>lt;sup>993</sup> Bossu et al. (2020), p. 9.

settle payments between financial institutions.<sup>994</sup> With regard to retail CBDCs or general-purpose CBDCs, central banks offer digital currency to the public for day-to-day payments. Retail CBDCs do not entail any credit risk for payment system participants as they are a direct claim on the central bank.<sup>995</sup>

#### 2.1.2 Account-based or token-based

CBDCs may be account-based or token-based. With regard to accountbased CBDCs, balances in cash current accounts in the books of the central bank are digitalised.<sup>996</sup> This approach requires verification of the account holder's identity and would be based on a digital identity scheme. Intermediaries usually verify the user's identity. With regard to token-based CBDCs the digital currency is designed in the form of a digital token, not connected to an account relationship between the central bank and the holder.<sup>997</sup> This approach most closely resembles cash and provides for anonymity in payment. Individual users access the CBDC based on a password-like digital signature using private-public key cryptography, without requiring personal identification.<sup>998</sup> Storage would be either custodial (managed by a trusted third-party entity or service), non-custodial (residing on a physical device owned by the end-user) or some balance between the two.<sup>999</sup>

Account-based CBDCs resemble typical bank account models where control is linked to the holder's identity.<sup>1000</sup> Therefore, they are only feasible in places with strong identity verification systems and typically require good connectivity and smartphone use.<sup>1001</sup> However, token-based CBDCs could be more efficient in areas with limited connectivity, as end-users can exchange tokens stored in digital wallets.<sup>1002</sup>

#### 2.1.3 Centralised or decentralised

The CBDC infrastructure can be based on a centrally controlled database or on a decentralised system, typically by way of distributed ledger technology (DLT). With a centralised ledger, data can be stored in different physical nodes, but control is in the hands of a trusted administrator authorised to make changes to the database.<sup>1003</sup> A distributed ledger (DL) is a record of transactions held across a network of computers (nodes) where

<sup>&</sup>lt;sup>994</sup> Bank for International Settlements (2021), p. 70.

<sup>&</sup>lt;sup>995</sup> ibid., p. 72.

<sup>&</sup>lt;sup>996</sup> Bossu et al. (2020), p. 9.

<sup>997</sup> ibid., p. 9

<sup>&</sup>lt;sup>998</sup> Bank for International Settlements (2021), p. 72.

<sup>&</sup>lt;sup>999</sup> Didenko and Buckley (2021), p. 17.

<sup>&</sup>lt;sup>1000</sup> Bank for International Settlements (2020b), p. 93.

<sup>&</sup>lt;sup>1001</sup> Didenko and Buckley (2021), p. 18.

<sup>&</sup>lt;sup>1002</sup> ibid., p. 17.

<sup>&</sup>lt;sup>1003</sup> ibid., p. 18.

each node has a synchronised copy.<sup>1004</sup> The technology utilised for the DL usually relies on cryptography to allow nodes to securely propose, validate and record state changes (or updates) to the synchronised ledger without necessarily requiring for a central authority.<sup>1005</sup> Each update of the DL has to be harmonised between the nodes of all entities (often using algorithms known as consensus mechanisms), which typically involves broadcasting and awaiting replies on multiple messages before a transaction can be added to the ledger with finality.<sup>1006</sup> This requirement for coordination between the nodes can reduce transaction speed.

#### 2.1.4 Direct or indirect

Direct CBDCs occur where a central bank issues the digital currency and circulates it. In this case, the CBDC is a direct claim on the central bank. Central banks may also opt to utilise a tiered form, where the end-user has a claim on an intermediary, with the central bank keeping track only of wholesale accounts.<sup>1007</sup> This has been called a "synthetic CBDC".<sup>1008</sup> However, since it is not a direct liability of a central bank it cannot be considered a CBDC. There is also the possibility of a hybrid CBDC which provides for direct claims on the central bank while allowing intermediaries to handle payments.<sup>1009</sup>

#### 2.2 Legal considerations arising out of design features

A robust and unambiguous legal framework is an essential prerequisite for any central bank issuing a CBDC.<sup>1010</sup> The appropriate regulatory framework is required to ensure that risks associated with digital currencies are dealt with. These risks include illicit financing as well as privacy and cybersecurity concerns. Regulatory expertise is crucial to liberate the benefits and curb the risks of CBDCs.<sup>1011</sup> As a starting point it is essential to ensure that the central bank has the legal authority to issue a digital currency and that the digital currency so created will also have the same legal tender status as the physical currency. The type of design selected will also impact the regulatory changes required. Since token-based CBDCs cannot be considered banknotes or coins, central banks are authorised to issue them only if central bank law provides an explicit function *to issue currency* without limiting the issuance of currency to banknotes and coins.<sup>1012</sup> There should also be an explicit reference to the

<sup>&</sup>lt;sup>1004</sup> Bank for International Settlements (2020b), p. 72.

<sup>&</sup>lt;sup>1005</sup> ibid., p. 72.

<sup>&</sup>lt;sup>1006</sup> Bank for International Settlements (2021), p. 92.

<sup>&</sup>lt;sup>1007</sup> Bank for International Settlements (2020b), p. 88.

<sup>&</sup>lt;sup>1008</sup> Adrian and Mancini-Griffoli (2019).

<sup>&</sup>lt;sup>1009</sup> Bank for International Settlements (2020b), p. 88.

<sup>&</sup>lt;sup>1010</sup> Boar and Wehrli (2021), p. 8.

<sup>&</sup>lt;sup>1011</sup> Didenko and Buckley (2021), p. 28.

<sup>&</sup>lt;sup>1012</sup> Bossu et al. (2020), p. 26.

issuance of currency in the form of both banknotes and digital tokens.<sup>1013</sup> To legally equate token-based CBDCs with banknotes there should be consideration as to whether it should be granted legal tender status.<sup>1014</sup>

As regards account-based CBDCs, among IMF membership, 85% of central bank laws limit the power to open cash current accounts to a limited category of institutions, while a minority of central bank laws (ten central banks corresponding to 6% of total IMF membership) allow for the opening of cash current accounts by a broader public.<sup>1015</sup> Therefore, if a central bank wishes to issue an account-based CBDC it should ensure that its laws provide it with the power to open cash current accounts for the general public.

### 3 Global landscape of CBDCs

Central banks throughout the world are at various stages of considering the issuance of CBDCs. The Bank for International Settlements (BIS) published a survey in January 2021, conducted among 65 central banks, which indicated that 86% of the surveyed central banks were exploring the benefits and drawbacks of CBDCs, while 60% were conducting experiments or proofs of concept and 14% were moving forward to development and pilot arrangements.<sup>1016</sup> The survey also revealed that local circumstances shape the motivations for the CBDC work, with emerging market and developing economies (EMDEs) citing financial inclusion as a main factor for the CBDC development, while financial stability, monetary policy implementation, domestic payment efficiency and payment safety are key motivations for both advanced economies (AEs) and EMDEs.<sup>1017</sup> Another significant factor driving central banks in both AEs and EMDEs to consider CBDCs is ensuring continued access to central bank money for households and companies, with the use of cash declining.1018

Central banks in major economies and developing economies are actively developing and testing CBDCs. The People's Bank of China became the first central bank of a major economy to roll out its digital renminbi or digital yuan in major cities. China plans to popularise the digital yuan by running city-level trials in 2021 so that it will be ready by the time China hosts the Winter Olympic Games in February 2022.<sup>1019</sup> Since the CBB's official launch of its digital currency, the Bahamian Sand dollar in 2020, the National Bank of Cambodia has officially launched its digital currency, Bakong, on 28 October 2020 and in October 2021 Nigeria launched the eNaira. Other countries have launched the CBDC pilots, such as Sweden's

<sup>&</sup>lt;sup>1013</sup> ibid., p. 26.

<sup>&</sup>lt;sup>1014</sup> ibid., p. 41.

<sup>&</sup>lt;sup>1015</sup> ibid., p. 23.

<sup>&</sup>lt;sup>1016</sup> Boar and Wehrli (2021).

<sup>&</sup>lt;sup>1017</sup> ibid., pp. 7-8.

<sup>&</sup>lt;sup>1018</sup> ibid., p. 8.

<sup>&</sup>lt;sup>1019</sup> Kynge and Yu (2021).

e-krona pilot, Uruguay's e-Peso pilot, Jamaica's CBDC pilot, South Korea's CBDC pilot and Turkey's digital lira.

#### 4 Caribbean CBDCs

The Caribbean has been blazing a trail for CBDCs worldwide. There are currently three CBDCs at different stages of development in the Caribbean region, namely the Bahamian Sand dollar, the Eastern Caribbean Central Bank's (ECCB's) DCash and the digital currency of the Bank of Jamaica (BOJ). The Central Bank of Trinidad and Tobago (CBTT) has indicated that it is exploring the feasibility of a CBDC.

#### 4.1 The Bahamian Sand dollar

The Sand dollar has been described by PricewaterhouseCoopers as "the world's most advanced 'official' digital currency".<sup>1020</sup> The Sand dollar is the digital version of the Bahamian dollar, which is issued by the CBB through authorised financial institutions (AFIs).

#### 4.1.1 History

The Sand dollar project was conceived as part of the Bahamian payments system modernisation initiative (PSMI), which commenced in the early 2000s. The PSMI targets improved outcomes for financial inclusion and access, making the domestic payments system more efficient and nondiscriminatory in access to financial services.<sup>1021</sup> The Sand dollar pilot was launched in December 2019 in Exuma followed by Abaco in February 2020. Prior to launching the pilot in Exuma, a targeted baseline survey on financial inclusion and access was conducted in the summer of 2019 for Exuma.<sup>1022</sup> Feedback from the survey demonstrated a high penetration of mobile phone usage in Exuma, and a likelihood that a higher share of the population would be willing to use digital financial services including electronic payments.<sup>1023</sup> The pilot was extended to Abaco, which had been devastated in September 2019 following the passage of Hurricane Dorian. Abaco was chosen to test emergency wireless communications features that would enable rapid financial services recovery following natural disasters and connect with the island's retail businesses early in their recovery process.<sup>1024</sup>

<sup>&</sup>lt;sup>1020</sup> See PricewaterhouseCoopers (2021), "The Sand Dollar is the world's most advanced 'official' digital currency", available at www.consulting.us/news/6047/the-sand-dollar-isthe-worlds-most-advanced-official-digital-currency

<sup>&</sup>lt;sup>1021</sup> Central Bank of The Bahamas (2019), p. 3.

<sup>&</sup>lt;sup>1022</sup> ibid., p. 6.

<sup>&</sup>lt;sup>1023</sup> ibid., p. 3.

<sup>&</sup>lt;sup>1024</sup> ibid., p. 11.

During the pilot phase, the CBB worked with the technology provider to make sure that all the pertinent components of the digital system were fully functional before the CBDC was more widely deployed. After successfully navigating its pilot phase, the CBB officially launched the Sand dollar in October 2020, making the CBDC available to the public. As part of the launch, the CBB issued digital currency to six licensed money transfer and payment firms. The CBB partnered with several local financial institutions for the rollout of the Sand dollar.

#### 4.1.2 Objectives

The Sand dollar's tagline is "Inclusive, Convenient, Secure". The Sand dollar is designed to increase access to financial services across The Bahamas, which comprises an archipelago of 700 islands scattered across more than 5,000 square miles of water. For some Bahamians access to commercial banks is limited and difficult. Access to banking may involve flying from one island to another or a half-day's worth of activity organising a trip to and from the bank. Therefore, financial inclusion has been an essential driver for the creation of the Sand dollar.

The CBB often cites the trauma caused by Hurricane Dorian as a key impetus for the push to forge ahead with the Sand dollar. The passage of Hurricane Dorian resulted in loss of lives, livelihoods, homes, electricity and communications. Bank branches were also destroyed. Hundreds were displaced and in dire need of financial assistance. However, government aid trickled out slowly and people could not get cash or rely on physical or electronic banking infrastructure, resulting in looting and evacuations from Abaco.<sup>1025</sup> John Rolle, Governor of the CBB declared, "After a natural disaster, if you don't have cash, commerce cannot quickly recover. You're just reduced to distributing aid in the form of goods. It's not ideal when people cannot exercise legitimate choice as to what they really need. After Hurricane Dorian [in 2019], it took banks more than a year to get their branch facilities restored. There are one or two banks that are still in the process of getting back to the state they were in. Commerce in those communities is a little bit hamstrung. If you wanted to quickly set up a system where people could trade credit-or anything of that naturehaving the wireless platform enables you to do that."1026

The CBB declared that the objectives of the Sand dollar are as follows: (i) to increase the efficiency of the Bahamian payments systems through more secure transactions and faster settlement speed; (ii) to achieve greater financial inclusion, cost-effectiveness and provide greater access to financial services across all of The Bahamas; (iii) to provide non-discriminatory access to payment systems without regard for age, immigration or residency status; and (iv) to strengthen The Bahamas'

<sup>&</sup>lt;sup>1025</sup> Boussidan (2021).

<sup>&</sup>lt;sup>1026</sup> Wyss (2021), "How the Tiny Bahamas Beat Global Giants in the E-Currency Race", available at www.bloomberg.com/news/articles/2021-05-20/the-bahamas-centralbanker-explains-why-its-sand-dollar-led-the-way

national defences against money laundering, counterfeiting and other illicit ends by reducing the ill effects of cash usage.<sup>1027</sup>

#### 4.1.3 Design features

The Sand dollar is legal tender and is a direct liability of the CBB backed by the central bank's foreign reserves. It is available for both wholesale and retail applications. Under the retail application, each holder of Sand dollars maintains a direct claim on the CBB and legally has the equivalent of a cash current account with the CBB.<sup>1028</sup> While the Sand dollar is tokenbased in structure, it does not allow anonymity. Under the Sand dollar project, the CBB does not provide front-end customer service and neither does it directly sponsor digital wallets. However, the CBB maintains the ledger of all individual holdings of the digital currency. The Sand dollar is based on DLT. A key feature of the technology is that it supports offline functionality even if communication between the islands is disconnected, since there are built-in safeguards which allow users to make a preset dollar value of payments when communications access to the CBDC network is disrupted.<sup>1029</sup> Once connectivity is re-established the digital wallets will be updated. The technology promotes interoperability among different payment systems.

The Sand dollar adopts a tiered wallet approach. There are three tiers. Tier I or basic wallets are for individuals who do not need to be subjected to any customer due diligence documentation, so no official identification (ID) is required to open a digital account.<sup>1030</sup> These wallets are low value accounts. Tier II or premium wallets are also for individuals, but do require some customer due diligence, which can be simplified but risk-based.<sup>1031</sup> Finally, there are Tier III wallets which apply to businesses, non-profit organisations and other entities. The holding limits for these wallets are set by the wallet provider using a risk-based template. These wallets do not have preset transaction limits.<sup>1032</sup>

According to the CBB, other key aspects of the Sand dollar project include multi-factor authentication for wallet users and digital ID solution (using know your customer (KYC) and identity features incorporated in the system design).

<sup>&</sup>lt;sup>1027</sup> Central Bank of The Bahamas (2019).

<sup>&</sup>lt;sup>1028</sup> See Central Bank of The Bahamas (2021a), "About Us", available at www.sanddollar. bs/about

<sup>1029</sup> ibid.

<sup>&</sup>lt;sup>1030</sup> Central Bank of The Bahamas (2021b), "Consumer-Centric Aspects of the Proposed Regulations for the Bahamian Digital Currency", available at www. centralbankbahamas.com/viewPDF/documents/2021-03-26-12-00-35-PSD-Policy-Paper-on-Consumers-Issues.pdf

<sup>1031</sup> ibid.

<sup>1032</sup> ibid.

#### 4.1.4 Regulatory framework

To create its Sand dollar the Bahamian government passed a new central bank act in 2020. The new act, the Central Bank of The Bahamas Act 2020 (the CBBA or the Act), makes fundamental changes to the CBB's regulatory framework. The Act governs all financial institutions supervised by the CBB and, in Section 12, establishes that digital currency issued by the CBB is legal tender. Under the CBBA, "the currency of The Bahamas shall comprise notes, coins and electronic money issued by the Bank under the provisions of this Act."1033 For the purposes of the Act, "electronic money" means monetary value represented by a claim on the issuer, which is: (i) stored electronically; (ii) issued on receipt of funds for the purpose of making payment transactions but does not amount to a deposit under the regulatory laws; and (iii) accepted as a means of payment by persons other than the issuer.<sup>1034</sup> The role of the CBB in relation to electronic money is defined by the CBBA wherein pursuant to Section 5(p) the CBB is responsible to "regulate and oversee the issuance, provision, and functioning of payment instruments, operating either with or without the opening of an account, including the issuance of electronic money or other forms of stored value."

Section 15 of the CBBA provides that the CBB shall make regulations for the purpose of prescribing the framework under which electronic money issued by the CBB as legal tender may be held or used by the public in keeping with best international practices for the development and functioning of the payments system. The Act also makes it an offence for a person to counterfeit digital currency or to reproduce digital currency without the permission of the CBB.<sup>1035</sup> Further, participation in payment settlements processes has been extended to non-banks (credit unions and payments services firms), through settlement accounts maintained at the CBB.<sup>1036</sup>

Interestingly, the CBBA does not explicitly state that the CBB has the sole right and authority to issue digital currency. It merely states that the currency of The Bahamas includes "electronic money issued by the Bank". Section 11 of the CBBA provides that the CBB has the sole right and authority to issue notes and coins throughout The Bahamas. The omission of "electronic money" from Section 11 is most likely motivated by pre-existing provisions in the 2012 Payment Systems Act (PSA) that deal with issuance of electronic money. Under the PSA, banks and trust companies licensed under the regulatory laws may issue electronic money once they have obtained a licence from the CBB (Section 26 PSA). If electronic money were included in Section 11, it would conflict with the PSA. The CBB has indicated that the 2021 Payment Systems (Amendment) Bill, when

<sup>&</sup>lt;sup>1033</sup> Section 8(1) of the CBBA.

<sup>&</sup>lt;sup>1034</sup> Section 8(3) of the CBBA; Section 29 of the Payments Systems Act, 2012 (No 7 of 2012).

<sup>&</sup>lt;sup>1035</sup> Section 14 of the CBBA.

<sup>&</sup>lt;sup>1036</sup> Moody's Analytics (2020).

enacted will recognise the CBB's exclusive right to issue Sand dollars.<sup>1037</sup> Additionally, the proposed Central Bank (Electronic Bahamian Dollars) Regulations 2021 (the Regulations) contain a provision that indicates that the CBB has the sole right and authority to issue the currency of The Bahamas as electronic money. However, it may have been more efficient if the CBBA established this right and not the PSA or subsidiary legislation, ensuring that all key matters pertaining to central bank law are found in the CBBA.

The Act empowers the CBB to open accounts for, accept deposits from and collect money for or on account of the government, any commercial bank, any financial institution or a public corporation. It does not extend it to the public.<sup>1038</sup> While this extends the number of institutions beyond what was provided under the previous Act, it does not go as far as providing the CBB with the power to open cash current accounts for the general public. As such, under the current law the CBB is not authorised to issue accountbased CBDCs to the general public.

The Bahamas has also commenced the process for the promulgation of the Regulations, with consultation commencing in February 2021. The aim of the Regulations is "to develop a legislative framework for the CBB's oversight of digital wallet providers in line with international best practices".<sup>1039</sup> The Regulations will cover the following matters: (i) qualifications to be a wallet provider; (ii) application process; (iii) interoperability: (iv) consumer protection; (v) obligations of the wallet provider; (vi) wallet limits; and (vii) enforcement powers of the CBB. In addition to electronic money the Regulations also cover virtual currency.

The CBB has indicated that it will also be reviewing existing legislation that impacts wallet providers to identify any potential areas of inconsistency with the draft Regulations and it is also proposing consequential amendments to its Payment Systems Act and Computer Misuse Act. The 2021 Computer Misuse (Amendment) Bill, when enacted, will amend the definition of computer to include mobile phones and tablets, thereby ensuring that the Act affords protection to key devices that would use the Sand dollar platform.<sup>1040</sup>

#### 4.1.5 Implementation

Since the launch of the Sand dollar in October 2020 the number of AFIs has increased from six to nine institutions. The AFIs that have integrated their mobile wallet applications include four money payment firms, three payment providers, a bank and a credit union. As of 20 May 2021 there were in excess of BSD 200,000 Sand dollars in circulation.<sup>1041</sup> The adoption

<sup>&</sup>lt;sup>1037</sup> Central Bank of The Bahamas (2021b).

<sup>&</sup>lt;sup>1038</sup> Section 23 of CBBA.

<sup>&</sup>lt;sup>1039</sup> Central Bank of The Bahamas (2021b).

<sup>&</sup>lt;sup>1040</sup> Central Bank of The Bahamas (2021b).

<sup>&</sup>lt;sup>1041</sup> Wyss (2021).

of the Sand dollar has been affected by the COVID-19 pandemic given its impact on the level of interaction that the CBB has been able to have with some of the communities in The Bahamas. "While the pandemic has slowed the outreach to people and businesses", Rolle said he wants "to redouble efforts before the start of the next hurricane season. There hasn't been resistance to digital currencies, but more work needs to be done to help people and businesses understand the benefits of digital payments and assuage concerns about privacy and security, so they become empowered to use them."<sup>1042</sup> In its social media campaign to promote the Sand dollar, the CBB described it as "fast, seamless and – in the age of COVID – safe".<sup>1043</sup> The COVID-19 pandemic has therefore encouraged the use of the Sand dollar as a means of avoiding dealing with cash and reducing the risk of contamination.

#### 4.2 DCash

The DCash pilot involves the secure minting of a digital version of the Eastern Caribbean dollar by the ECCB as legal tender. The ECCB is the monetary authority of the ECCU and will remain the sole authority to mint, issue, and redeem DCash.<sup>1044</sup> The ECCU comprises the following eight countries: Anguilla, Antigua and Barbuda, Commonwealth of Dominica, Grenada, Montserrat, St. Kitts and Nevis, Saint Lucia, and St. Vincent and the Grenadines.

#### 4.2.1 History

The developing and testing phase of the DCash pilot started on 12 March 2019, while rollout and implementation started on 31 March 2021 in Antigua and Barbuda, Grenada, Saint Lucia and St. Kitts and Nevis. St. Vincent and the Grenadines joined the pilot in July 2021, leaving only three member countries operating without DCash. These countries were expected to join the pilot in September 2021, however, to date they have not joined because of the impact of the most recent COVID-19 spike in these countries. The pilot is expected to run for 12 months. There is a limit for the total amount of DCash that can be issued by the ECCB during this pilot. The ECCB had indicated on its website that at the end of the pilot program it would redeem and destroy the DCash balances. It has since indicated, however, that it will revisit this approach.

<sup>&</sup>lt;sup>1042</sup> See Hyman (2021), "The Bahamas is 'disaster proofing' payments with its first-ever digital currency", available at www.mastercard.com/news/perspectives/2021/ the-bahamas-is-disaster-proofing-payments-with-its-first-ever-digital-currency

<sup>&</sup>lt;sup>1043</sup> See Wilson (2020), "Analysis: Central bankers comb for crypto clues as Bahamas launches 'Sand Dollar'", available at www.reuters.com/article/us-cenbanks-digitalanalysis-idUSKBN28S0KT

<sup>&</sup>lt;sup>1044</sup> Eastern Caribbean Central Bank (2021a), "Frequently Asked Questions", available at www.eccb-centralbank.org/p/frequently-asked-questions

#### 4.2.2 Objectives

The DCash pilot was launched to address following recurring issues: the high cost of issuing and managing cash (printing, transporting, security); the relatively high cost of current payment methods and banking services (including point of sale merchant fees); inadequacy of banking services in addressing the needs of various customers; and inefficient methods of settling cheque transactions, which slow the pace of commerce.<sup>1045</sup> To that end, the tagline of DCash is "Safer, Faster, Cheaper". The project's objectives include increasing opportunities for financial inclusion, growth, competitiveness and resilience for citizens of the ECCU.<sup>1046</sup> The Governor of the ECCB, Timothy Antoine, commenting on the first DCash transaction on 12 February 2021 declared: "DCash is about the people of the ECCU. Through DCash, we intend to increase their financial inclusion, competitiveness and resilience." The ECCB aims to reduce the use of cash by 50% by 2025 since it strongly believes that "the future of the EC Dollar is digital".<sup>1047</sup>

#### 4.2.3 Design features

DCash is issued by the ECCB and is distributed by licensed bank and non-bank financial institutions in the ECCU. It is a direct liability of the ECCB and is backed by the central bank's foreign reserves. DCash is equivalent to the physical Eastern Caribbean dollar. It is a token-based retail CBDC. Like the CBB with the Sand dollar, the ECCB does not directly sponsor digital wallets. Consumers may obtain DCash from commercial banks, credit unions or other authorised institutions. Once both parties have DCash wallets, DCash provides for cross border transactions. It works regardless of physical location. However, offline DCash transactions are currently not possible. Transactions can be conducted via a mobile app available for all iOS and Android users, conducted free of charge, and no minimum payment amount is required. The technology promotes interoperability among different payment systems.

DCash is accessible by users with or without an account at a financial institution such as a bank or credit union. Participating financial institutions and approved service providers manage access to the DCash system by converting bank deposits into CBDC. Users without a bank account will be able to obtain value-based wallets through agents authorised by the ECCB.<sup>1048</sup> These wallets are loaded by converting physical cash into DCash and have an initial threshold of XCD 2,700 per month.<sup>1049</sup> Users with

<sup>&</sup>lt;sup>1045</sup> Eastern Caribbean Central Bank (2021a).

<sup>1046</sup> ibid.

<sup>&</sup>lt;sup>1047</sup> Eastern Caribbean Central Bank (2021b).

<sup>&</sup>lt;sup>1048</sup> See Antoine (2021), "The ECCB's Digital Currency (DCash) is a Critical Step in the Buildout of a Digital Economy in the ECCU", available at www.eccb-centralbank.org/ blog/view/the-eccbas-digital-currency-dcash-is-a-critical-step-in-the-buildout-of-adigital-economy-in-the-eccu

<sup>1049</sup> ibid.

accounts at participating financial institutions will have a registered-based wallet, for which there is no fixed threshold; instead, their financial institution will make that determination based on their existing profile.<sup>1050</sup> Limits are linked to KYC profiles, as well as anti-money laundering (AML) and combating the financing of terrorism (CFT) regulations.

DCash is based on DLT developed by the technology provider Bitt Inc. and designed in accordance with *security by design* principles.<sup>1051</sup> Multi-factor authentication is required for financial institutions, all AFIs are authenticated and authorised, and all participants are vetted. As regards privacy concerns, the ECCB assures that all procedures will ensure compliance with the General Data Protection Regulation and other international standards as well as relevant local and regional laws pertaining to data protection.<sup>1052</sup> According to the ECCB, only the user's financial institution has access to their personal data, which is transmitted exclusively via an encrypted channel.<sup>1053</sup> Where any personal data is stored on disk, it is encrypted and stored in a secure facility.<sup>1054</sup> For the duration of the pilot, the ECCB guarantees all funds on the DCash network against losses due to infrastructure failure. However, the ECCB has indicated that it will not be responsible for losses of DCash resulting from the use of weak passwords.<sup>1055</sup>

#### 4.2.4 Regulatory framework

Unlike The Bahamas, which first repealed and then passed new central bank legislation, the ECCU has followed a more conservative approach. The Monetary Council of the ECCB approved amendments to the Eastern Caribbean Central Bank Act to facilitate the Bank's creation and issuance of a digital Eastern Caribbean currency.<sup>1056</sup> A draft order amending the Eastern Caribbean Central Bank Agreement Act (ECCBAA) introduces a definition of currency, something which was lacking before. Under the draft order, currency includes: (i) currency notes and coins; (ii) commemorative coins; and (iii) digital currency. The draft order defines "digital currency" as fiat currency in an electronic form. The definitions for currency and digital currency are both circular and lack the clarity found in the CBBA. Additionally, the definition for currency is not exhaustive and implies that currency in the ECCU goes beyond notes, coins, commemorative coins and digital currency. Therefore, there is flexibility in the definition which may encourage innovation but also creates uncertainty.

The amendment provides the ECCB with sole authority to issue currency and stipulates that digital currency is legal tender for the payment of any

1050 ibid.

<sup>1052</sup> ibid.

<sup>&</sup>lt;sup>1051</sup> Eastern Caribbean Central Bank (2021a).

<sup>&</sup>lt;sup>1053</sup> ibid.

<sup>&</sup>lt;sup>1054</sup> ibid.

<sup>&</sup>lt;sup>1055</sup> ibid.

<sup>1056</sup> ibid.

amount. The ECCB does not have a specific provision (similar to Section 15 of the CBBA) that provides the central bank with the authority to make regulations to establish a framework for digital currency to be held or used by the public. The omission of this section does not preclude the ECCB from making regulations pertaining to digital currency under the general regulations provision in the ECCBAA (Section 45). The ECCB intends to issue regulations, but no public statement has been made in this regard. It is advisable that the ECCB formulates regulations to cover key matters such as consumer protection, confidentiality, data protection and oversight of wallet providers.

No amendment has been made to the categories of institutions for which the ECCB can open accounts and from which it can accept deposits. Therefore, the ECCB is not able to issue an account-based CBDC to the general public. It appears from a reading of both the CBBA and the ECCBAA that the CBB is authorised to issue accounts to a wider crosssection of institutions than the ECCB.

#### 4.2.5 Implementation

Like the Sand dollar, the uptake of DCash has been impacted by the COVID-19 pandemic. As of 29 October 2021 there was approximately XCD 1.8 million DCash in circulation. While the need for contactless means of payment caused some persons to utilise DCash, the COVID-19 pandemic has impacted the public rollout of the pilot as well, forcing the ECCB to rely mostly on virtual means of promotion. One of the greatest challenges faced by the ECCB in bringing DCash to the market was the cultural disposition present within the ECCU to refuse new technologies.<sup>1057</sup> Therefore, ECCB had to embark on a campaign to educate people on the benefits of DCash and to dispel the notion that DCash is a cryptocurrency.

#### 4.3 BOJ's digital currency

Of the three CBDCs in the region, the BOJ's digital currency is the least advanced. Though its pilot is completed, its testing pool was considerably smaller than that of DCash.

#### 4.3.1 History

In May 2020, and after quietly exploring the option for some time, the BOJ decided that it would join The Bahamas and other territories in issuing a CBDC. From May to December 2021 the pilot CBDC solution was tested in the BOJ's fintech regulatory sandbox.<sup>1058</sup> Jamaica's first batch of CBDC was minted on 9 August 2020 totalling JMD 230 million. The BOJ has

<sup>&</sup>lt;sup>1057</sup> BITT (2021).

<sup>&</sup>lt;sup>1058</sup> Haynes (2021).

engaged the National Commercial Bank of Jamaica (NCB) as the initial wallet provider during the pilot. On 29 October 2021, the CBDC was issued to the NCB which, in turn, distributed it to its customers. Although, another financial institution was expected to join the pilot in November 2021, this has not yet occurred. Currently, some payment providers have been testing their solutions in the regulatory sandbox. These providers will provide the CBDC to persons without bank accounts. The BOJ intends to officially launch its digital currency in the first quarter of 2022.

#### 4.3.2 Objectives

The BOJ has not yet issued a statement to indicate what the objectives of its digital currency are. However, based on various press releases and other articles, it is clear that the BOJ hopes to obtain the following benefits from the introduction of the CBDC: (i) increased financial inclusion; (ii) greater efficiencies at the central bank; (iii) increased systemic efficiency and significant reductions in costs for cash distribution and storage; and (iv) increased services available to consumers.<sup>1059</sup>

#### 4.3.3 Design features

The BOJ's CBDC will be available for both wholesale and retail application. The BOJ intends to issue the CBDC to commercial banks as well as other deposit-taking institutions such as building societies, merchant banks and authorised payment service providers, all licensed or authorised by the BOJ.<sup>1060</sup> These institutions will then distribute the digital currency to the general public. Consumers will be required to have a CBDC account to use the CBDC. However, the BOJ claims that these accounts differ from regular bank accounts and are easier to obtain since they are subject to streamlined and simplified KYC requirements.<sup>1061</sup>

The BOJ has taken a different path from both the CBB and the ECCB as it will not be using DLT. Instead, the BOJ will use centralised technology, by fully integrating the issuance and distribution of the CBDC within its financial market infrastructure, the JamClear® Real Time Gross Settlement System.<sup>1062</sup> The BOJ has opted to take this route since it: (i) is a turnkey product that establishes the currency management process from minting through redemption and up to destruction; (ii) supports distribution of the CBDC through financial intermediaries' payment solutions and facilitates immediate integration with existing legacy and payment systems; (iii) facilitates delivery to the end-user on mobile devices and cards; and (iv) facilitates robust risk management tools.<sup>1063</sup>

<sup>&</sup>lt;sup>1059</sup> See Haynes (2021) and Henry (2021).

<sup>&</sup>lt;sup>1060</sup> ibid.

<sup>&</sup>lt;sup>1061</sup> ibid.

<sup>1062</sup> ibid.

<sup>1063</sup> ibid.

#### 4.3.4 Regulatory framework

The BOJ has indicated that it is conducting a legislative review regarding the issuance of its CBDC. At present, the Bank of Jamaica Act does not include digital or electronic currency in its definition of currency, and it is not included as legal tender. The pilot was tested in the BOJ's fintech regulatory sandbox. This is governed by the BOJ's Fintech Regulatory Sandbox Guidelines (last updated 14 July 2021), which were developed pursuant to Section 28 of the Payment, Clearing and Settlement Act of 2010. The sandbox provides participants with a controlled environment for the deployment of financial technology, including testing of regulatory requirements or procedures that may unintentionally inhibit innovation or render the products, services or business models non-viable.<sup>1064</sup> Prior to officially launching its CBDC, central bank legislation should be in place to (i) give the BOJ the legal authority to issue digital currency; (ii) provide that the digital currency so created has equal legal tender status with the physical currency; and (iii) give the BOJ the sole right to issue digital currency. The BOJ will also need to consider whether it needs an expanded list of institutions from which it can accept deposits and for which it can open accounts.

#### 4.3.5 Implementation

The BOJ's implementation process differs from that of the Sand dollar and DCash. Both the CBB and the ECCB had names for their digital currency prior to launching their pilots. The BOJ has completed its CBDC pilot, but a name has not yet been unveiled to the public. However, the public has been involved in the process. A public contest was held in April 2021 to propose a name, tagline, logo and image design for Jamaica's CBDC. The winners were announced on 21 January 2022 but BOJ is awaiting completion of the relevant registration and intellectual property processes before revealing the name, tagline and logo to the public. The BOJ has also been working with a number of key stakeholders including telecommunications providers, financial institutions, toll operators, the Office of Utilities Regulation, Tax Administration Jamaica and the Ministry of Finance, and the Public Service.<sup>1065</sup>

BOJ's pilot ended on 31 December 2021 and was touted as a success by officials of BOJ. During the pilot, NCB onboarded 57 customers comprising 4 merchants and 53 consumers. Customers were able to successfully conduct transactions using the CBDC at an NCB-sponsored event, "Market on the Lawn" held in December 2021. Given the small pool tested in its pilot, it is questionable whether BOJ is ready for a national rollout that will service the wider Jamaican population by the end of the first quarter of 2022. Additionally, the absence of a name, tagline or logo for the CBDC throughout the pilot process raises the question as to the efficacy of BOJ's

<sup>&</sup>lt;sup>1064</sup> Bank of Jamaica (2021).

<sup>1065</sup> ibid.

public campaign. As demonstrated by the DCash pilot experience, an effective public education campaign is necessary to deal with public concerns as regards digital currencies.

## 5 Policy considerations of CBDCs

On 14 October 2021, the G7 published a report outlining public policy principles for retail CBDCs, which are set out below<sup>1066</sup>:

Principles	Explanation
Principle 1: Monetary Stability	Any CBDC should be designed such that it supports the fulfilment of public policy objectives, does not impede the central bank's ability to fulfil its mandate and 'does no harm' to monetary and financial stability.
Principle 2: Legal and governance frameworks	G7 values for the International Monetary and Financial System should guide the design and operation of any CBDC, namely observance of the rule of law, sound economic governance and appropriate transparency.
Principle 3: Data Privacy	Rigorous standards of privacy, accountability for the protection of users' data, and transparency on how information will be secured and used is essential for any CBDC to command trust and confidence. The rule of law in each jurisdiction establishes and underpins such considerations.
Principle 4: Operational Resilience and Cyber Security	To achieve trusted, durable, and adaptable digital payments; any CBDC ecosystem must be secure and resilient to cyber, fraud and other operational risks.
Principle 5: Competition	CBDCs should coexist with existing means of payment and shoul operate in an open, secure, resilient, trapport and competitive environment that promotes choice and diversity in payment options.
Principle 8: Illicit Finance	Any CBDC needs to carefully integrate the need for faster, more accessible, gater and cheaper payments with a commitment to mitigate their use in facilitating crime.
Principle 7: Spill overs	CBDCs should be designed to avoid risks of harm to the international monetary and financial system, including the monetary sovereignty and financial stability of other countries.
Principle 8: Energy and Environment	The energy usage of any CBDC infrastructure should be as efficient as possible to support the international community's shared commitments to transition to a 'net zero' economy
Principle 9: Digital Economy and Innovation	CBDCs should support and be a catalyst for responsible innovatio in the digital economy and ensure interoperability with existing an future payments solutions.
Principle 10: Financial Inclusion	Authorities should consider the role of CBDCs in contributing to financial inclusion. CBDC should not impede, and where possible should enhance, access to payment services for those exoluded from or underserved by the existing financial system, while also complementing the important role that will continue to be played b cash.
Principle 11: Payments to and from the public sector	Any CBDC, where used to support payments between authorities and the public, should do so in a fast, inexpensive, transparent, inclusive and safe manner, both in normal times and in times of crisis.
Principle 12: Cross-border functionality	Jurisdictions considering issuing CBDCs should explore how they might enhance cross-border payments, including through central banks and other organisations working openly and collaboratively to consider the international dimensions of CBDC design.
Principle 13: International Development	Any CBDC deployed for the provision of international developmen assistance should safeguard key public policies of the issuing an recipient countries, while providing sufficient transparency about the nature of the CBDC's design features

Source: G7 (2021)

<sup>&</sup>lt;sup>1066</sup> G7 (2021).

These principles reflect current thoughts on CBDCs. However, the order and categorisation of these principles more closely aligns with the views of AEs. For developing countries, particularly SVEs, financial inclusion is considered foundational when considering the CBDCs and cannot be simply categorised as an opportunity. Financial inclusion means that individuals and businesses have access to useful and affordable financial products and services that meet their needs - transactions, payments, savings, credit and insurance - delivered in a responsible and sustainable way.<sup>1067</sup> Financial inclusion has been described as a key enabler to reducing poverty, boosting prosperity and achieving 7 of the 17 Sustainable Development Goals.<sup>1068</sup> As accountholders, persons are more likely to use other financial services, such as credit and insurance, to start and expand businesses, invest in education or health, manage risk and weather financial shocks, which can improve the overall guality of their lives.<sup>1069</sup> According to the Findex 2017 report, 1.7 billion adults are unbanked. Half of the unbanked people include persons living in poverty. The COVID-19 pandemic has heightened the need for financial inclusion. The crisis put financial inclusion at the centre of governments' priorities as they tried to reach those who were most affected by the lockdowns.<sup>1070</sup> The need for financial inclusion is greater today than it has ever been.

As seen with the Sand dollar and DCash, financial inclusion is a significant driver for the development of CBDCs in SVEs. For countries which are susceptible to natural disasters such as hurricanes, the introduction of a CBDC, built on the foundational principles above, becomes a key contributor to development if it can reach the unbanked and provide access to finance in the event of emergencies. As John Rolle, Governor of the CBB, indicated, restoring mobile phone coverage after a natural disaster takes far less time than rebuilding a bank. As such, he views the CBDC as a public good in a very small country where alternatives may not easily arise. Therefore, for these countries the principle of financial inclusion must be at the forefront of the minds of central banks when creating CBDCs.

A review of the G7 public policy principles for retail CBDCs, within the context of the three Caribbean CBDCs, shows that they are all on the right path. They have taken these key principles into consideration in the design of their respective CBDCs and have tailored them to reflect their own local realities. Specifically:

 (i) monetary stability has been a key consideration in the designs of all three CBDCs – they have all sought to introduce CBDCs, in accordance with public policy objectives, in a manner that would cause the least disruption to their economies;

<sup>&</sup>lt;sup>1067</sup> See World Bank (2018)," Financial Inclusion: Overview", available at www.worldbank. org/en/topic/financialinclusion/overview#1

<sup>&</sup>lt;sup>1068</sup> ibid.

<sup>&</sup>lt;sup>1069</sup> ibid.

<sup>&</sup>lt;sup>1070</sup> The Economist Intelligence Unit (2020), p. 5.

- (ii) changes have been made to the legal and governance framework for both the CBB and the ECCB to provide them with the requisite authority to issue digital currency;
- (iii) the Sand dollar and DCash use secure systems, including multifactored authentication, and high-level encryption protocols;
- (iv) the Sand dollar and DCash incorporate features to address confidentiality and data protection;
- (v) the Caribbean CBDCs have all integrated AML and CFT considerations into their design as a means of preventing the use of CBDCs for illicit finance;
- (vi) the CBB and the ECCB have permitted the unbanked to have digital currency wallets, while still requiring them to comply with streamlined and simplified KYC provisions and imposing limitations on their use;
- (vii) the Sand dollar and DCash are both non-anonymous, CBDCs thus reduce the risk of the digital currency being used for illicit finance;
- (viii)they have all focused on achieving interoperability among existing and new channels for the provision of payments services.

The interoperability of CBDCs is a key necessity, especially when one considers the potential use of CBDCs for cross border transactions, particularly remittances. In the Caribbean, remittances account for a significant portion of the region's gross domestic product. By expanding the options available for remitting funds to the region CBDCs will assist in regional development. Interoperability will also result in greater regional integration.

## 6 Conclusion

There are several lessons to be learned from the piloting and establishment of Caribbean CBDCs. A fundamental lesson is that CBDCs must be forged with consideration for the key principles outlined in the G7 Report but tailored to suit local realities and goals. The Sand dollar, DCash, and the BOJ's digital currency have all taken into consideration international best practices but have been crafted to suit local circumstances and public policy goals. Another key lesson is that extensive public education campaigns are necessary in order to communicate a compelling value proposition and address public misconceptions regarding digital currencies, which may reduce the uptake of digital wallets. A well-crafted and sustained marketing campaign is an essential tool for CBDC adoption. The ECCB cited, as one of its greatest lessons learned during the pilot, the need to build the appropriate ecosystem during implementation, through widespread consultation, to ensure the buy-in of all stakeholders.
Most importantly, the Caribbean CBDCs, particularly the Sand dollar, have made a powerful case for the important role that CBDCs can play in development in SVEs. The Sand dollar's launch in Abaco, a mere five months after the passage of Hurricane Dorian, prior to the rebuilding of some commercial bank branches, and the successful roll out of DCash in St. Vincent and the Grenadines in the immediate aftermath of the volcanic eruption in April 2021, demonstrate that CBDCs do have a key role to play in extending banking services and creating true financial inclusion in vulnerable economies.

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# AI credit scoring and evaluation of creditworthiness – a test case for the EU proposal for an AI Act

By Katja Langenbucher\*

On 21 April 2021, the European Commission published a proposal for a regulation laying down harmonised rules on artificial intelligence (hereinafter the "proposal").<sup>1071</sup> In the spirit of fostering innovation and at the same time ensuring the trustworthiness of artificial intelligence (AI) applications, the proposal follows a risk-based approach. Under this framework, many AI systems face no or minimal obligations. By contrast, those which are considered "high risk" must comply with newly established requirements. A few AI applications are entirely prohibited.

Among the high-risk categories we find "AI systems to be used to evaluate the creditworthiness of natural persons or establish their credit score".<sup>1072</sup> This goes back to the concern that they "may lead to discrimination of persons or groups and perpetuate historical patterns of discrimination ... or create new forms of discriminatory impacts".<sup>1073</sup> The ensuing compliance requirements concern the quality of data sets, technical documentation, human oversight and more.

This paper provides a brief overview on algorithmic credit scoring and the evaluation of creditworthiness, introduces the proposal's risk-based approach and critically discusses its compliance requirements and institutional design. It makes two contributions to the debate. First, it challenges the proposed regulatory architecture which risks a dual standard between bank supervisors and AI supervisors. Second, it highlights the normative, not quantitative nature of fundamental rights,

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<sup>&</sup>lt;sup>1071</sup> Proposal for a Regulation of the European Parliament and of the Council laying down harmonised rules on artificial intelligence (Artificial Intelligence Act), Commission (2021a). In what follows, references to articles and recitals for which no source is given are from this proposal.

<sup>1072</sup> Annex III (5)(b).

<sup>&</sup>lt;sup>1073</sup> Recital 37.

concluding that these are ill-suited as a benchmark for banking and credit scoring supervision.

# 1 Algorithmic credit scoring and evaluation of creditworthiness: a brief overview

Historically, loan decisions were based on a mix of qualitative and quantitative information. Where individual loan officers decided on the creditworthiness of each applicant, cognitive errors and implicit biases often distorted the assessment of credit default risks. The introduction of statistical computations in the 1950s greatly enhanced the understanding of risk and was quickly introduced in both banks and – where available – credit scoring agencies.<sup>1074</sup> Currently, most established credit scoring agencies use a fixed number of input variables such as, for instance, free income or past credit history, to produce standardised scores.

With the advent of big data, powerful computing power and machine learning technology, novel forms of credit scoring have surfaced.<sup>1075</sup> In addition to (or instead of) a limited number of variables, they collect "alternative data" such as web browsing or purchasing patterns, the location of the applicant's computer, Facebook friends, typos in text messages, tastes in music, font types found on electronic devices, time needed to fill out an application, or diligence in charging one's smartphone.<sup>1076</sup> The relevant score is established based on correlations between such data and historical data on, for instance, timely repayment or ability to pay high interest on a short-term loan.<sup>1077</sup>

Machine learning models of this type can contribute to better pricing of credit decisions based on more traditional variables. It might also help (re-) evaluate existing credit portfolios. Additionally, it has raised high hopes for the unbanked, underbanked, or credit invisible. Applicants who do not have the credit history to inform the traditional factors may profit from alternative data to achieve a better score. Banks, especially those with a FinTech bent, might be willing to broaden their creditworthiness assessments, thereby accessing new markets. The use of algorithms might reduce the extent of discrimination when compared to a world in which humans make all the decisions.<sup>1078</sup>

<sup>&</sup>lt;sup>1074</sup> Lauer (2017).

<sup>&</sup>lt;sup>1075</sup> Adolff and Langenbucher (2020); Burrell and Fourcade (2021). See Pistor (2020) on the predictive power of data.

<sup>&</sup>lt;sup>1076</sup> Bruckner (2018). On the anonymity of such data and privacy concerns see Boenisch (2021).

<sup>&</sup>lt;sup>1077</sup> Aggarwal (2021); Barocas and Selbst (2016); Bruckner (2018); for an evaluation of the predictive accuracy of models using email usage and psychometric variables see Djeundje et al. (2021).

<sup>&</sup>lt;sup>1078</sup> Such is the finding of Rambachan et al. (2021).

However, a growing body of research suggests that not all loan applicants will profit to the same extent.<sup>1079</sup> Predictions based on machine learning depend on training data. The quality of their predictions is only as good as the match between how the training data describes the world and the world as it is. If the training data reflects past inequality, any applicant who shares features with a historically underserved group will be flagged as less creditworthy than a comparable applicant who does not share the relevant feature. Historic bias of this kind has been understood to present a troublesome concern<sup>1080</sup>, and has motivated the EU proposal to qualify AI credit scoring systems and credit evaluation systems as high risk.

Some of these concerns go back to modelling bias.<sup>1081</sup> Because input to a model is shaped by data (or lack of data), conditional expectation functions look different across various groups. Some underbanked will profit if their alternative data profile resembles the profile of candidates which in the past have been successful at getting loans (e.g. the new immigrant who lacks the specifics of a national credit history but has a steady income, is male and in early middle age). For underbanked candidates with an alternative data profile which does not match historically successful candidates, AI scoring is not necessarily as helpful and might even backfire (e.g. the candidate might just about make a traditional score, but the AI score might be lower due to gender, race, religion, age, educational background etc.).

In some instances, the problem can be mitigated, for example by defining output variables (e.g. 35% of the successful candidates must be female) or by fitting separate models for each group. This latter approach faces complex questions as to whether anti-discrimination law prohibits using data on protected group membership for the purposes of credit risk model building.<sup>1082</sup> On a side note, as to this specific question, the EU proposal takes a bold step forward: "To the extent that it is strictly necessary for the purposes of ensuring bias monitoring, detection, and correction in relation to high-risk AI systems, the providers of such systems may process special categories of data (referred to in Article 9 General Data Protection Regulation [GDPR]<sup>1083</sup>, Article 10 Law Enforcement Directive<sup>1084</sup>, Article 10 Data

<sup>&</sup>lt;sup>1079</sup> Burrell and Fourcade (2021). See for a case study on upstart: Langenbucher and Corcoran (2021); for the use of credit scores in car insurance pricing: Kiviat (2019a); on the use of credit reports by employers: Kiviat (2019b); for personalised transactions more generally: Wagner and Eidenmüller (2019).

<sup>&</sup>lt;sup>1080</sup> Barocas and Selbst (2016); Graham (2021); Gillis (2020).

<sup>&</sup>lt;sup>1081</sup> Blattner and Nelson (2021), p. 12 et seq.

<sup>1082</sup> ibid.

<sup>&</sup>lt;sup>1083</sup> Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation) (OJ L 119, 4.5.2016, p. 1).

<sup>&</sup>lt;sup>1084</sup> Directive (EU) 2016/680 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data by competent authorities for the purposes of the prevention, investigation, detection or prosecution of criminal offences or the execution of criminal penalties, and on the free movement of such data, and repealing Council Framework Decision 2008/977/JHA (OJ L 119, 4.5.2016, p. 89).

Protection Regulation for EU Institutions<sup>1085</sup>) subject to appropriate safeguards for the fundamental rights and freedoms of natural persons ...".<sup>1086</sup>

However, there are more worries. Modelling bias is compounded if the training data used for machine learning systems is less rich for protected classes. The model will then favour some variables and not adequately cope with others ("majority bias").<sup>1087</sup> Additional concerns go back to data bias.<sup>1088</sup> It is a typical feature of the underbanked to have a "thin" credit file with low explanatory power as to the underlying credit report data.<sup>1089</sup> The way in which default is reported may not adequately reflect relevant details of the default situation or the observables may be less informative. The risk of discrimination along those lines and the potential distrust of consumers when faced with AI seem to have motivated the Commission to list AI credit scoring as a high-risk AI system.

# 2 The proposal: a brief overview

#### 2.1 What is an "AI system"?

The proposal applies to "AI systems". These are defined as "software that is developed with one or more of the techniques and approaches listed in Annex I [of the proposal] and can, for a given set of human-defined objectives, generate outputs such as content, predictions, recommendations, or decisions influencing the environments they interact with".<sup>1090</sup> As to the techniques mentioned in this definition, Annex I, which is rather comprehensive, lists three approaches, namely machine learning, logic- and knowledge-based approaches, and statistical approaches.<sup>1091</sup>

## 2.2 The top-down, risk-based approach

The proposal is organised top-down, establishing "common normative standards for all high-risk AI systems".<sup>1092</sup> This distinguishes the proposal from sectoral approaches which treat AI systems differently according to their intended area of use in, for instance, health, air traffic, or finance.<sup>1093</sup>

1087 ibid.

<sup>1089</sup> ibid.

<sup>&</sup>lt;sup>1085</sup> Regulation (EU) 2018/1725 of the European Parliament and of the Council of 23 October 2018 on the protection of natural persons with regard to the processing of personal data by the Union institutions, bodies, offices and agencies and on the free movement of such data, and repealing Regulation (EC) No 45/2001 and Decision No 1247/2002/EC (OJ L 295, 21.11.2018, p. 39).

<sup>&</sup>lt;sup>1086</sup> Article 10(5). For a critique, see EDPB-EDPS (2021).

<sup>1088</sup> ibid.

<sup>&</sup>lt;sup>1090</sup> Article 3(1).

<sup>&</sup>lt;sup>1091</sup> Spindler (2021).

<sup>&</sup>lt;sup>1092</sup> Recital 13.

<sup>&</sup>lt;sup>1093</sup> Comparing sectoral and omnibus approaches to privacy in credit scoring, see Langenbucher (2020); for AI more generally, see Hacker (2021).

In preparatory work the EU has considered sectoral approaches as one regulatory option. However, rather than addressing broad sectors (such as finance or health), the approach was framed as "ad hoc… or revision of existing legislation on a case-by-case basis".<sup>1094</sup> Against that background, the Commission was understandably concerned about "sectoral market fragmentation" and an increased "risk of inconsistency".<sup>1095</sup> Broader framing of sectors might have mitigated this concern.

Eager to avoid overregulation, the proposal has introduced a risk-based approach. Legal rules are tailored to "the intensity and the scope of the risks that AI systems can generate".<sup>1096</sup> A small number of AI applications are entirely ruled out, such as, for instance, social scoring if done by public authorities or on their behalf.<sup>1097</sup> Many applications face only minimal or no compliance requirements. Between these categories we find high risk applications.

#### 2.3 Al systems where conformity assessment procedures exist

Some AI systems are intended to be used as safety components of a product or are products themselves. They are automatically considered high risk if they are required to undergo third party conformity assessments according to a list in Annex II of the proposal. This Annex captures products as diverse as toys, lifts, cableway installations and medical devices.

Conformity assessments are for those AI systems integrated into the EU New Legislative Framework. This (general) framework for product regulation imposes the duty to run conformity assessments on the producer of a product (rather than on a public agency). Private standard-making bodies develop guidance on how to assess conformity. Compliance with such guidance leads to a presumption of conformity with the proposal's requirements.<sup>1098</sup> This presumption does not extend to conformity with other legal rules such as, for instance, the GDPR.<sup>1099</sup>

For AI systems that operate in an area where conformity assessment procedures exist, standard-setting bodies such as the European Committee for Standardisation (CEN) will be important rule-setters.<sup>1100</sup> Consequently, there is concern regarding lobbying and regulatory capture.<sup>1101</sup>

<sup>&</sup>lt;sup>1094</sup> Commission (2021b), p. 43, referencing the NYC Council proposal for a regulation on automated hiring tools.

<sup>&</sup>lt;sup>1095</sup> ibid., p. 45. For a positive view on the sectoral approach, see Spindler (2021).

<sup>1096</sup> Recital 14.

<sup>&</sup>lt;sup>1097</sup> Recital 17, Article 5(1)(c).

<sup>&</sup>lt;sup>1098</sup> Article 40.

<sup>&</sup>lt;sup>1099</sup> EDPB-EDPS (2021) recommends that compliance with the GDPR should be a precondition of assessing conformity under the proposal.

<sup>&</sup>lt;sup>1100</sup> On the interplay between the proposal and these rules, see Spindler (2021).

<sup>&</sup>lt;sup>1101</sup> Veale and Zuderveen Borgesius (2021).

#### 2.4 Stand-alone AI systems

Al systems where no conformity assessment procedures exist are held to a different standard. Relevant risks in these areas are (exclusively) harm to health, safety, or fundamental rights. Put differently: Al systems are considered high risk if they "have a significant harmful impact on the health, safety and fundamental rights of persons".<sup>1102</sup> Annex III specifies a list of areas of use for these stand-alone Al systems. The critical areas listed encompass: (1) biometric identification, (2) critical infrastructure, (3) education, (4) employment, (5) essential private services, (6) law enforcement, (7) migration, and (8) administration of justice and democratic processes.

The Commission has the power to update Annex III, but it may not add new areas.<sup>1103</sup> Updating requires showing why the relevant context belongs to one of the existing areas.<sup>1104</sup> Additionally, the Commission would need to establish that the relevant risk is, "in respect of severity and probability of occurrence, equivalent or greater than the risk of harm or adverse impact posed by the high-risk AI system already referred to in Annex III".<sup>1105</sup> The drafters include a long list of considerations to be balanced when making this decision, such as, for instance, the intended purpose of the AI system, the extent of its use, harm already caused, the scale and extent of such harm, any imbalances in power between the user of the AI system and the adversely impacted person, and the degree of protection provided by existing EU law.<sup>1106</sup>

# 3 Al credit scoring and evaluation of creditworthiness as a high-risk system

Machine learning models used for credit decisions fall under Annex III No 5 if they concern natural<sup>1107</sup> persons. Annex III No 5 captures access to essential public and private services. Among the private services listed, two qualify: systems which establish priority in accessing emergency services<sup>1108</sup> and systems which are "intended to be used to evaluate the creditworthiness of natural persons or establish their credit score".<sup>1109</sup>

 $<sup>^{\</sup>rm 1102}\,$  Recital 27: the "and" should probably be read as "or"; the text of Article 7(1)(b) is more precise.

<sup>&</sup>lt;sup>1103</sup> Article 7(1); critique in EDPB-EDPS (2021): "black-and-white effect".

<sup>&</sup>lt;sup>1104</sup> Article 7(1)(a).

<sup>&</sup>lt;sup>1105</sup> Article 7(1)(b).

<sup>&</sup>lt;sup>1106</sup> Article 7(2).

<sup>&</sup>lt;sup>1107</sup> Annex III No 5(b). Al systems used for internal rating of legal persons are not covered under the Annex.

<sup>1108</sup> Annex III No 5(c).

<sup>1109</sup> Annex III No 5(b).

#### 3.1 Essential private services

The proposal does not specify what makes a service "essential". Recital 37 lists three examples, namely "housing, electricity and telecommunication services". Any AI system which evaluates creditworthiness in the context of these three services will be considered high risk. Additionally, recital 37 refers to "access to financial resources". A narrow reading would suggest that only loan contracts give such access. By contrast, a broader reading might understand any firm that lets the consumer pay in instalments as giving "access to financial resources". This could cover any mail order firm which offers a "buy now, pay later" service and uses AI to evaluate its customers' creditworthiness. Whether such a firm qualifies as high risk would then depend on a follow-up question: is "access to financial resources", which is mentioned only in recital 37 but not in the Annex, automatically an "essential private service"? Or are we looking at a two-prong test where we need access to financial services which must be given in the context of an essential private service? The latter reading would suggest that some mail order firms could qualify, but not others. Similarly, bank products which involve an assessment of creditworthiness but are not a loan, for instance investment opportunities or an insurance offer, might qualify as an essential service - or not.

#### 3.2 Relevant risks and the spirit of product regulation

Recital 37 explains the risk the drafters have in mind for AI scoring systems: "they determine those persons' access to financial resources ... AI systems used for this purpose may lead to discrimination of persons or groups and perpetuate historical patterns of discrimination... or create new forms of discriminatory impacts".

Considering the discussion above about historic modelling and data bias<sup>1110</sup>, this might not come as a surprise. However, against the background of the intense global discussion on algorithmic fairness, the nonchalance of the proposal is surprising. From a legal perspective the question of when exactly "persons or groups" are being discriminated against is equally hotly debated as that of what historic bias entails. Economists have repeatedly pointed out that statistical discrimination is a necessary feature of creditworthiness evaluations and financial institutions insist on it as a form of protecting business.

The proposal does not address this question but claims that they are dealt with in other parts of EU law (such as the GDPR and anti-discrimination directives).<sup>1111</sup> Instead, it brings product regulation to mind. The drafters frame AI systems as dangerous products in need of quality management.<sup>1112</sup> Their "ingredients" (software and data)<sup>1113</sup> have to be

<sup>&</sup>lt;sup>1110</sup> See Section 1.

<sup>&</sup>lt;sup>1111</sup> On implications for tort law see Grützmacher (2021).

<sup>&</sup>lt;sup>1112</sup> Articles 9 and 17.

<sup>&</sup>lt;sup>1113</sup> Article 10.

monitored, tested and documented.<sup>1114</sup> Manuals have to be prepared for users,<sup>1115</sup> and a human overseer must make sure everything goes according to plan.<sup>1116</sup> Where risk management systems are already a requirement of the law, carve-outs apply.<sup>1117</sup>

This spirit of regulating a "dangerous product" shapes what type of compliance the drafters expect as to quality and risk management. The proposal (roughly) distinguishes five categories, which focus on data and data governance, technical documentation and record-keeping, transparency, human oversight and, lastly, robustness, accuracy, and cybersecurity. Requirements are adapted to the situation of (professional) developers and users. There are no rules on end consumers in the proposal.

### 3.3 Quality of data sets

I have said above that the quality of predictions produced by an AI system depends on its training data.<sup>1118</sup> Improving the quality of data sets, as required by Article 10, serves that end. Training, validation and testing data sets "shall be subject to appropriate data governance".<sup>1119</sup> Some hints are given as to what might count as "appropriate", but the term remains vague. The drafters seem to hope that data can be "relevant, representative, free of errors and complete".<sup>1120</sup>, and that its statistical properties, once again, have to be "appropriate".<sup>1121</sup>

"Sloppy data" are often a root cause for algorithmic discrimination<sup>1122</sup>, aggravated by the fact that alternative data are not as carefully scrutinised as, for instance, credit reporting data.<sup>1123</sup> The proposal mentions "data collection" as a space where data governance and management practices are in order.<sup>1124</sup> It reminds developers to assess "availability, quantity and suitability of the data sets"<sup>1125</sup> and to identify "data gaps or shortcomings".<sup>1126</sup>

Additionally, the drafters call for an "examination in view of possible biases"<sup>1127</sup>: whether they have model construction or data gathering (or

<sup>&</sup>lt;sup>1114</sup> Articles 11, 12 and 15.

<sup>&</sup>lt;sup>1115</sup> Article 13.

<sup>&</sup>lt;sup>1116</sup> Article 14.

<sup>&</sup>lt;sup>1117</sup> See Section 4 below for credit institutions.

<sup>&</sup>lt;sup>1118</sup> See Section 1 above.

<sup>&</sup>lt;sup>1119</sup> Article 10(2).

<sup>&</sup>lt;sup>1120</sup> Article 10(3).

<sup>&</sup>lt;sup>1121</sup> Article 10(3).

<sup>&</sup>lt;sup>1122</sup> Barocas and Selbst (2017).

<sup>&</sup>lt;sup>1123</sup> See for the EU, the GDPR and national law (for instance section 31 of the German Federal Data Protection Act [BDSG]); for a US comparison see the Fair Credit Reporting Act.

<sup>&</sup>lt;sup>1124</sup> Article 10(2)(b).

<sup>&</sup>lt;sup>1125</sup> Article 10(2)(e).

<sup>&</sup>lt;sup>1126</sup> Article 10(2)(g).

<sup>&</sup>lt;sup>1127</sup> Article 10(2)(f).

both) in mind is not clear. As noted above, the proposal opens the door to the mitigation of model risks by allowing for the possibility to fit a model to specific groups, if to do so is "strictly necessary for the purposes of ensuring bias monitoring, detection and correction"; processing of especially sensitive data under the GDPR is allowed.<sup>1128</sup>

#### 3.4 Transparency

Article 13 addresses transparency and the provision of information to "users". In a credit scoring context, one might expect potential borrowers to qualify as "users", able to profit from guidance on what the scoring process entails and how they might adapt their behaviour to better their score.<sup>1129</sup> However, "users" under the proposal are only those entities or persons which employ the AI system.<sup>1130</sup> These are, for instance, banks, mobile phone companies or credit scoring agencies, not the private citizens who are being scored. As noted in the proposal, the GDPR is more relevant for these private citizens being scored, which the drafters of the proposal understand as complementary to it.<sup>1131</sup>

However, meaningful access and transparency for borrowers is more difficult to realise under the GDPR than one might assume.<sup>1132</sup> Article 6(1) of the GDPR allows for processing of data as soon as the data subject has consented. Such consent will often be included in general terms and conditions if banks score their own customers, based on data to be gathered on where, when, and how customers use their payment cards or make wire transfers. More complicated issues as to consent under the GDPR arise if scoring agencies use alternative data from the internet. If consent is given in a social media context, the wording of the general terms and conditions might be broad enough to capture credit scoring. If this is not the case, consent will often be requested as part of the process when signing up for a credit platform.<sup>1133</sup> While this consent most likely satisfies the legal requirement (i.e. the letter of the law), it is more doubtful as to whether it also satisfies the spirit of the law. Research by computer scientists has long discussed how "uninformed consent" can be triggered by certain properties of the graphical user interface such as the position of the notice, the type of choice offered and the content framing.<sup>1134</sup> The more giving consent resembles a "tick-the-box" exercise, the more it loses its significance as an initial threshold under the GDPR.<sup>1135</sup>

<sup>&</sup>lt;sup>1128</sup> Article 10(5). See Section 1 above.

<sup>&</sup>lt;sup>1129</sup> On "gaming the system" in this context, see Langenbucher (2020), p. 541 et seq.

<sup>&</sup>lt;sup>1130</sup> Article 3(4).

<sup>&</sup>lt;sup>1131</sup> EU Commission (2021a), Explanatory Memorandum, p. 4.

<sup>&</sup>lt;sup>1132</sup> Langenbucher (2020).

<sup>&</sup>lt;sup>1133</sup> Alternatively, Article 6(1)(b) GDPR allows for processing at the request of the data subject to prepare entering into a contract, Article 6(1)(f) permits data processing if it is necessary for "the purposes of the legitimate interests pursued by the controller", see Langenbucher (2020).

<sup>&</sup>lt;sup>1134</sup> Utz et al. (2019).

<sup>&</sup>lt;sup>1135</sup> Pistor (2020); Comparative law exercise at Langhanke (2018).

As to transparency and explainability, the GDPR seems even less helpful. While Article 13 of the GDPR regulates access to one's data, which includes information about the "purposes of processing"<sup>1136</sup>, the drafters clearly did not have the explanation of a credit score or the reasons for denial of credit in mind. Credit risk models are carefully guarded trade secrets, a fact the GDPR explicitly acknowledges and counts as a reason to limit access to one's data.<sup>1137</sup> Refusal of a credit contract is mentioned in the GDPR, but exclusively in the context of an automated action.<sup>1138</sup> Neither the explainability of scoring nor the evaluation of creditworthiness are the focus of this recital. Rather, it is restricted to purely automated decisionmaking.<sup>1139</sup> Along those same lines, Article 13(2)(f) of the GDPR requires "meaningful information about the logic involved" only where automated decision-making is at stake. Even then, it is unclear whether the concept of giving "meaningful information" and addressing the "logic involved" is up to the challenge of data being processed via algorithms which, possibly, not even their user can explain. Additionally, the GDPR's top-down, omnibus approach seems to focus more on access as such (a paradigmatic case being access to one's own medical data), rather than explaining to the data subject the intricacies of what their data is used for.

The more variables enter into the computation of a score, the more unlikely it is that the data subject's rights flowing from Articles 6 and 13 of the GDPR provide an adequate remedy. To understand which data was used, the data subject might need to keep a file on websites visited and check their data privacy rules, which is an unrealistic prospect.<sup>1140</sup>

Seen from this angle, credit scoring already falls between the cracks of the GDPR's regulatory framework.<sup>1141</sup> The proposal deepens these concerns by relegating borrowers under the GDPR (which doesn't always help them) and not granting them an enforceable right to an explanation for the collection and use of their data.

Coming back to the "users" that Article 13 of the proposal has in mind, the spirit is again one of product regulation. The drafters focus on who will employ the AI system and try to make sure they understand the system's output well enough. Paragraph 2 requires instructions for use and paragraph 3 specifies what these should provide for. At the same time, full transparency, for instance of credit risk models, does not seem to be intended. In vague terms, the proposal stipulates that operation of the system must be "sufficiently" transparent and that the "type and degree of transparency" must be "appropriate". Given that the reason for qualifying AI

<sup>&</sup>lt;sup>1136</sup> Article 13(1)(c) of the GDPR.

<sup>&</sup>lt;sup>1137</sup> Recital 63.

<sup>&</sup>lt;sup>1138</sup> Recital 71 of the GDPR.

<sup>&</sup>lt;sup>1139</sup> Langenbucher (2020).

<sup>&</sup>lt;sup>1140</sup> But see the judgment of the European Court of Justice on burden of proof as to active consent: Case C-61/19, Orange Romania EU:C:2020:901; in the context of debt management: Oberlandesgericht Naumburg of 10.3.2021 – 5 U 182/20.

<sup>&</sup>lt;sup>1141</sup> See for a comparison to the United States Langenbucher (2020); more generally: Hacker (2021); for damages under the GDPR: *Bundesverfassungsgericht* (2021); Landgericht Lüneburg (2021); Paal and Aliprandi (2021).

credit scoring as high risk lies with the risk it entails for fundamental rights, one might expect detailed transparency on a potential risk of disparate impact. Yet, Article 13(3)(b)(iv) speaks only of "performance as regards the persons or groups... on which the system is intended to be used". "Performance" is defined as "the ability of an AI system to achieve its intended purpose".<sup>1142</sup> The "intended purpose", as defined by the proposal<sup>1143</sup>, is what the provider had in mind when developing the AI system. However, what the provider of an AI credit scoring software has in mind, is a prediction of credit default risk, not of the impact of the AI credit scoring software on fundamental rights. Somewhat lamely, recital 47 reminds us that "instructions of use" are to "include concise and clear information, including in relation to possible risks to fundamental rights and discrimination". But the recital immediately adds: "where appropriate". Applied to credit scoring and evaluation of creditworthiness, there is little reason to assume that the drafters had transparency as to the inner workings of credit risk models in mind.

#### 3.5 Human oversight

Human oversight has often been thought to provide evidence of trustworthiness or dignity to private citizens faced with automated decisionmaking by Al.<sup>1144</sup> The proposal has a different role in store for human oversight, in line with its product regulation and quality management approach. Human oversight is not intended to serve the consumer, process input or to provide explanations. Instead, Article 14 requires high risk systems "to be designed and developed in such a way... that they can be effectively overseen by natural persons".<sup>1145</sup> The human overseer is envisaged as someone able to "interrupt the system through a 'stop' button", <sup>1146</sup> to "correctly interpret the high-risk AI system's output"<sup>1147</sup> and to "disregard, override or reverse the output".<sup>1148</sup> In contrast to transparency requirements, the drafters explicitly expect the "human-in-the-loop" to prevent or minimise "risks to… fundamental rights".<sup>1149</sup>

In some situations, human oversight of this type will be very useful. Examples include, for instance, the use of AI in internal compliance or risk management to provide "red flags" based on key words. Where such key words are used in compliance management, they will often require a second pair of human eyes to understand their significance and possibly supervise and retrain the AI. Without a second look of this type, AI will increase costs, rather than lowering them, hence there is a business case for a human-in-the-loop. It is less clear whether, in terms of consumer

<sup>&</sup>lt;sup>1142</sup> Article 3(18).

<sup>&</sup>lt;sup>1143</sup> Article 3(12).

<sup>&</sup>lt;sup>1144</sup> EDPB-EDPS (2021); Veale and Zuiderveen Borgesius (2021).

<sup>&</sup>lt;sup>1145</sup> Article 14(1).

<sup>&</sup>lt;sup>1146</sup> Article 14(4).

<sup>&</sup>lt;sup>1147</sup> Article 14(4)(c).

<sup>&</sup>lt;sup>1148</sup> Article 14(4)(d).

<sup>&</sup>lt;sup>1149</sup> Article 14(2).

credit, there will necessarily be a business case along those lines. Relevant concerns include the amount of the credit, the extent to which it was automated and the cost of a human-in-the-loop when compared to an automatic refusal of credit.

The problem seems even more intricate if the human overseer is not (only) supposed to evaluate a "red flag", but to consider the entire credit evaluation/scoring suggested by the machine. The hope for a smarter-thanthe-machine human overseer might be an unrealistic one. Empirical studies suggest that people are unable to perform oversight functions of this type, mostly because they are bad at judging the guality of AI predictions which can lead to discounting accurate AI results.<sup>1150</sup> Instead, cognitive errors and biases might find a back door via the human oversight doublecheck.<sup>1151</sup> Additionally, there is a worry that all concerned parties fall under the spell of a false sense of security which ends up diminishing both accountability and incentives to enhance the quality of the AI system.<sup>1152</sup> "Automation bias", the phenomenon of deferring to an Al's recommendation which has been highlighted by computer scientists and psychologists, is explicitly taken up by the proposal.<sup>1153</sup> Faced with this phenomenon, users are encouraged to train their personnel and highlight this risk. The chances of producing a meaningful<sup>1154</sup> second look, rather than a rubber-stamping exercise, will often be slim.1155

# 4 Regulatory architecture: the special regime for credit institutions

The proposal contains carve-outs from its decision to follow a top-down, omnibus approach rather than a sectoral approach. Where conformity assessment procedures exist, the proposal's requirements are integrated into these procedures.<sup>1156</sup> Against the background of existing heavy regulation of credit institutions, exemptions have been accommodated for internal risk management and for market supervision.

<sup>&</sup>lt;sup>1150</sup> Green and Chen (2019); Green (2021).

<sup>&</sup>lt;sup>1151</sup> FRA (2020): "Humans overrule ... mainly when the result from the algorithm is not in line with their stereotypes"; Green and Chen (2019).

<sup>&</sup>lt;sup>1152</sup> Green and Chen (2019); Green (2021); Koulu (2020).

<sup>&</sup>lt;sup>1153</sup> Article 14(4)(b); Green and Chen (2019); Green (2021).

<sup>&</sup>lt;sup>1154</sup> While some regulators have started asking for "meaningful" human intervention (see Green and Chen (2019); Green (2021)), the proposal does not include such a qualifier.

<sup>&</sup>lt;sup>1155</sup> For the additional concern that end consumers have no right to access the service provided without the use of an AI system, see Spindler (2021).

<sup>&</sup>lt;sup>1156</sup> See Section 2.3 above.

#### 4.1 Internal risk management

A first element of a sectoral, rather than an omnibus regulatory approach concerns internal risk management of credit institutions.<sup>1157</sup> The proposal has integrated its conformity assessment as well as some of the obligations regarding risk management, post marketing monitoring and documentation into the existing framework under the Capital Requirements Directive 2013 (CRD IV).<sup>1158, 1159</sup>

Article 74 of CRD IV stipulates the basic duties of financial institutions to have robust internal governance arrangements. This includes a clear organisational structure, consistent lines of responsibility, processes to identify risk, and adequate internal control mechanisms. The European Banking Authority (EBA) issues guidelines on relevant processes.<sup>1160</sup>

Following up on Article 74 of CRD IV, the proposal understands high-risk Al management to be part of the general CRD IV risk management procedures.<sup>1161</sup> Identifying and analysing known and foreseeable risks associated with the AI systems would be integrated in the financial institution's regular risk assessment procedures. Reasonably foreseeable misuse is to be estimated and evaluated, post-marketing monitoring being put in place.<sup>1162</sup> Appropriate risk management measures must be identified through testing.<sup>1163</sup> Any residual risk must be judged acceptable, considering the purpose of the AI system, including reasonably foreseeable misuse.<sup>1164</sup> Technical documentation and automatically generated logs must be maintained as part of the documentation required under Article 74 of CRD IV.<sup>1165</sup>

Going one step further along those same lines, a credit institution that is in compliance with Article 74 of CRD IV is deemed to fulfil the proposal's requirement to put a quality management system in place.<sup>1166</sup> This includes regulatory compliance, testing the AI design, technical standards, systems and procedures for data management, post-market monitoring, record-keeping, accountability and more.<sup>1167</sup> The same is true for monitoring obligations if a credit institution is not the provider, but instead the user of

<sup>&</sup>lt;sup>1157</sup> Credit institutions are defined in Article 4(1)(1) of the Capital Requirements Regulation (CRR), Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

<sup>&</sup>lt;sup>1158</sup> Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

<sup>&</sup>lt;sup>1159</sup> Recital 80.

<sup>1160</sup> Article 74(2) of CRD IV.

<sup>&</sup>lt;sup>1161</sup> Article 9(9).

<sup>&</sup>lt;sup>1162</sup> Article 9(2).

<sup>&</sup>lt;sup>1163</sup> Article 9(5) to (7).

<sup>&</sup>lt;sup>1164</sup> Article 9(4).

<sup>&</sup>lt;sup>1165</sup> Articles 18 and 20, and Article 29(5).

<sup>&</sup>lt;sup>1166</sup> Article 17(3).

<sup>&</sup>lt;sup>1167</sup> See in detail Article 17(1); for post-market monitoring see Article 61(4).

an AI system.<sup>1168</sup> As far as the provider's quality management obligations and the user's monitoring duties are concerned, the proposal additionally suggests "limited derogations"<sup>1169</sup> to avoid regulatory overlap. A special regime applies to the reporting of serious incidents. If a credit institution is a provider and regulated under CRD IV, only a malfunction that constitutes a breach of obligations under EU law must be reported to market surveillance authorities.<sup>1170</sup>

#### 4.2 Supervisory authorities and enforcement

The second sectoral, rather than omnibus element in the proposal's regulatory architecture concerns supervision. Chapter 3 of the proposal stipulates that, as a rule, the regulatory framework of the EU Regulation on Market Surveillance and Compliance of Products<sup>1171</sup> shall apply to AI systems. However, as far as credit institutions are concerned, the competent authority, which may be the European Central Bank<sup>1172</sup> will be the market supervisor under financial services legislation.<sup>1173</sup> The hope is to ensure "coherent enforcement"<sup>1174</sup>, given that AI is not only used in customer-facing applications, but also in internal risk-management, in governance, in trading and more.

Banking supervisory agencies face the need to define how they will go about filling this new role. The proposal expects them to take over (yet more) market surveillance activities.<sup>1175</sup> The conformity assessment, which providers of high-risk AI systems have to undergo prior to placing the product on the market, will be integrated for credit institutions in the supervisory review and evaluation process (SREP) under CRD IV.<sup>1176</sup> Against that background, the proposal grants supervisors "full access to the training, validation and testing datasets"<sup>1177</sup> and requires them to "assess the conformity of the... high risk AI system"<sup>1178</sup>, while protecting trade secrets.<sup>1179</sup>

Given that the high-risk qualification of AI scoring applications goes back to risks for fundamental rights<sup>1180</sup>, things are even more complicated. National bodies "which supervise or enforce the respect of obligations under Union

<sup>&</sup>lt;sup>1168</sup> Article 29(4).

<sup>&</sup>lt;sup>1169</sup> Recital 80.

<sup>&</sup>lt;sup>1170</sup> Article 62(3).

<sup>&</sup>lt;sup>1171</sup> Regulation (EU) 2019/1020 of the European Parliament and of the Council of 20 June 2019 on market surveillance and compliance of products and amending Directive 2004/42/EC and Regulations (EC) No 765/2008 and (EU) No 305/2011 (OJ L 169, 25.6.2019, p. 1).

<sup>&</sup>lt;sup>1172</sup> Recital 80.

<sup>&</sup>lt;sup>1173</sup> Article 63(4).

<sup>&</sup>lt;sup>1174</sup> EU Commission (2021a), Explanatory Memorandum, p. 4, recital 80.

<sup>&</sup>lt;sup>1175</sup> On the new EBA guidelines on creditworthiness assessments see Feldhusen (2021).

<sup>&</sup>lt;sup>1176</sup> Articles 97 to 101 of CRD IV.

<sup>&</sup>lt;sup>1177</sup> Article 64(1).

<sup>&</sup>lt;sup>1178</sup> Article 64(2). <sup>1179</sup> Article 70(1).

<sup>&</sup>lt;sup>1180</sup> See Section 5 below.

law protecting fundamental rights in relation to the use of high-risk systems" are also granted access to documents.<sup>1181</sup> This is restricted to "the limits of their jurisdiction"<sup>1182</sup> and they are to inform the market surveillance authority (hence, the financial supervisory authority) of requests they make. If they wish to test models for their impact on fundamental rights, public authorities charged with enforcing fundamental rights may make a "reasoned request" to the market surveillance authority "to organise testing of the high-risk AI system through technical means".<sup>1183</sup>

The penalties are considerable. Violating rules on data and data governance risks administrative fines of up to EUR 30 million or up to 6% of total worldwide annual turnover.<sup>1184</sup> Other rule violations face fines of up to EUR 20 million or up to 4% of total worldwide annual turnover.<sup>1185</sup> The supply of incorrect, incomplete, or misleading information leads to fines of up to EUR 10 million or up to 2% of total worldwide annual turnover.<sup>1186</sup>

It remains to be seen how happy banking regulators (and internal risk managers) will be with their new role. While regulators have so far largely left the interplay between algorithmic models, credit evaluations and scoring to the internal risk assessment of banks, this would need to change under the proposal. Supervisors will have to build proprietary expertise in the area to closely monitor AI systems. Additionally, they will have to work out a strategy for supervisory action to the extent that they are entrusted with a consumer protection mandate.<sup>1187</sup>

#### 4.3 Non-banks and the risk of inconsistent regulation

Article 74 of CRD IV applies to "institutions" under the CRR. The term covers credit institutions and investment firms.<sup>1188</sup> Among these, the proposal's provision for special treatment as to oversight and internal risk management is restricted to credit institutions<sup>1189</sup> under the CRR.

It follows that non-bank entities that evaluate creditworthiness or establish credit scores do not qualify for the proposal's carve-out. This applies to companies offering essential private services such as housing, electricity

<sup>&</sup>lt;sup>1181</sup> Article 64(3).

<sup>1182</sup> ibid.

<sup>&</sup>lt;sup>1183</sup> Article 64(5).

<sup>&</sup>lt;sup>1184</sup> Article 71(3)(b).

<sup>&</sup>lt;sup>1185</sup> Article 71(4).

<sup>&</sup>lt;sup>1186</sup> Article 71(5).

 <sup>&</sup>lt;sup>1187</sup> For Germany see section 4(1a) of the *Finanzdienstleistungsaufsichtsgesetz*.
<sup>1188</sup> Institutions are both credit institutions and investment firms, Article 4(1)(3) of the CRR. An investment firm is a legal person which provides investment services to third

parties and/or performs investment activities on a professional basis, Article 4(1)(1) of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (OJ L 145, 30.4.2004, p. 1).

<sup>&</sup>lt;sup>1189</sup> These are undertakings taking deposits or other repayable funds from the public and granting credit for its own account. See Article 4(1)(1) of the CRR.

and telecommunication<sup>1190</sup>, and using AI systems to evaluate creditworthiness. It also applies to credit scoring agencies.

Evidently, the special regime can only cover credit institutions as far as substantive rules on internal risk management are concerned, given that non-banks do not have to provide risk-assessment structures along the lines of Article 74 of CRD IV. It is unclear whether the drafters of the proposal made a wise choice regarding the regulatory design of supervisors. Two concerns come to mind.

The first concern is that it seems that AI systems that evaluate creditworthiness or score persons are best assessed by regulators with a background in finance, rather than a more general, all-purpose regulator. A glance at US regulation in the context of credit reporting and scoring, which originated in the 1970s, offers an interesting benchmark for comparison.<sup>1191</sup> The Fair Credit Reporting Act<sup>1192</sup> (FCRA) targets the dissemination of a consumer's financial information to a third party. In that sense its policy goal resembles that of the GDPR, albeit that it covers financial data only. Consumers have the right to know what information is contained in their file, dispute inaccurate information and have it corrected, know whether their credit report was used against them and more. The FCRA also requires creditors to provide consumers with a risk-based pricing notice or an adverse action notice, in the hope of allowing improvement in their credit history.<sup>1193</sup> The FCRA follows a sectoral regulatory philosophy; hence, its rules are enforced by financial supervisors, namely the Federal Trade Commission and the Consumer Financial Protection Bureau (CFPB). The Dodd-Frank Act<sup>1194</sup> sharpened the focus by giving the CFPB the authority to supervise credit reporting bureaus and transferring rulemaking authority to this agency.<sup>1195</sup> Additionally, litigation offers an important means of private enforcement.

US regulators have started to consider how this regulatory framework works in the context of big data and AI. In 2020, the Board of Governors of the Federal Reserve System, the CFPB, the Federal Deposit Insurance Corporation, the National Credit Union Administration and the Office of the Comptroller of the Currency issued a "Request for Information on Financial Institution's Use of AI, Including Machine Learning".<sup>1196</sup> Informing credit decisions based on traditional or alternative data has been flagged as one area where the agencies wish to learn more. In line with their sectoral (i.e. not omnibus) approach, it is likely that they will be tailoring solutions to the area of financial services. As we have seen, the EU has in principle decided against a sectoral architecture, yet allows for sector-specific rules

<sup>&</sup>lt;sup>1190</sup> See Section 3.1 above.

<sup>&</sup>lt;sup>1191</sup> For more detail, see Langenbucher (2020).

<sup>&</sup>lt;sup>1192</sup> 15 U.S.C. § 1681 et seq.

<sup>&</sup>lt;sup>1193</sup> Barr, Jackson and Tahyar (2021), p. 676 et seq.

<sup>&</sup>lt;sup>1194</sup> The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), H. R. 4173.

<sup>&</sup>lt;sup>1195</sup> Barr, Jackson and Tahyar (2021), p. 676 et seq.

<sup>&</sup>lt;sup>1196</sup> Available at www.federalregister.gov/documents/2021/03/31/2021-06607/request-forinformation-and-comment-on-financial-institutions-use-of-artificial-intelligence

on credit institutions. When refining the proposal, it might be worth considering further sector-specific rules. Credit scoring is one obvious candidate; evaluating creditworthiness more generally might be another one.

The second concern has to do with the risk of inconsistent regulatory standards. Banking regulators will develop one set of rules for evaluating creditworthiness and scoring in the context of banking supervision. The general AI supervisory authorities will develop another set of rules for that same purpose. This will impact competition between credit institutions and non-bank FinTechs offering similar services. Whether this creates helpful market effects or distorts competition is hard to gauge. Additionally, there is a risk of unfair results for consumers if the two sets of rules differ as to the level of protection offered.

Assessing credit scoring agencies in the context of banking supervision is outside the scope of this paper. On a side note, it is remarkable that the proposal takes a first step into an area which so far seems largely to be a regulatory void. There are no rules at European level that capture credit scoring agencies in the context of financial regulation.<sup>1197</sup> The Credit Rating Agency Regulation (CRAR)<sup>1198</sup> explicitly carves out "credit scores, credit scoring systems, or similar assessments".<sup>1199</sup> Not all EU Member States have credit scoring agencies, nor is there a standardised European credit scoring agency or a procedure for "translating" scores from one country to the next. Whether the fact that banks use credit scores delivered by third parties gualifies as "outsourcing" (which entails compliance requirements for credit scoring agencies) is a question of national banking supervisory law.<sup>1200</sup> The German Federal Financial Supervisory Authority (BaFin) has made clear that it understands credit scores as external input data and reviews them as a component of the internal rating-based approach. BaFin does not supervise credit agencies.<sup>1201</sup>

While there are excellent reasons to contemplate tighter regulation of credit scoring,<sup>1202</sup> the proposal's top-down approach and focus on AI does not seem to be ideally suited to this task. The glance at the US regulations above helped to show how credit scoring agencies trigger distinct issues

<sup>&</sup>lt;sup>1197</sup> They fall under the general rules of the GDPR (see Langenbucher (2020)). For Germany see additionally section 31 BDSG on data privacy.

<sup>&</sup>lt;sup>1198</sup> Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) No 1060/2009 on credit rating agencies (OJ L 146, 31.5.2013, p. 1).

<sup>&</sup>lt;sup>1199</sup> Article 2(2)(b), recital 7 of the CRAR.

<sup>&</sup>lt;sup>1200</sup> The EBA does not regard market information services as outsourced activities, see EBA (2019), p. 26 (listing Bloomberg, Moody's and more). For the position under German law, see section 1(10) of the *Kreditwesengesetz*, which has, in response to the Wirecard scandal, introduced a new definition of outsourcing. The words of the rule could theoretically be read as covering some forms of scoring, however, there is no preparatory legislative material pointing in that direction. Section 88(2a) of the *Wertpapierhandelsgesetz* has, also in response to the Wirecard scandal, somewhat tightened BaFin's competencies.

<sup>&</sup>lt;sup>1201</sup> See statement of 23 April 2019, available at www.bafin.de/dok/12359218

<sup>&</sup>lt;sup>1202</sup> See Sachverständigenrat (2018).

such as data privacy, transparency, explainability and discrimination which are not limited to AI, but concern traditional agencies as well. While in the United States rules are concentrated in one legislative framework, the EU offers more of a mosaic of laws with a background in data privacy, antidiscrimination, banking supervision, and (now) AI. A focused, sectoral approach to (traditional and algorithmic) credit scoring would be a logical first step. Once put in place, the AI proposal could reference such a scoring regulation in the same way as for Article 74 of CRD IV.

# 5 Banking oversight and human rights

Under the proposal, AI is not the only area in which banking regulators need to build up knowledge. The benchmark for high-risk AI systems is their potential to negatively impact health, safety, or fundamental human rights.<sup>1203</sup> For AI systems which are intended to evaluate creditworthiness or to provide a credit score, human rights are the only relevant source of risk.<sup>1204</sup> It follows that banking regulators will have to supervise and offer guidance on the complicated interplay between AI fairness, statistical discrimination, macroprudential stability and internal risk management within credit institutions.

Globally, securities regulators and oversight bodies have taken the first steps towards assessing AI in that context. In January 2020, the EBA published a report on big data and advanced analytics, identifying the "four pillars" of data management, technological infrastructure, organisation/ governance and analytics methodology.<sup>1205</sup> Issues of trust and trustworthiness are highlighted as cutting across the four pillars. The EBA names a list of concerns including, for instance, explainability, interpretability, fairness and avoidance of bias, traceability, data protection, data quality and more.<sup>1206</sup> Automated credit scoring is listed as a use case in the report<sup>1207</sup>, even if the risk the EBA identifies in the context of credit scoring is not related to discrimination. Instead, the EBA is concerned about bank staff, coaching applicants with a low credit score to game the system, thereby making the model less useful.<sup>1208</sup> So far, the EBA has understood its role as descriptive, refraining from policy recommendations or standard setting for supervisors.<sup>1209</sup>

In their 2021 supervisory principles on big data and AI, the BaFin notes that "it is essential to ensure that there are no biased results in algorithm-based decision-making processes".<sup>1210</sup> "Bias-based systematic discrimination of

<sup>&</sup>lt;sup>1203</sup> See Section 2.4 above.

<sup>&</sup>lt;sup>1204</sup> See Section 3.2 above.

<sup>&</sup>lt;sup>1205</sup> EBA (2020), p. 5.

<sup>&</sup>lt;sup>1206</sup> ibid., pp. 5-6.

<sup>&</sup>lt;sup>1207</sup> ibid., p. 20.

<sup>&</sup>lt;sup>1208</sup> ibid., p. 21; more generally on bias and discrimination see p. 37 et seq.

<sup>&</sup>lt;sup>1209</sup> ibid., p. 9.

<sup>1210</sup> BaFin (2021).

certain groups of customers" is understood as a reputational risk.<sup>1211</sup> To the extent that the making of distinctions is prohibited by anti-discrimination laws, BaFin sees additional legal risks if "conditions are systematically set out on the basis of such characteristics" or if these distinctions "are replaced with an approximation".<sup>1212</sup> The need on BaFin's side for supervisory action is mentioned.<sup>1213</sup>

Worries as to risks to fundamental rights, both for data privacy and discrimination, had already been the topic of an earlier BaFin study.<sup>1214</sup> The agency wisely noted that the "technical challenge… is to transform the ethical/legal definition of discrimination into a mathematical one" and that there is "no currently accepted standard for non-discriminating data analysis".<sup>1215</sup> Under the proposal, banking supervisors and risk managers have no choice but to take up this challenge.

# 5.1 Why fundamental rights are different from health and safety

Some of the problems regulators might face when establishing guidance revolve around the proposal's risk-based approach.<sup>1216</sup> Its compliance requirements are there to mitigate specific categories of risk: namely health, safety and fundamental rights.

Product regulation provides model definitions of health and safety and a wide array of standardised norms have been developed in the past. This is not to deny that AI will give rise to enormously complex questions. However, there will usually be a clear theoretical concept of an "ideal AI system": one that poses no risk to health or safety. Cost considerations play a role, forcing us to accept a certain level of risk if the costs of avoiding it are excessive.<sup>1217</sup> But this does not change the ideal goal of not incurring any risk to health or safety.

For human rights, things are more complicated.<sup>1218</sup> At first glance, one might argue that, as with health and safety, the "ideal AI system" is one that poses no risk to fundamental rights. However, fundamental rights do not come in isolation. Protecting one fundamental right to its maximum potential will usually impact on competing fundamental rights: the protection of one right accordingly needs to be balanced against the potential risk to another. Depending on the context, the weight to be given to each human right will vary. When considering, for instance, gender

<sup>&</sup>lt;sup>1211</sup> ibid.

<sup>1212</sup> ibid.

<sup>1213</sup> ibid.

<sup>&</sup>lt;sup>1214</sup> BaFin (2018).

<sup>&</sup>lt;sup>1215</sup> ibid., p. 40.

<sup>&</sup>lt;sup>1216</sup> See Section 2.2 above.

<sup>&</sup>lt;sup>1217</sup> Veale and Zuiderveen Borgesius (2021) highlight the "value-laden nature" of seemingly technical standards because of such choices.

<sup>&</sup>lt;sup>1218</sup> Geminn (2021).

discrimination in the context of credit decisions, competing rights might include rights of other loan applicants, shareholder property rights, or rights linked to the macro-stability of financial systems. If the percentage of women eligible for a loan is lower than the percentage of women in the overall population, this might only seem like a human rights violation at first glance. A normative assessment of the women's right to equal protection against competing principles might suggest that the overall population is no adequate benchmark – a more appropriate benchmark might be the percentage of women in a comparable financial situation. Only after a balancing and weighing exercise has been carried out can we discuss the additional question of whether the costs of avoiding the remaining risk to a fundamental right are excessive.

The reason why it is more straightforward to define health and safety and more complicated to define human rights as a benchmark for risk quantification is the latter's normative nature. The way in which these two terms are defined is subject to ongoing debate and frequent reformulation. The impact of a violation of a fundamental right depends on the competing principles in question and on mitigating factors such as the availability of less discriminatory but equally useful means of achieving the desired goal. These features are characteristic of legal or ethical norms. They allow for the potential for the norms to evolve and adapt to changing societal needs. At the same time, they make those norms fluid and hard to pin down in a workable definition which could serve as a quantitative benchmark.

#### 5.2 All bark, no bite, and the lack of private enforcement

The job of defining human rights and balancing them against competing rights has so far rested with legislators and courts, not with (banking) regulators. To take on the proposal's challenge, supervisory authorities, users and providers<sup>1219</sup> of relevant AI systems will have to define standards concerning what they consider a relevant human rights violation. Only then can they meaningfully quantify relevant risk. Importantly, these are normative<sup>1220</sup> and not quantitative questions<sup>1221</sup>.

Today, we can only speculate how supervisors and regulated entities would go about this task. There is the theoretical possibility that credit officers and regulators will need human rights training in the future. The more likely outcome is a box-ticking exercise. Similar to AI systems in areas where EU conformity assessments exist<sup>1222</sup>, standard setters, which are not democratically elected bodies, will develop guidance on what they consider necessary for risk management when faced with potential human rights violations. Such guidance will inform credit institutions' SREP procedures.

<sup>&</sup>lt;sup>1219</sup> See EDPB-EDPS (2021) advocating for a third-party ex ante assessment.

<sup>&</sup>lt;sup>1220</sup> Economists might call them "qualitative".

<sup>&</sup>lt;sup>1221</sup> Gillis (2020).

<sup>&</sup>lt;sup>1222</sup> See Section 2.3 above. For a critical evaluation in those areas, see Veale and Zuiderveen Borgesius (2021).

For non-banks, similar (or different!)<sup>1223</sup> guidance will be established, again probably by entities with little or no democratic accountability.

Taking these concerns together, the lack of private enforcement is an especially worrisome flaw in the proposal's regulatory design.<sup>1224</sup> The GDPR's deficiencies as to private enforcement are hinted at above.<sup>1225</sup> Litigating a human rights violation in a credit context is even more cumbersome, both for practical reasons, such as gaining access to information, and for intricate theoretical questions of anti-discrimination doctrine.<sup>1226</sup> The proposal would have offered an elegant opportunity to provide a framework for facilitating private claims in the context of creditworthiness, including legislative guidance on the disclosure of scoring models (when balanced against trade secrets), rights to explanation and rectification, contours of a business defence, and allocation of the burden of proof.<sup>1227</sup> In its current form under the GDPR, the proposal leaves borrowers with difficulties accessing data they would need to litigate a doctrinally difficult anti-discrimination claim.

# 6 Summary

This paper provides a brief overview of the use of machine learning and big data for the purposes of evaluating creditworthiness and credit scoring. It mentions the potential for inclusion which these techniques offer along with a risk of discrimination.

It moves on to discuss the Commission's proposal for an AI Act, introducing its general framework as well as specific compliance requirements for AI credit scoring and evaluation of creditworthiness which the proposal considers a high-risk system.

This paper makes two contributions to the debate.

First, it explores the proposed regulatory architecture and highlights a troubling risk of inconsistent standards between banks and non-banks. In passing, it encourages legislators to consider the regulation of credit scoring across the EU.

Second, it critically analyses the challenge of engaging in the human rights discourse banking supervisors may face under the proposal. It concludes with a comment on the lack of private enforcement options under the proposal in its current form.

<sup>1225</sup> See Section 3.4 above.

<sup>&</sup>lt;sup>1223</sup> See Section 4.3 above.

<sup>&</sup>lt;sup>1224</sup> EDPB-EDPS (2021): "Blind Spot"; FRA (2020): "people need to know that Al is used, and how and where to complain", Veale and Zuiderveen Borgesius (2021).

<sup>&</sup>lt;sup>1226</sup> Langenbucher (2020). See Wachter (2021) for the argument that the ECJ's approach to anti-discrimination does not fit with algorithmic discrimination. On US doctrine of disparate impact see Barocas and Selbst (2016); Harvard Law Review (2021).

<sup>&</sup>lt;sup>1227</sup> EDPB-EDPS (2021); Hurlin, Pérignon and Saurin (2021).

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Panel 5: The COVID-19 crisis: a Hamiltonian moment for Europe?

# The COVID-19 crisis: a Hamiltonian moment for Europe

By Frank Smets\*

# 1 Introduction

The fifth and final panel of the ECB Legal Conference 2021 took place under the title "The COVID-19 crisis: a Hamiltonian moment for Europe". It has become a platitude to quote Monet and say that Europe is made in crises. But the COVID-19 crisis has been a catalyst for change in many respects. For the Economic and Monetary Union (EMU) and its institutional architecture, the establishment of a European unemployment insurance scheme, the "European instrument for temporary Support to mitigate Unemployment Risks in an Emergency" (SURE) and common budget and debt issuance in the context of the NextGenerationEU (NGEU) plan were amongst the most relevant changes. These changes, together with the use of the general escape clause and the suspension of the fiscal rules for Member States, have allowed fiscal policy to work hand in hand with monetary policy to address the fallout from the pandemic crisis. The forceful joint policy response has allowed European households and firms to bridge the pandemic crisis, enabling a strong recovery and avoiding the scarring effects we experienced after the global financial crisis and the sovereign debt crisis. As a result, the level of economic activity in the euro area is expected to recover to its pre-pandemic level at the beginning of 2022 and to reach its pre-pandemic potential output path by the end of the projection horizon.

As highlighted in the ECB's monetary policy strategy review, it is especially important to have an effective and targeted fiscal stabilisation tool in an environment where monetary policy is constrained by the effective lower bound on interest rates and there is a need to resort to unconventional measures such as large-scale asset purchases and forward guidance. Moreover, the NGEU plan has a number of features that make it effective beyond its stabilisation role. First, it allows the European Union (EU) to direct funds to those countries that have been affected most by the pandemic crisis, thereby sharing the burden of the common pandemic shock and reducing debt sustainability risks. Second, it mostly finances investment in the green and digital areas and is embedded in national structural reform agendas, thereby underpinning potential growth in the euro area. And, third, it creates a significant EU safe asset class that is in high demand and can underpin the Capital Markets Union and the role of the euro as an international currency.

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The panel discussed the relevance of these policy measures for the institutional architecture of the EMU. Two main questions were addressed. First, can some of these measures be seen as permanent changes to the EU framework or will they remain exceptional measures for exceptional circumstances? More generally, how do these measures change the institutional architecture of the EMU? For example, how does it change the balance between the EU institutions, the European Council and the Member States? Second, what does the overall positive experience with the policy response mean for the reform of the fiscal governance framework? For example, how does the increased focus on stabilisation square with the need for rules to ensure debt sustainability in an incomplete fiscal union?

**Bruno de Witte**, professor of European Union Law at Maastricht University, emphasises two points. First, as the decision-making on the recovery plan and both its resources and spending are EU-wide and not euro area specific, he sees a decline in the differentiated integration process between the euro area and the rest of the EU. Second, the potential for a future (post-NGEU) fiscal capacity for the EU-27 is strengthened by the "rediscovery" of the macroeconomic competence of the EU related to the cohesion objective under Article 175(3) TFEU.

**Paul Dermine**, *référandaire* at the European Court of Justice, focuses on the impact of the measures related to COVID-19 on the fiscal surveillance regime of the EU. In agreement with Bruno de Witte, he sees the NGEU as a policy shift towards a bigger and more positive stabilisation role for the EU and as the embryo of a fiscal capacity. With respect to the revision of the rules, he emphasises the importance of a simplified and clearer fiscal rulebook, the need to better protect public investment and the move towards more country-specific targets and paces. On the institutional framework, he highlights the tension the European Commission may face as between technical assessment and surveillance and more discretionary policymaking, and also highlights the importance of independent fiscal institutions in this context.

**Diane Fromage**, Marie Sklodowska-Curie Individual Fellow at the Sciences Po Law School in Paris, assesses the shift in emphasis from the euro area to the EU due to the measures related to COVID-19. In addition, she raises the important issues of democratic control and the adequate involvement of organs of democratic representation and the effective cooperation between the European Parliament, the Commission, the Council and the Member States and national parliaments.

Finally, **Rhoda Weeks-Brown**, General Counsel and Director of the Legal Department of the Internal Monetary Fund (IMF), reviews the IMF's view on the EU response, highlighting its policy position on simplifying the Stability and Growth Pact rules and the need for a central fiscal capacity. She also reviews the IMF's own response to the COVID-19 crisis.

Overall, the panellists see the measures related to COVID-19 as giving a new and positive impetus to improving the institutional architecture of the EMU. While the NGEU remains a one-off, temporary measure, it highlights the recovery of the EU's macroeconomic competences going beyond the rule-based framework and the benefits of coordinated EU action. It also raises the need to streamline the EU's institutional framework and its interinstitutional structure and cooperation.

The innovative European response to COVID-19: decline of differentiated integration and reinvention of cohesion policy

By Bruno De Witte\*

# 1 Introduction

The European Union's response to the economic consequences of the COVID-19 crisis has been marked by new institutional practices and rethinking of legal interpretations. In this contribution, I will deal with two such changes that are interrelated: a decline of differentiated integration and the reinvention of cohesion policy. These changes do not directly implicate the European Central Bank (ECB) but they modify the legal-institutional environment within which the ECB operates.

# 2 A decline of differentiated integration

I will first present the view that we are witnessing, in the institutional practice of the COVID-19 response, a decline of differentiated integration within the European Union (EU), and thus a reversal of a trend that had been prevalent since the euro crisis. Indeed, there had been an upsurge of differentiated integration in the domain of economic policy as a consequence of the euro crisis, as specific policy solutions and institutional arrangements were developed that applied to euro area Member States only. During and after that crisis, an animated debate took place among political actors and scholars on whether the financial assistance mechanisms adopted during the crisis should be complemented by the creation of a true "fiscal capacity" for the euro area. Such a fiscal capacity would be separate from the emergency assistance provided under the European Stability Mechanism. It would enable euro area institutions to structurally help the ECB in protecting the stability of the euro area and its currency against economic downturns or financial crises.

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One central issue in that debate was where the financial resources for building such a fiscal capacity should be found.<sup>1228</sup> For many years, the discussion focused on the creation of "Eurobonds", that is, common debt issued by euro area Member States acting together. This, many economists argued<sup>1229</sup>, would improve the financial and economic stability of the euro area: Eurobonds would be considered a safe asset by the financial markets, and the economically weakest (and/or most heavily indebted) euro area Member States could thus raise funds on those markets at better conditions than when borrowing individually. The idea remained politically unacceptable for some key countries, including Germany, where a "transfer union" or "debt union" (as it was pejoratively called) was firmly rejected.<sup>1230</sup> It also met with legal objections: it was argued that the no-bail-out clause of Article 125 of the Treaty on the Functioning of the European Union (TFEU) prohibited euro area Member States from becoming jointly liable for common debts<sup>1231</sup>, and even that common debts would anyway be contrary to the German constitution.<sup>1232</sup>

As the creation of Eurobonds did not appear a feasible option, the attention shifted to other ways of improving the long-term stability of the euro area, namely through the creation of dedicated funding instruments of the EU itself. The European Parliament gave strong support to that idea in a resolution of February 2017.<sup>1233</sup> The Commission, in May 2018, tabled proposals for legislation creating a Reform Support Programme and a European Investment Stabilisation Function.<sup>1234</sup> Only the former of the

<sup>&</sup>lt;sup>1228</sup> For an overview of the various proposals and the legal issues involved, see notably: Leino, P. and Saarenheimo, T. (2018), "Fiscal Stabilization for EMU: Managing Incompleteness", *European Law Review*, Vol. 43, pp. 623-647; Crowe, R. (2018), "Is a Separate Eurozone Budget a Good Idea?", ADEMU Working Paper 2018/120; Fabbrini, F. (2019), "Fiscal capacity", in Fabbrini, F. and Ventoruzzo, M. (eds.), *Research Handbook on EU Economic Law*, Edward Elgar, pp. 107-135; da Costa Cabral, N. (2021), *The European Monetary Union after the Crisis: From a Fiscal Union to a Fiscal Capacity*, Routledge, chapter 5; Van der Sluis, M. (2019), "A Euro Area Budget: Another Seedling?", in Fromage, D. and De Witte, B. (eds.), *Recent Evolutions in the Economic and Monetary Union and the European Banking Union: A Reflection*, Maastricht University, Faculty of Law Working Paper series, 2019/03, pp. 18-37.

<sup>&</sup>lt;sup>1229</sup> See for example: Delpla, J. and von Weizsäcker, J. (2010), "The Blue Bond Proposal", Bruegel Policy Brief, 2010/03.

<sup>&</sup>lt;sup>1230</sup> Howarth, D. and Schild, J. (2021), "Nein to 'Transfer Union': The German Brake on the Construction of a European Union Fiscal Capacity", *Journal of European Integration*, Vol. 43, pp. 211-228.

 <sup>&</sup>lt;sup>1231</sup> For discussion of the compatibility of Eurobonds with EU law, see Allemand, F. (2012),
"La faisabilité juridique des projets d'euro-obligations", *Revue trimestrielle de droit européen* Vol. 48, pp. 553-593, and several contributions to the special issue
"Eurobonds beyond Crisis Management" of the *Review of Law & Economics* (2016) issue 3.

<sup>&</sup>lt;sup>1232</sup> Müller-Franken, S. (2012), "Eurobonds und Grundgesetz", *JuristenZeitung*, Vol. 67, pp. 219-225.

<sup>&</sup>lt;sup>1233</sup> European Parliament resolution of 16 February 2017 on budgetary capacity for the euro area, P8\_TA(2017)0050.

<sup>&</sup>lt;sup>1234</sup> European Commission, Proposal for a Regulation of the European Parliament and of the Council on the establishment of the Reform Support Programme, COM(2018) 391 of 31 May 2018; Proposal for a Regulation of the European Parliament and of the Council on the establishment of a European Investment Stabilisation Function, COM(2018) 387 of 31 May 2018.

Commission's two initiatives found favour among the governments of euro area Member States. Eventually, by the end of 2019, they agreed on setting up a new European financial instrument, called the budgetary instrument for competitiveness and convergence (BICC), which would support structural reforms in national economic policy.<sup>1235</sup> This project would be implemented as a hybrid action between the EU and the euro area Member States, as it would have consisted of an EU regulation setting out its governance<sup>1236</sup>, and an intergovernmental agreement concluded by euro area Member States in order to co-finance the instrument out of their national budgets.<sup>1237</sup> The size of the programme had shrunk during the negotiations to little more than EUR 10 billion, to be spent during the course of the 2011-2017 Multiannual Financial Framework. This meant that the BICC could hardly be considered as providing the euro area with true fiscal capacity. In fact, one could wonder whether an instrument aiming at facilitating structural reform of national economic policy should be limited to euro area Member States, since that reform objective could seem equally pressing in non-euro area Member States. At any rate, the finalisation of the BICC, which was supposed to take place in 2020, was superseded by the pandemic crisis and the elaboration of a much more ambitious Next Generation EU (NGEU) programme, which includes structural economic reform as one of its many aims.

During the early months of 2020, it remained uncertain whether the common European response to the economic consequences of the pandemic would be euro area specific or rather based on the EU-27 format. At first, it seemed that the economic policy response would be produced essentially through euro area specific instruments and programmes. On 24 March, the ECB decided its temporary pandemic emergency purchase programme (PEPP) amounting to EUR 750 billion initially.<sup>1238</sup> Furthermore, the Eurogroup meeting of 9 April agreed on the establishment of a new financial assistance programme of the European Stability Mechanism (ESM) called Pandemic Crisis Support, which was formally launched by a decision of the ESM's Board of Governors on 15 May. The programme offered cheap and almost unconditional loans to all euro area Member

<sup>&</sup>lt;sup>1235</sup> The main content of the instrument, as politically agreed in October 2019, can be found in: Eurogroup, "Term Sheet on the Budgetary Instrument for Convergence and Competitiveness", Council Press Release 642/19, 10 October 2019.

<sup>&</sup>lt;sup>1236</sup> European Commission, Proposal for a Regulation of the European Parliament and the Council on a governance framework for the budgetary instrument for convergence and competitiveness for the euro area, COM(2019) 354, 24 July 2019. Its legal basis was Article 136 TFEU, that is, the legal basis allowing for the adoption of "measures specific to those Member States whose currency is the euro".

<sup>&</sup>lt;sup>1237</sup> See Eurogroup report on a possible inter-governmental agreement for the budgetary instrument for convergence and competitiveness, Eurogroup press release of 17 February 2020. Finding a consensus on such an agreement had been far from straightforward as it caused considerable tension between, on the one hand, France and Germany, which supported it, and, on the other hand, the group of "frugal" Member States led by the Netherlands. On the negotiations leading to the BICC, see Schoeller, M. (2021), "Preventing the Eurozone Budget: Issue Replacement and Small State Influence in EMU", *Journal of European Public Policy*, Vol. 28, pp. 1727-1747.

<sup>&</sup>lt;sup>1238</sup> Decision (EU) 2020/440 of the European Central Bank) of 24 March 2020 on a temporary pandemic emergency purchase programme (ECB/2020/17) (OJ L 91, 25.3.2020, p. 1).

States. It was presented as a one-off instrument of a temporary nature, strictly linked to the COVID-19 crisis and of course, given the membership of the ESM, limited to euro area Member States.<sup>1239</sup>

The counter-movement, advocating an EU-27-wide response, had been launched by the letter, written on 25 March 2020, by nine heads of government (including those of France, Italy and Spain), calling for "a common debt instrument issued by a European institution" to "counter the damage caused by the pandemic". Similarly, in its resolution of 17 April, the European Parliament proposed the use of "recovery bonds guaranteed by the EU budget". These initiatives were met, at first, with strong opposition by Germany and the "frugals" who saw the spectre of a "transfer union" appearing once again. However, as we know, the German government changed camps by agreeing on the Franco-German document of 18 May which provided for the Commission to take EUR 500 billion worth of loans on the financial markets, to be distributed as non-repayable subsidies to all EU Member States. The Commission's NGEU package of proposals, submitted shortly afterwards on 28 May, endorsed this EU-wide approach which was then gradually accepted by all the national governments and sealed at the European Council meeting of July 2020.

The recovery plan eventually came about as an economic policy instrument combining legal competences situated in the European Monetary Union (EMU) and in the non-EMU parts of the Treaties, but without using euro area specific legal bases such as Article 136 TFEU. The decision-making on the recovery plan took place entirely within the EU's institutional framework (there was no "outsourcing" to agencies or ESM-type international bodies) and both the resources and the expenditure of the recovery plan are EU-wide and, thus, not limited to euro area Member States, unlike the ECB's PEPP programme or the ESM's Pandemic Crisis Support Programme.

The billions of euro paid in grants under the main financial instrument of the NGEU package, namely the Regulation on the Recovery and Resilience Facility (RRF)<sup>1240</sup> (hereinafter the "RRF Regulation"), will allow the Member States to make investments in their economies without the need to incur new public debt: "nobody has to pay now".<sup>1241</sup> The distribution of funds through the EU does not operate a direct transfer from the richer to the poorer Member States, as the EUR 750 billion will neither be "German" nor "Greek" debt but truly common debt. Whether the NGEU programme eventually leads to a fiscal transfer between EU Member States will only become clear in the future, when the EU starts repaying the capital of its

<sup>&</sup>lt;sup>1239</sup> On the main features of the Pandemic Crisis Support instrument, see Markakis, M. (2020), "The Reform of the European Stability Mechanism: Process, Substance, and the Pandemic", *Legal Issues of Economic Integration*, Vol. 47, pp. 359-384, at p. 373 ff.

<sup>&</sup>lt;sup>1240</sup> Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility (OJ L 57, 18.2.2021, p. 17).

<sup>&</sup>lt;sup>1241</sup> Gros, D. (2020), "The Franco-German Bond to the Rescue", CEPS Brief, 20 May 2020.

massive borrowing – depending on whether this repayment will be based either on newly created own resources of the EU, or on the "old" own resource of contributions based on gross national income. The adoption of the rhetoric of solidarity between the EU Member States was naturally prompted by the pandemic, but was also made relatively painless by the fact that there are no costs involved in the plan for the frugal Member States, at least not for the time being.

Time will tell whether the recovery plan can be transformed into a permanent tool for common fiscal policy and macro-economic stabilisation. As the NGEU programme is limited in time, the question will arise, towards the end of it, whether there is still a need for a euro area specific reform instrument (like the BICC) or whether the recovery plan has marked a long-term decline of the trend towards differentiated integration in the economic policy domain. For sure, the development of the euro area into an autonomous organisation, separate from the EU, was halted by the legal evolution of 2020, as both the Support to mitigate Unemployment Risks in an Emergency (SURE) and the NGEU are EU-wide programmes.<sup>1242</sup> The adoption of the NGEU programme also calls into question the role of the ESM. Indeed, the ESM's Pandemic Crisis Support programme has remained unused, as the euro area Member States could access funding in more appealing ways through the ECB's debt purchase programme and through the loans and grants provided by the EU through its new programmes.<sup>1243</sup> The Commission demurely noted that the ESM's programme "remains available and has also contributed to anchor confidence in the EU policy response".1244

## 3 The reinvention of cohesion policy

The second part of this paper proposes the view that the pandemic recovery plan has allowed for the reinvention of cohesion policy, making it into the main tool for the EU's intervention in the macroeconomic domain. This retooling of cohesion policy entails that there is indeed a legal basis for a future, post-NGEU or permanent, fiscal capacity for the EU-27 (rather than for the euro area).

EU economic policy is described in Article 5(1) TFEU as a competence to merely "coordinate" Member State policies, but this was never an accurate description of the actual competences conferred in the "E" part of the EMU chapter of the TFEU: one finds there law-making powers (e.g. harmonisation of national budgetary procedures) and funding powers (in

<sup>&</sup>lt;sup>1242</sup> Fromage, D. (2020), "Towards Increasing Unity and Continuing Executive Predominance within the E(M)U Post-COVID?", *Legal Issues of Economic Integration*, Vol. 47, pp. 385-408.

<sup>&</sup>lt;sup>1243</sup> See Guttenberg, L. (2020), "Time to come home – If the ESM is to stay relevant, it should be reinvented inside the EU", Hertie School Jacques Delors Centre Policy Brief, 11 November 2020.

<sup>&</sup>lt;sup>1244</sup> Commission communication of 19 October 2021, The EU economy after COVID-19: implications for economic governance, COM(2021) 662, p. 9.

particular Article 122 TFEU, allowing the EU to provide financial assistance to countries facing exceptional circumstances).<sup>1245</sup> The modest description of EU competences in Article 5(1) TFEU also hides the existence of broad economic policy competences elsewhere in the Treaties, in particular the internal market competence (which was the basis, among many other things, for the regulation of the financial markets) and the cohesion policy competence (a funding power with macro-economic policy aims).

Cohesion policy is, generally speaking, a policy with broadly defined aims. It has been the vehicle, over the years, for policy goals for which there is no clear competence elsewhere in the Treaties. It was aptly described as playing a "joker role".<sup>1246</sup> In addition to the structural funds, whose aims have gradually become broader over the years, the cohesion policy chapter contains its own flexibility clause in Article 175(3) TFEU, which allows for cohesion measures to be adopted "outside the Funds". This legal basis thus partakes in the broadly defined aims of cohesion, and allows for a broad range of measures, namely any "action" that would "prove necessary". Financial assistance is not specifically mentioned but is not excluded either.

Article 175(3) TFEU served as the legal basis for the RRF Regulation. That legal basis had been used quite frequently in the past, but never for such an ambitious instrument as the RRF.<sup>1247</sup> The broad potential of this legal basis was first employed in 2002, when it served for the creation of the European Solidarity Fund (EUSF).<sup>1248</sup> The legal basis of that Regulation was Article 159 of the Treaty establishing the European Community, the predecessor of the current Article 175 TFEU, but the recitals of the Regulation gave no explanation or justification for the use of that legal basis.<sup>1249</sup> The EUSF was intended to offer rapid financial support to Member States facing major natural disasters such as floods or earthquakes, but it was amended in 2020 to include major public health emergencies within its scope of application<sup>1250</sup>, and some relatively small

<sup>&</sup>lt;sup>1245</sup> See Bieber, R. (2014), "The Allocation of Economic Policy Competences in the European Union", in Azoulai, L. (ed.), *The Question of Competence in the European Union*, Oxford University Press, pp. 86-100.

<sup>&</sup>lt;sup>1246</sup> Tömmel, I. (2020), "Die Regional- und Kohäsionspolitik der EU: Strukturhilfen für Fördergebiete oder Joker der Integration?", *Integration*, Vol. 43, nr 1, pp. 33-47.

<sup>&</sup>lt;sup>1247</sup> For the earlier practice, see Flynn, L. (2019), "Greater Convergence, More Resilience? Cohesion Policy and the Deepening of the Economic and Monetary Union", in Fromage, D. and De Witte, B. (eds.), *Recent Evolutions in the Economic and Monetary Union and the European Banking Union: A Reflection*, Maastricht University Faculty of Law Working Paper Series, pp. 48-60.

<sup>&</sup>lt;sup>1248</sup> Council Regulation (EC) No 2012/2002 of 11 November 2002 establishing the European Solidarity Fund (OJ L 311, 14.11.2002, p. 3).

<sup>&</sup>lt;sup>1249</sup> The EUSF regulation had a second legal basis, namely the flexibility clause of Article 308 EC (the current Article 352 TFEU), and that additional legal basis was expressly justified as needed to allow the inclusion of accession candidate countries within the scope of application of the fund.

<sup>&</sup>lt;sup>1250</sup> Regulation (EU) 2020/461 of the European Parliament and of the Council of 30 March 2020 amending Council Regulation (EC) No 2012/2002 in order to provide financial assistance to Member States and to countries negotiating their accession to the Union that are seriously affected by a major public health emergency (OJ L 99, 31.3.2020, p. 9).

sums were allocated to a number of Member States to deal with the health emergency caused by the coronavirus pandemic.

Article 175(3) furthermore served as the legal basis for the European Globalisation Adjustment Fund in 2006<sup>1251</sup>, and for the Fund for European Aid to the Most Deprived in 2014.<sup>1252</sup> The latter instrument contributes to the fight against poverty and social exclusion, objectives which are thus considered to be part of the aim to improve social cohesion. Article 175(3) was also chosen by the Commission as the legal basis for some of its post-euro-crisis proposals on economic policy<sup>1253</sup>, in particular for the Structural Reform Support Programme (SRSP), which was established in 2017.<sup>1254</sup> Its budget was modest, when viewed from a post-COVID-19 perspective: EUR 0.14 billion, to be spent by 2020. It had a dual legal basis: Article 197 TFEU, which allows the EU to support the administrative capacity of the Member States for implementing EU law, and Article 175(3). It was considered that Article 197 would not allow for actions unconnected with the implementation of EU law and, since the SRSP had a much broader scope, another legal basis had to be found.<sup>1255</sup> The justification for using Article 175(3) as the legal basis of the SRSP was rather straightforward: structural reforms in the Member States will improve the performance of their national economies, which in turn will favour economic and social convergence between the Member States and thus the cohesion of the EU as a whole. This institutional practice was, however, criticised by some authors for nullifying the distinction between cohesion policy and economic policy as separate policy fields, each with its distinct nature as EU competences: "Interpreting cohesion policies in such an expansive

<sup>&</sup>lt;sup>1251</sup> Regulation (EC) No 1927/2006 of the European Parliament and of the Council of 20 December 2006 on establishing the European Globalisation Adjustment Fund (OJ L 406, 30.12.2006, p. 1).

 <sup>&</sup>lt;sup>1252</sup> Regulation (EU) No 223/2014 of the European Parliament and of the Council of 11 March 2014 on the Fund for European Aid to the Most Deprived (OJ L 72, 12.3.2014, p. 1). This instrument was amended in February 2021 (still on the same legal basis) in order to increase its resources in response to the COVID-19 outbreak.

<sup>&</sup>lt;sup>1253</sup> Article 175(3) was one of the four legal bases of the Regulation on the European Fund for Strategic Investment (the so-called Juncker plan): Regulation (EU) 2015/1017 of the European Parliament and of the Council of 25 June 2015 on the European Fund for Strategic Investments, the European Investment Advisory Hub and the European Investment Project Portal and amending Regulations (EU) No 1291/2013 and (EU) No 1316/2013 — the European Fund for Strategic Investments (OJ L 169, 1.7.2015, p. 1). The other legal bases of this Regulation were Article 172 (on trans-European networks), Article 173 (industrial policy) and Article 182 (research and development policy). This Regulation was recently amended by Regulation (EU) 2021/523 of the European Parliament and of the Council of 24 March 2021 establishing the InvestEU Programme and amending Regulation (EU) 2015/1017 (OJ L 107, 26.3.2021, p. 30), which has only two legal bases: Article 173 and Article 175(3).

<sup>&</sup>lt;sup>1254</sup> Regulation (EU) 2017/825 of the European Parliament and of the Council of 17 May 2017 on the establishment of the Structural Reform Support Programme for the period 2017 to 2020 and amending Regulations (EU) No 1303/2013 and (EU) No 1305/2013 (OJ L 129, 19.5.2017, p. 1).

<sup>&</sup>lt;sup>1255</sup> Flynn, L. (2020), "Non-Fiscal Surveillance of the Member States", in Amtenbrink, F., Herrmann, C. and Repasi, R. (eds.), *EU Law of Economic and Monetary Union*, Oxford University Press, pp. 850-877, at p. 873.

manner so as to effectively empty the field of economic policies of independent content would seem to contravene this Treaty logic".<sup>1256</sup>

Article 175(3) then served as the legal basis for the Commission proposal for a Just Transition Fund. This instrument was initially presented in January 2020 with the aim of supporting the economic diversification of territories most affected by the climate transition measures (such as, for example, the coal mining region in Poland).<sup>1257</sup> The Commission presented an amended proposal on 28 May 2020 in which it proposed that the Fund should be one of the elements of the NGEU package.<sup>1258</sup> The Just Transition Regulation was adopted only in June 2021<sup>1259</sup>, but there was no dispute among the institutions or among the Member States about the fact that Article 175(3) was an appropriate legal basis for it. Indeed, the territorial cohesion element is particularly evident in this programme.

The fact that the RRF Regulation is, in turn, based on Article 175(3) is again justified by stating its objective "to promote the Union's economic, social and territorial cohesion"<sup>1260</sup> but, within the same sentence, a dozen more objectives were added that correspond to the different policy strands of the RRF. Even more curiously, Article 3 of the Regulation (entitled "Scope") mentions "economic cohesion" and "social and territorial cohesion" as two of the six pillars of the Facility, thereby giving the impression that the other four pillars (namely, green transition, digital transformation, crisis preparedness, and policies for the next generation) are not about cohesion. This could seem to question the suitability of Article 175(3) as the legal basis, but one should maybe not read too much into the text of Article 3 of the RRF Regulation. One could very well consider that, whereas two constitutive elements of cohesion are explicitly highlighted as pillars of the RRF programme as a whole.

Anyway, one can see, in the adoption of the RRF Regulation, a clear confirmation of a trend foreshadowed in the previous instruments based on Article 175(3), namely a move away from the domain of cohesion in the strict sense (namely, the sort of measures funded by the structural funds) towards a much broader domain of macro-economic policy measures aiming at improving the overall balance of economic development within the territory of the EU – that is, the whole territory of the EU. This aim also incorporates the economic stability of the euro area that benefits more specifically from this EU-wide initiative. What we see here is, in a sense, a merger of the policy aims of cohesion and euro area economic stability and, politically speaking, a reconciliation of the concerns and interests of both euro and non-euro Member States. And what we got with Article 175

<sup>&</sup>lt;sup>1256</sup> Leino, P. and Saarenheimo T., op.cit, at p. 639.

<sup>&</sup>lt;sup>1257</sup> Commission proposal for a Regulation of the European Parliament and of the Council establishing the Just Transition Fund, COM(2020) 22 of 14 January 2020.

<sup>&</sup>lt;sup>1258</sup> Amended Commission proposal for a Regulation of the European Parliament and of the Council establishing a Just Transition Fund, COM(2020) 460 of 28 May 2020.

<sup>&</sup>lt;sup>1259</sup> Regulation (EU) 2021/1056 of the European Parliament and of the Council of 24 June 2021 establishing the Just Transition Fund (OJ L 231, 30.6.2021, p. 1).

<sup>&</sup>lt;sup>1260</sup> RRF Regulation, Article 4(1).

TFEU is a new permanent legal tool for EU-wide fiscal capacity. Whether that tool is going to be used again in the future depends on political choices, and not on legal constraints. The step taken by the adoption of the RRF certainly takes the EU away from the "surveillance model" of fiscal integration and closer to the alternative "fiscal federalism" model.<sup>1261</sup>

#### 4 Conclusion

The first evolution embodied by the recovery plan that I have presented in this paper, namely the decline of differentiated integration, can be seen as backing away from institutional experimentalism: there is no creation of further euro area specific institutional arrangements, situated within or outside the EU legal order, but instead a choice for more straightforward EU-27 based solutions. The second evolution highlighted in this paper, namely the rediscovery of the EU's neglected macroeconomic competences, can be seen as a new form of experimentalism. It offers a fresh interpretation of the existing Treaty norms in the light of changing circumstances, thereby putting in place a new tool for fiscal integration.<sup>1262</sup> The creation of a new budgetary capacity for the EU-27 is an innovative institutional practice that stands witness to the fact that the EU Treaties form a "living constitution" for the EU: those Treaties may be rigid in the sense of being very difficult to revise formally, but they are flexible enough to allow for new institutional practice adapted to new challenges faced by the EU.

<sup>&</sup>lt;sup>1261</sup> For the distinction between these two models, see Hinarejos, A. (2013), "Fiscal Federalism in the European Union: Evolution and Future Choices for EMU", *Common Market Law Review*, Vol. 50, pp. 1621-1642.

<sup>&</sup>lt;sup>1262</sup> See, for a broader description of the recovery plan as denoting an "experimental Union": Schelkle, W. (2021), "Fiscal Integration in an Experimental Union: How Path-Breaking Was the EU's Response to the COVID-19 Pandemic?", *Journal of Common Market Studies* (first view article).

# Fiscal surveillance and coordination in post-pandemic times – between uncertainty and opportunity

**By Paul Dermine\*** 

# 1 Introduction – COVID-19 and the wider trajectory of fiscal integration in the EU

The COVID-19 crisis will certainly have a lasting impact on the wider trajectory of fiscal integration in the European Union (EU). Will it constitute Europe's Hamiltonian moment? Beyond the reservations I have with the use of that analogy, we certainly lack hindsight to properly answer this question. However, one must concede that the EU's Next Generation EU (NGEU) recovery plan, the main policy initiative to tackle the effects of the pandemic, stands as a true policy shift. Much has already been written on NGEU, its meaning for the dynamics of European integration, its legal and institutional organisation and the way it disrupts the organising paradigms of economic governance in Europe and the EU's public finances.<sup>1263</sup>

At the start of this contribution there is the acknowledgement that COVID-19 and the passing of NGEU, as a large-scale macroeconomic stabilisation mechanism, contributes to rebalancing the positive and negative prongs of fiscal and budgetary integration in Europe and the euro area. Historically, fiscal integration in the EU has been primarily conducted in a negative manner: budgetary policies were enacted at Member State level, with collective, rules-based surveillance and supervision carried out at EU level, in the name of national responsibility and joint commitment to the stability of the single currency. NGEU embodies a more positive form of fiscal integration based on solidarity through funding, assistance through transfers, a collective capacity for joint action and a greater dose of redistribution and risk-sharing across the EU.

Unlike the other contributions of this panel, this article does not focus on NGEU itself, but intends to look precisely at this interaction between NGEU and the negative prong of fiscal integration, and considers the impact that

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<sup>&</sup>lt;sup>1263</sup> Among others, see De Witte (2021), Dermine (2020) and Iliopoulou-Penot (2021).

NGEU can be expected to have on fiscal coordination and surveillance in the EU.

This article is structured as follows. First, it analyses the most direct impact COVID-19 had on fiscal surveillance, namely the suspension of the Stability and Growth Pact (SGP) through the activation of the general escape clause. Then, it considers the more structural, longer-term consequences COVID-19 and the adoption of NGEU are likely to have on fiscal surveillance, as well as examining the possible next reform of the SGP COVID-19 might have paved the way for. It describes the exceptional context we are currently in and the window of opportunity that COVID-19 has opened. It then investigates the main avenues for reform that are currently being considered, both with regard to the fiscal rules themselves and the institutional arrangements that support them. It ends with a set of conclusive reflections.

# 2 The direct impact of COVID-19 on fiscal surveillance and coordination – the suspension of the SGP

The most direct and immediate impact of the pandemic on the EU's system of fiscal surveillance and coordination has been the activation of the general escape clause of the SGP (enshrined in Articles 5(1) and 9(1) of Council Regulation (EC) No 1466/97 and Articles 3(5) and 5(2) of Council Regulation (EC) No 1467/97), which led to its de facto suspension. In the very early stages of the health crisis in March 2020, the European Commission, eager to accommodate national fiscal responses, and to give Member States the fiscal space they needed to tackle the economic impact of the pandemic, proposed to activate the clause<sup>1264</sup>, and was quickly followed by the Council of the European Union.<sup>1265</sup> The clause has been part of the EU's fiscal rulebook since 2011 and seeks to offer Member States the fiscal leeway to deal with periods of severe economic downturn. Its activation was formalised in the fiscal country-specific recommendations adopted in July 2020, which for the first time were identical for all Member States and only contained qualitative guidance, asking Member States to take measures to address the pandemic and support the recovery, while preserving fiscal sustainability in the medium term.

The general escape clause stands as the most far-reaching form of flexibility under the SGP and its activation was as significant as it was unprecedented. For the first time in the rather short but already turbulent life of the SGP, the EU froze adjustment trajectories and exhorted Member States to spend and invest, without strict regard to the rules on debt and deficit which normally constrain budgetary policy in the euro area. Retrospectively, the signal sent was timely and welcome. The initiative also

<sup>&</sup>lt;sup>1264</sup> European Commission (2020d).

<sup>&</sup>lt;sup>1265</sup> Council of the European Union (2020).

stood in stark contrast with the EU's initial reaction to the sovereign debt crisis<sup>1266</sup> and suggested that the EU had come to understand the importance of counter-cyclicality and coordinated fiscal stimuli in times of economic downturn. Interestingly, the clause, which is formally labelled as a locus for country-specific flexibility, acted as a general waiver and its activation led to a de facto general suspension of the SGP.<sup>1267</sup>

A crucial issue that the activation of the clause still raises, which will have great bearing on the future trajectory of EU fiscal surveillance, is that of timing. When will the escape clause be deactivated? Whereas several stakeholders have been pushing for a speedy return to normalcy, i.e. to the EU's ordinary fiscal regime, the Commission is playing for time and has suggested that the clause should not be deactivated before the end of 2022.<sup>1268</sup> This is obviously a period of deep ambiguity for fiscal surveillance in the EU. A regime of exception currently applies. But it is unclear if, and when, this parenthesis will be closed. The policy dilemma is evident. On the one hand, the EU does not want to put the economic recovery into jeopardy by reactivating its fiscal discipline regime too soon. Fiscal consolidation should only start once the recovery has matured. But, on the other hand, the EU also wants to avoid free-riding and prevent the accumulation of heavy fiscal legacies which might impair the EU and its Member States for the decades to come.<sup>1269</sup> In its conclusions on the future of the European Semester, the Council hinted at the difficult balance to be preserved and stressed "the need to safeguard the economic recovery, also taking into account the uncertainty of the economic outlook and the asymmetric impacts of this crisis, while ensuring that fiscal policy is agile and adjusted to circumstances, and fiscal sustainability preserved in the medium term".1270

The discussion is all the more complex given that the issue of when the SGP should be reactivated is intrinsically linked to the issue of which SGP should be reactivated. Should the EU favour a return to the *status quo ante*: that is, an unchanged SGP, in its pre-pandemic version? Or, on the contrary, would the new macroeconomic reality Europe has been propelled into by the pandemic, and the economic recovery of the years to come, not call for new budgetary rules and an updated SGP? This is the question that the following sections want to consider.

<sup>&</sup>lt;sup>1266</sup> In the aftermath of the Great Financial Crisis, the EU did not put such a fiscal régime d'exception in place. On the contrary, it insisted on strict adherence to the fiscal policy rules, further exacerbating the effects and intensity of the shock.

<sup>1267</sup> EFB (2021), pp. 33-36.

<sup>&</sup>lt;sup>1268</sup> European Commission (2021a). See also European Commission (2021b) and European Commission (2021d).

<sup>&</sup>lt;sup>1269</sup> On this dilemma and the issue of the clause's deactivation, see Jones (2020).

<sup>&</sup>lt;sup>1270</sup> Council of the European Union (2021).

# 3 The indirect impact of COVID-19 on fiscal surveillance and coordination – towards the next reform of the SGP?

A more indirect, although far more groundbreaking, consequence of COVID-19 for EU fiscal surveillance might indeed be that it could pave the way for the next serious reform of the SGP. Nothing should be taken for granted of course and no one can predict what future political developments will hold. The mountain might give birth to a mouse and the *muddling through* strategy could once again take precedence within the EU's institutional spheres. Nonetheless, recent trends do provide the EU with a clear and rare window of opportunity to overhaul its fiscal governance system.<sup>1271</sup> Three main factors contribute to such a window of opportunity.

First, there is the new macroeconomic reality COVID-19 has propelled the EU into. To many observers, the world the current rules were built for no longer exists<sup>1272</sup> and, as a consequence, the EU's fiscal rulebook has become somewhat outdated. The EU's new macroeconomic environment indeed presents several distinctive features calling for regulatory adjustment: higher levels of public debt, very low if not negative interest rates and limited effectiveness of monetary policy in the vicinity of the effective lower bound. On top of that, policy priorities are shifting and the challenges of post-pandemic recovery and climate change, which have been placed at the top of the EU's political agenda, call for stronger Member State interventions, through new public investment strategies and a novel approach to government debt.<sup>1273</sup> Last but not least, the recent emergence of an embryonic form of central fiscal capacity at EU level with NGEU (and the European instrument for temporary Support to mitigate Unemployment Risks in an Emergency (SURE)) not only embodies this new approach to investment and debt, but will also rebalance EU fiscal governance and lighten the pressure which had been so far placed on EU fiscal coordination and surveillance of national policies. Against this background, post-pandemic times might call for a new policy mix, a new role for EU fiscal policy and EU fiscal coordination and surveillance, resulting in fiscal policy rules being made more accommodative and flexible.

Second, institutional readiness for reform in the field has grown increasingly over the past few years, as the EU engaged in a serious exercise of self-assessment and investigated ways to enhance the SGP and fiscal governance as a whole. This ambition is not new and can certainly be traced back to the Five Presidents' Report<sup>1274</sup> and the Commission's Reflection Paper on the Deepening of the Economic and

<sup>&</sup>lt;sup>1271</sup> In general, see Hinarejos (2021).

<sup>&</sup>lt;sup>1272</sup> See, most emblematically, Pisani-Ferry (2021).

<sup>&</sup>lt;sup>1273</sup> Along these lines, see Andor (2021).

<sup>&</sup>lt;sup>1274</sup> Five Presidents' Report (2015), p. 14.

Monetary Union.<sup>1275</sup> It is also the result of the political pressure which has been mounting on the EU and the Commission, from EU bodies and institutions such as the European Fiscal Board (EFB)<sup>1276</sup>, the European Stability Mechanism (ESM)<sup>1277</sup>, the European Central Bank (ECB)<sup>1278</sup> and the European Parliament<sup>1279</sup>, from national governments<sup>1280</sup> and from other international players such as the International Monetary Fund.<sup>1281</sup> This reform ambition took another turn when the Commission launched, in February 2020, its review of the Six-Pack and Two-Pack<sup>1282</sup>, which was envisioned as the stepping stone for a deeper reform of SGP rules.<sup>1283</sup> The pandemic has naturally put the exercise on the back burner, but it was relaunched in October 2021 and the Commission can be expected to table its reform proposals by early 2023.<sup>1284</sup>

Last but not least, the reconfiguration of the macroeconomic environment prompted by COVID-19, recent institutional developments and the prospect of a reform of EU fiscal governance in the near future did intensify intellectual exchanges on the topic, in both the academic and policy spheres. Over the past few months, the EU has seen reflection papers and proposals on the future of fiscal rules and fiscal surveillance and coordination mushrooming. In this regard, the recent proposals made by Martin, Pisany-Ferry and Ragot<sup>1285</sup>, and by Blanchard, Leandro and

<sup>&</sup>lt;sup>1275</sup> European Commission (2017), p. 28.

<sup>&</sup>lt;sup>1276</sup> In its 2017 and 2018 annual reports, and 2019 assessment of EU fiscal rules, the EFB emphasises the need for a fundamental overhaul of fiscal policy rules in the European Union. For the latest versions of the EFB's proposals on the future of fiscal policy rules, see EFB (2020), pp. 85-95; EFB (2021), pp. 71-86.

<sup>&</sup>lt;sup>1277</sup> See, for example, Regling (2020). See also ESM (2021).

<sup>&</sup>lt;sup>1278</sup> The ECB has recently been quite vocal about the need for a more supportive and expansive fiscal policy in the euro area, indirectly calling for a loosening of the rules. See, for example, Draghi (2019a) and Draghi (2019b). In the framework of the June 2021 Monetary Dialogue with the European Parliament, Christine Lagarde stated that "Europe needs a modernized framework with transparent, flexible and credible fiscal rules that will enable counter-cyclical and sustainable fiscal policies" (European Parliament's ECON Committee (2021)).

<sup>&</sup>lt;sup>1279</sup> See, most notably, European Parliament (2021).

<sup>&</sup>lt;sup>1280</sup> For an early example, see Schäuble's non-paper (Schäuble (2017), which includes several proposals on fiscal governance. Representatives of Northern European countries have also multiplied public statements on fiscal discipline and budgetary surveillance, before and after the pandemic, and strongly support a *no change* scenario. Countries like France and Italy argue in favour of a far-reaching revision of the SGP.

<sup>&</sup>lt;sup>1281</sup> See, for example, IMF (2019), pp. 12-14.

<sup>&</sup>lt;sup>1282</sup> In February 2020, the European Commission launched its *Economic governance review* and identified broad avenues for reflection. The Commission announced an inclusive debate with other EU institutions, national authorities, social partners, civil society organisations and the academic world on ways to enhance the effectiveness of economic and fiscal governance. On that basis, the Commission will then come forward with its own concrete proposals. In that regard, see European Commission (2020a), European Commission (2020b) and European Commission (2020c).

<sup>&</sup>lt;sup>1283</sup> See European Commission (2019).

<sup>&</sup>lt;sup>1284</sup> European Commission (2021c).

<sup>&</sup>lt;sup>1285</sup> Martin, Pisany-Ferry and Ragot (2021).

Zettelmeyer<sup>1286</sup> stand out. The 2018 roadmap presented by a Franco-German team of economists also remains very relevant.<sup>1287</sup>

In a nutshell, as a result of the pandemic and the notable developments in the institutional and wider societal spheres, the EU currently has a clear and rare opportunity to meaningfully revise its fiscal rulebook and fiscal governance system which, according to many, has only come to survive on inertia. Most would agree that returning, after the deactivation of the general escape clause, to an unchanged SGP would be both economically unwise and politically unfortunate.<sup>1288</sup> Many preconditions for a genuine overhaul of the EU's fiscal policy rules seem to be in place and a reform of the SGP thus appears warranted.

# 4 Reforming fiscal surveillance and coordination – main reform avenues

Considering the intense institutional and intellectual activity in the field of fiscal governance, and the reasonable prospects of an upcoming reform of the SGP, this section introduces, in a structured manner, the main items that are likely to drive discussions and constitute the reform agenda. This selection is of course not entirely objective, but intends to do justice to the richness and diversity of ideas that are currently circulating and to outline some of the main challenges that the next reform of the SGP, and the political negotiations leading to it, will need to confront. In doing so, I distinguish between action on the rules themselves and action on the institutional framework underlying the administration of these rules.

#### 4.1 Action on the rules

A first important theme which shapes ongoing discussions about the EU's future fiscal policy rules is the simplification of the EU's fiscal rulebook. There is wide consensus, both within the institutional world and academic circles, that the current rulebook has become nearly unmanageable because of its complexity and the constant addition of new rules, sub-rules, exceptions and escape clauses.<sup>1289</sup> National authorities tend to struggle to understand the exact rules they are to comply with and the margin of manoeuvre they still enjoy under the current framework.<sup>1290</sup> This greatly

<sup>&</sup>lt;sup>1286</sup> Blanchard, Leandro and Zettelmeyer (2021).

<sup>&</sup>lt;sup>1287</sup> Bénassy-Quéré et al. (2018), pp. 9-12.

<sup>&</sup>lt;sup>1288</sup> See, for example, Gros (2020), pp. 281-284; Thygesen, Beestma, et al. (2020); Anderson and Darvas (2020); Bofinger (2020).

<sup>&</sup>lt;sup>1289</sup> Wieser (2018a). See also EFB (2019a), pp. 84-88. See also Five Presidents' Report (2015), p. 14; European Commission (2017), p. 28; European Commission (2020a), pp. 10-11.

<sup>&</sup>lt;sup>1290</sup> According to Pisani-Ferry, "the Stability and Growth Pact's rules are so hopelessly complex that almost no government minister, let alone member of parliament, can decipher them" (Pisani-Ferry (2019)). Along similar lines, see Keppenne (2020), pp. 820-821.

hinders ownership, transparency, effective implementation and enforcement, and hurts the credibility and sustainability of the SGP. A related concern pertains to the fact that EU fiscal governance has come to amount to micromanagement, with the EU intervening in almost each and every aspect of national public finances, following an annual, short-termist approach. Considering the backlash such system creates and in view of the recent emergence of a strong fiscal capacity for the EU with NGEU, which could contribute to easing the burden borne so far by fiscal coordination and surveillance, some voices advocate that the SGP should take a step back and be refocused around the correction of gross policy errors and the long-term pursuit of a limited set of collective goods.<sup>1291</sup> In view of the above, simplification stands as a key priority. How could this be achieved? If the SGP is to be recentred around fewer rules and operational targets, there must first be agreement on the core objective that fiscal governance intends to pursue. There is a growing consensus today around the idea that this ultimate goal is the long-term sustainability of public finances across the euro area.<sup>1292</sup> The recent pandemic and the related surge of debt levels only confirms this assertion.<sup>1293</sup> On that basis, a streamlining of the existing rules could be envisaged. Most proposals share the same philosophy and suggest a two-pillar approach, revolving around one fiscal anchor (a medium-term debt ratio objective and a declining path towards it), to be operationalised by a debt reduction target. Concerning the fiscal anchor, there is a broad consensus as to the need to restructure the EU's fiscal framework around the debt criterion, at the expense of the deficit benchmark.<sup>1294</sup> Some recent proposals also emphasise the need to move beyond uniform reference values and allow for increased differentiation and country-specificity in the setting up of debt targets and adjustment paces. This aspect has gained prominence in the EFB's proposals.<sup>1295</sup> The Martin et al. report recommends a five-year countryspecific debt target.<sup>1296</sup> The Blanchard et al. report goes even further, proposing a broader fiscal standard, implemented through stochastic debt sustainability analysis, following which debt must appear sustainable with high probability, conditional on current and projected policies.<sup>1297</sup> When it comes to the operational benchmark to be relied upon, where the IMF has suggested a structural fiscal effort variable<sup>1298</sup>, most recent proposals favour an expenditure rule.<sup>1299</sup> An assessment of the merits of these various options goes beyond the scope of this paper and my expertise as a lawyer. They all seem to be consistent with the overarching aim of debt

<sup>&</sup>lt;sup>1291</sup> European Commission (2021c), p. 10.

<sup>&</sup>lt;sup>1292</sup> In that regard, see EFB (2018), pp. 72-73. This view is also shared by the IMF (see Eyraud and Wu (2015), pp. 30-33). This also transpires very clearly from the "14 economists" roadmap (Bénassy-Quéré et al. (2018), pp. 9-10), and the Martin, Pisany-Ferry and Ragot ((2021), pp. 6-7) and Blanchard, Leandro and Zettelmeyer ((2021), pp. 21-24) reports. See also Debrun (2019), pp. 142-157.

<sup>&</sup>lt;sup>1293</sup> EFB (2020), p. 85.

<sup>&</sup>lt;sup>1294</sup> The ESM's proposal, which keeps both, is a notable exception.

<sup>&</sup>lt;sup>1295</sup> EFB (2021), pp. 74-81; EFB (2020), pp. 85-92; EFB (2019b), pp. 77-79.

<sup>&</sup>lt;sup>1296</sup> Martin, Pisany-Ferry and Ragot (2021), pp. 7-8.

<sup>&</sup>lt;sup>1297</sup> Blanchard, Leandro and Zettelmeyer (2021), pp. 22-24.

<sup>&</sup>lt;sup>1298</sup> See IMF (2019), p. 10.

<sup>&</sup>lt;sup>1299</sup> That is most explicitly the case for the EFB's proposals; the "14 economists" roadmap (Bénassy-Quéré et al. (2018)); and the Martin, Pisani-Ferry and Ragot (2021) report.

sustainability and would contribute to greatly simplifying the regulatory picture. However, as will be explained below, there are strong arguments for the system to reduce its dependence on structural indicators, which are plagued with many conceptual and qualitative deficiencies; this would favour the expenditure rule. Along similar lines, most proposals argue in favour of a radical streamlining of the flexibility regime. The most sophisticated proposal in this regard is that of the EFB, which suggests replacing the existing system of waivers and derogations with a general escape clause.<sup>1300</sup>

Other proposals go further down the path of adjusting the EU's fiscal framework to Europe's post-pandemic macroeconomic reality and the future needs and challenges of the EU. In direct line with what has been discussed in the above, some have suggested that the reference values of the Maastricht criteria might need to be updated as they have progressively fallen out of sync with the budgetary reality of the EU. For example, the ESM recently proposed, considering the higher debt levels in Europe and the low growth and low interest environment which now prevails, moving from a 60% to a 100% debt-to-GDP reference value.<sup>1301</sup>

On a different level, considering the immense investment needs Europe faces to address the combined challenges of post-pandemic recovery and the green and digital transition, many voices argue that the next reform of the SGP should make sure that in the future fiscal policy rules boost, protect, or at least do not discourage (as they sometimes did in the past) public investment. Gross government investment has been in decline almost everywhere in the EU and many observers relate this phenomenon to the SGP, which does not sufficiently engage with the composition of government expenditure. Several proposals suggest that government investment should be treated preferentially, either through ad hoc flexibility or by subjecting investment and current expenditures to different rules altogether (following the original spirit of the golden rule). Against this background, the EFB, supported by the European Parliament<sup>1302</sup>, proposes that some clearly delineated sustainable growth-enhancing expenditure and investment are excluded from the net primary expenditure growth ceiling that should, in its view, structure fiscal surveillance in the future.1303 Other proposals are more narrow and focus on specific categories of investment. For example, Darvas and Wolff recently proposed a "green golden rule", which would exclude net green investment from the fiscal indicators used to measure fiscal rule compliance.<sup>1304</sup> These proposals all have merits and would bring about a much-needed compromise between the EU's investment needs and a renewed emphasis on fiscal sustainability (and the necessary consolidation efforts it entails in the short term). One should, however, remain aware that these investment protection

<sup>&</sup>lt;sup>1300</sup> See EFB (2018), p. 81. In direct support of the EFB proposal, see European Parliament (2021), para. 43.

<sup>1301</sup> ESM (2021), pp. 24-38.

<sup>&</sup>lt;sup>1302</sup> European Parliament (2021), para. 45.

<sup>&</sup>lt;sup>1303</sup> EFB (2020), pp. 92-93.

<sup>&</sup>lt;sup>1304</sup> Darvas and Wolff (2021). On this topic, see also van den Noord (2020).

mechanisms entail their own challenges and risks. Most notably, to avoid creative accounting and limit politicisation they must be clearly targeted and precisely delineate eligible investment.<sup>1305</sup>

Finally, I should also evoke the ongoing discussions about the indicators EU fiscal governance relies upon. In the aftermath of the euro area crisis, the SGP has been marked by a move from nominal to structural indicators, especially so in the preventive arm.<sup>1306</sup> Although such indicators have their merits (starting with their alleged ability to measure governments' real fiscal efforts), they are largely intuitive, rely on unobservable variables (i.e. the output gap) and therefore lack transparency and open large spaces for discretion and, ultimately, contestation.<sup>1307</sup> Against this background, many consider that fiscal governance would do well to reduce its dependence on structural indicators by turning to more observable indicators (such as the expenditure rules evoked in the above). Most tellingly, the European Parliament recently pointed out in its resolution on the economic governance review that "the metrics at the heart of the economic governance framework must be easily observable and controllable by political decision-makers in order to increase transparency and comprehensibility for both policy-makers and the public [and] that concepts such as an output gap analysis do not satisfy those criteria".<sup>1308</sup> The European Commission<sup>1309</sup> and the EFB also place the issue at the heart of the ongoing reform process.

How legally demanding would the reform process necessary to bring about the changes mentioned above be?<sup>1310</sup> First, one should underline that a lot is already feasible by mere legislative reform under the current framework of the Treaties, relying on the legal bases of the SGP, namely Articles 121(6) and 126(14) of the Treaty on the Functioning of the European Union (TFEU). Primary law is less a constraint than it is often depicted as being, and the comprehensive reform of the SGP passed in the aftermath of the euro area crisis with the Six-Pack and Two-Pack is clear testament to this. Reference values, which are enshrined in Protocol (No 12) on the excessive deficit procedure, would need to be amended through the special legislative procedure provided by Article 126(14)(2) TFEU. This is demanding (it requires unanimity in the Council and consultation of the European Parliament and the ECB), but nonetheless does not amount to an ordinary revision procedure. In theory, the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG) would need to be amended if necessary, for example if the 1/20th debt reduction rule were to be abandoned, even though the complex interaction between the TSCG and EU law would leave room for creative

<sup>&</sup>lt;sup>1305</sup> On these challenges, and others, see ESM (2021), pp. 19-20.

<sup>&</sup>lt;sup>1306</sup> Most notably, see the new Article 5 of Regulation (EU) No 1466/97 or Article 3(1)(b) of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union.

<sup>&</sup>lt;sup>1307</sup> Which even justified the establishment of a dedicated organ, the Output Gaps Working Group, within the Economic Policy Committee.

<sup>&</sup>lt;sup>1308</sup> European Parliament (2021), para. 42.

<sup>&</sup>lt;sup>1309</sup> European Commission (2021c), p. 10.

<sup>&</sup>lt;sup>1310</sup> For interesting insights on the topic, see ESM (2021), p. 23.

lawyering. More radical departures from the rules-based organisation of EU fiscal surveillance and coordination, such as the move from rules to standards advocated by Blanchard et al.<sup>1311</sup>, would however require more far-reaching Treaty revision.

#### 4.2 Action on the institutional framework

As a result of the various reforms passed in the aftermath of the euro area crisis, the European Commission has become the institution that now dominates the institutional architecture of EU fiscal governance. With rules such as reverse gualified majority voting or the comply-or-explain mechanism, the division of tasks which used to prevail in the pre-crisis era between the Commission and the Council of Ministers has been deeply rethought, at the expense of the latter. EU fiscal governance has also taken an increasingly discretionary turn which has contributed to politicising the Commission's action in the field.<sup>1312</sup> By that, I mean that the complex regulatory regime which the crisis brought about – characterised by an increased level of stringency, an attempt to achieve absolute comprehensiveness, the use of structural indicators and a convoluted flexibility regime - repeatedly places the Commission in situations in which it has to exercise judgement and make use of its interpretative authority. As a result, the distinction between economic assessment (based on objective, technical analysis) and final decision-making (which naturally involves judgement, discretion and taking account of non-technical considerations) has progressively blurred<sup>1313</sup>, and the Commission finds itself in the difficult, almost schizophrenic position of undertaking the roles of both a neutral, technical assessor and a final political enforcer.<sup>1314</sup> Thomas Wieser has described the current conundrum and the challenging position of the Commission in the following words: crisis reforms were designed to "empower the Commission to take unpopular decisions, and see them through. In reality, the burden of decision taking has become heavier, as the Commission is seen as the one and only relevant actor in this game ... As the Commission attempts to steer a course that is described as political, sticking to the rules often imply unpopular decisions. Not sticking to the rules is not possible in a system that is so clearly rules-based. The only way out is creating new rules when difficult decisions loom, so that unpopular decisions need not be taken, and rules are upheld. This, however, creates in turn conflicts with other Member States that lament the resulting lack of fiscal discipline". 1315 Such double-hatting raises important issues in terms of congruence, equality, transparency and legitimacy, and has created real political tensions.

<sup>&</sup>lt;sup>1311</sup> Blanchard, Leandro and Zettelmeyer (2021).

<sup>&</sup>lt;sup>1312</sup> On this phenomenon, see Mérand (2021); Schmidt (2020), pp. 176-207; Leino and Saarenheimo (2018), pp. 135-139. More generally, on the institutional dynamics of fiscal governance following the euro area crisis, see Dermine (2022).

<sup>&</sup>lt;sup>1313</sup> See EFB (2019a), pp. 87-88.

<sup>&</sup>lt;sup>1314</sup> According to the EFB, the Commission is currently "caught between two roles", that of impartial guardian and executive decision-maker (EFB (2018), p. 82).

<sup>&</sup>lt;sup>1315</sup> Thomas Wieser (2018b), p. 180.

As a result, several stakeholders have come to question the sustainability of this arrangement which, to many, hurts the credibility of the European Commission in its role of enforcer of the bloc's economic and fiscal discipline and the efficiency, transparency and legitimacy of fiscal governance as a whole. These doubts, and the lack of trust it prompts, certainly explain why Member States have sought a bigger say in the governance of the recovery plan, most notably through the approval of National Recovery and Resolution Plans and the introduction of an *emergency brake* on disbursements.

Some take the view that this challenge should also be addressed in an eventual upcoming reform of the SGP; clearer demarcation between technical assessment and discretion, between rules and decisions ought to be established.<sup>1316</sup> Such an endeavour requires rethinking the institutional structures for the monitoring and enforcement of fiscal discipline in the euro area and the position of the Commission within them. The paragraphs below provide an overview of the main options that recent discussions have brought to the fore.

A first option for a better separation of the roles of assessor and decisionmaker would comprise returning to the pre-crisis division of labour that used to govern the relationship between the Commission and the Council, most notably by getting rid of reverse qualified majority voting and the comply-or-explain rule. The EFB has made recommendations along those lines.<sup>1317</sup> Although such proposals could be easily implemented by simple legislative reform they ought to be approached with caution. The flaws of the pre-crisis pattern have been painfully established. In view of its natural inclination to act in the European interest, there is a strong case in favour of maintaining strong decision-making powers at Commission level.

Another option is to retain decision-making at Commission level, but to allocate technical economic assessment to another body, thereby empowering an external source of economic expertise. The most radical version of this option would consist in taking the logic of technocratic delegation one step further, that is delegation beyond the Commission, to an expert body devoted to the task, with the obvious intention of disciplining the Commission and limiting the ways in which it uses its powers of interpretation. The analytical and technical functions would then be outsourced to an external structure. The EFB<sup>1318</sup> and the ESM<sup>1319</sup> would

<sup>&</sup>lt;sup>1316</sup> As recently advocated by the EFB, "one of the main objectives [of future reforms] should be to separate the economic analysis, which underpins the assessment of compliance, from the decision to launch corrective procedures and sanctions, which is inherently political" (EFB (2019b), p. 7). See also EFB (2020), pp. 94-95.

<sup>1317</sup> EFB (2019a), p. 88.

<sup>&</sup>lt;sup>1318</sup> In its 2017 Annual Report, the EFB hesitantly expressed its interest in assuming this role (EFB (2017), p. 63).

<sup>&</sup>lt;sup>1319</sup> This was explicitly advocated for by Wolfgang Schäuble in several interviews (see, for example, Brown (2015)) and in his 2017 non-paper (Schäuble (2017)). States forming the new Hanseatic League have also called for a stronger role of the ESM in monitoring national budgets (Financial Times (2018)). See also Fuest's proposals, Fuest (2018).

constitute the most obvious candidates. The Martin et al. and Blanchard et al, reports also consider a more prominent role for national independent fiscal institutions<sup>1320</sup>, which would be placed at the frontline of EU fiscal surveillance, thereby enhancing country-specificity, decentralisation and ownership. All these scenarios would involve taking away some of the prerogatives primary law directly entrusts to the Commission and would therefore require Treaty change. A milder version of this option, easily implementable within the current legal framework, would comprise keeping both economic assessment and final decision-making at Commission level, while ensuring a clearer demarcation between both functions within the institutional structures of the Commission. Along these lines, the EFB has recently proposed giving more autonomy and independence to the Directorate General for Economic and Financial Affairs (eventually protected by a system of Chinese walls) and clearly separating the analysis and recommendations made by the Commission's experts from those ultimately favoured by the College of Commissioners.1321

Taking a wider perspective, some have argued that a more optimal separation of the functions of assessment and decision-making and a sounder arrangement for fiscal governance as a whole could be achieved by empowering an independent, non-political adjudicator to rule on the conflicts the application of fiscal rules sparks between the EU (and most notably, the Commission) and Member States. Along those lines, Blanchard, Leandro and Zettelmeyer propose, in their 2021 report, to bestow this role upon the Court of Justice of the European Union, which would become the final arbitrator of the SGP, in both its preventive and corrective arms.<sup>1322</sup> This is certainly not the place to engage in a discussion about the merits of judicial involvement in the field of fiscal and budgetary policy. Let me just offer the following observations. First, this path would necessarily imply Treaty amendment, as primary law so far excludes the jurisdiction of the Court in matters related to fiscal surveillance, most explicitly so under the excessive deficit procedure (Article 126(10) TFEU). Second, one has to remain aware of the specificities (and inherent limits) of judicial review as a control mechanism and an adjudication process. There is the issue of judicial timing, which, even when accelerated, is slower than the political pace. There is a risk that judicial review might not be able to provide the speed required by fiscal governance and budgetary politics. Expertise might also be an issue: one might argue that judges simply lack the knowledge and cognitive resources to adjudicate over budgetary disputes and that legal frameworks are simply not appropriate to solve the disputes that fiscal governance precipitates. None of these considerations is in itself prohibitive, but they certainly contribute to questioning the appropriateness of judicial review as a channel for conflict resolution and enforcement in the realm of EU fiscal governance.

<sup>&</sup>lt;sup>1320</sup> Martin, Pisani-Ferry and Ragot (2021), pp. 10-11; Blanchard, Leandro and Zettelmeyer (2021), pp. 24-28.

<sup>1321</sup> EFB (2019a), p. 88.

<sup>&</sup>lt;sup>1322</sup> Blanchard, Leandro and Zettelmeyer (2021), pp. 24-28.

Last but not least, one should not lose sight of the fact that discussions about the institutional reorganisation of euro area fiscal governance are intrinsically linked to the wider debate on the democratic credentials of the EU's economic governance system and the political legitimacy of the institutions administering it. Technocratic delegation in a value-based and politically salient area such as fiscal policy certainly has its limits, which explains why the Commission has a hard time directly confronting elected governments and forcing their hands and why it has often favoured bilateral negotiation and context-sensitive guidance at the expense of strict rule enforcement and the efficiency of fiscal surveillance as a whole.<sup>1323</sup> Enhanced democratic accountability and scrutiny, most notably through the more direct involvement of the European Parliament<sup>1324</sup>, would not only consolidate the legitimacy of EU fiscal governance, but it would also increase the Commission's credibility and institutional standing and serve the efficiency of the system.

# 5 Conclusive reflections – fiscal surveillance and coordination in post-pandemic times: between uncertainty and opportunity

The COVID-19 pandemic, and the main fiscal policy measures it brought about at EU level, namely the activation of the general escape clause and the adoption of NGEU (and SURE), have opened a clear and rare window of opportunity for reform of the SGP and, more generally, of the EU's fiscal governance system. If institutions play their cards well, and if Member States manage to find common ground, this might be the time where the EU's fiscal policy rules are adjusted to the new macroeconomic environment of Europe and where longstanding issues of fiscal governance are finally addressed.

It is a time of opportunity, but it is also a time of uncertainty. Proponents of the status quo remain strong<sup>1325</sup> and the position of certain key actors, starting with the new German *Ampelkoalition* formed in November 2021 under Olaf Scholz, remains ambiguous. Momentum for reform might fade away and the window of opportunity could soon close. But the general escape clause will eventually be deactivated. What happens if the SGP has not been reformed by then? Most commentators agree that reverting to pre-pandemic rules would be both economically unwise and politically explosive, but what other options would the EU then have? It is in my opinion crucial that the EU institutions, and most notably the Commission, anticipate this possible sequence of events and start seriously considering the *no reform* scenario, outlining how the existing rules might be applied and interpreted in the current context after the deactivation of the clause.<sup>1326</sup>

<sup>&</sup>lt;sup>1323</sup> On this phenomenon, see Saarenheimo (2018), pp. 57-68.

<sup>&</sup>lt;sup>1324</sup> See most notably, European Parliament (2021), paras. 54-74.

<sup>&</sup>lt;sup>1325</sup> Tooze (2021) and Smith-Meyer (2021).

<sup>&</sup>lt;sup>1326</sup> On this question, see EFB (2021), pp. 84-86.

So the question one is then left with is the following: can reform be achieved by the time the de facto suspension of the SGP ends: that is, in all likelihood, by early 2023? The schedule is obviously tight and the hurdles are manifold. But the last major reform of the SGP in 2011 with the Six-Pack was achieved in only six months, so the mission is not impossible. Once again, and as happened in the summer of 2020 with the adoption of the recovery plan, it will be up to the Member States to bridge their fundamental disagreements and reach common ground on Europe's future fiscal governance framework.

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# Post-COVID-19 E(M)U interinstitutional balance: assessment and outlook

#### By Diane Fromage\*

There is little doubt that the European response to the COVID-19 crisis has been radically different from the response that had been provided to the euro crisis, which struck the European Union (EU) a decade earlier. This is the case for a series of reasons; the chief reason being the fact that, this time around, all national and EU institutions immediately pulled together to limit the dramatic economic consequences that were likely to affect the EU's economies following the severe lockdown measures that were imposed and the sudden reduction in trade exchanges that the pandemic caused. By contrast, during the euro crisis, the EU's response was much slower. The European Central Bank (ECB) was deemed to have remained the "only game in town" as Member States were slow in agreeing on the deployment of common measures.<sup>1327</sup> It thus seems that some lessons were learnt from the euro crisis, to a certain extent at least. However, the fact that, this time around, the shock that struck the European economies was completely exogenous certainly contributed to Member States' readiness to act (swiftly) at EU level.1328

The response national and EU institutions provided to support a European economy faced with the COVID-19 outbreak was undoubtedly *prompt*, *massive*, and *all-encompassing*.<sup>1329</sup> It has included *standard instruments* such as the relaxation of the rules applicable to state aid measures, the suspension of the Stability and Growth Pact, the easing of prudential requirements, and sovereign asset purchases by the ECB. But it has also entailed *innovative and unique tools*, primarily the European instrument for temporary Support to mitigate Unemployment Risks in an Emergency (SURE) and – especially – the Next Generation EU (NGEU) recovery plan,<sup>1330</sup> both of which rely on the massive issuance of bonds by the European Commission on behalf of the EU. They provide for the attribution of back-to-back loans. In the framework of NGEU, the attribution of *grants* 

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<sup>&</sup>lt;sup>1327</sup> For an account of the reaction to the euro crisis, see Hinarejos, A. (2015) and Tuori, K. and Tuori, K. (2014).

<sup>&</sup>lt;sup>1328</sup> Other factors, such as the shock provoked by the decision of the German Federal Constitutional Court in the *Weiss* case (Judgment of the Second Senate of 05 May 2020 - 2 BvR 859/15) have also been deemed to have contributed to this change of paradigm.

<sup>&</sup>lt;sup>1329</sup> For a list of the measures adopted, see the lists regularly updated by the European Banking Institute, the European Commission, and the European Parliament.

 <sup>&</sup>lt;sup>1330</sup> On the legal engineering on which these instruments are based, see Croonenborghs, K. (2020); De Gregorio Merino, A. (2020), B. De Witte, B. (2020); and Repasi, R. (2020).

to the Member States is also possible, which is a novelty in the EU, and is arguably a great step forward for European integration in the area of Economic and Monetary Union (EMU). The question thus arises whether and how these changes may have affected the role played by the various EU institutions and their dynamics. Additionally, considering that a majority of the measures introduced are bound to remain temporary (or one-off), the question may legitimately be posed whether any long-lasting effects on the EU's interinstitutional balance should be expected or whether, on the contrary, a return to the *status quo ex ante* is more likely. The desirability of such a return to the previous situation should be explored as well.

These questions are particularly relevant because, as will be shown in this contribution, just a decade before the outbreak of the COVID-19 crisis, the responses adopted to counter the euro crisis had profoundly reshaped the interinstitutional balance in place within the EU. Some of the reforms that were launched then were in fact still under discussion when the COVID-19 crisis broke out. On the one hand, this situation should be viewed both as advantageous because it allowed for some additional flexibility in the design of the measures adopted to counter the COVID-19 crisis and because the COVID-19 crisis could have acted (or could still act) as a trigger for change where no agreement had been possible until then. On the other hand, it can be viewed as disadvantageous because it may also act as a potential weakening factor since the EMU was arguably not as resilient as it could otherwise have been.<sup>1331</sup>

It is against this background that this contribution analyses whether and how the adoption of the measures designed to protect the European economy from the negative effects of the COVID-19 pandemic has affected the interinstitutional balance between E(M)U institutions, which had already shifted following the adoption of measures to counter the euro crisis. To this end, the main features of the post-euro crisis E(M)U's interinstitutional balance are covered first (Section 1). The measures adopted to counter the COVID-19 crisis and their impact on the E(M)U's interinstitutional balance are considered next (Section 2). This analysis sets the background for a reflection on the EMU's governance framework and its desirable (or likely) future evolution (Section 3).

Before turning to these questions, a disclaimer is in order. The present contribution does not assess the measures introduced in terms of their economic effects and desirability; nor does it examine the measures adopted by individual Member States (whether on their own, or as part of their implementation of the EU instruments). It does not consider the

<sup>&</sup>lt;sup>1331</sup> For instance, the third pillar of the Banking Union, the European Deposit Insurance Scheme (EDIS), is still missing because of the inability of the Member States to come to an agreement despite the fact that the EDIS could contribute to the enhancement of the Banking Union's banking sector. On the other hand, the fact that the agreement on the euro area-specific budgetary tool, the Budgetary Instrument for Convergence and Competitiveness and the reform of the Stability and Growth Pact were still outstanding in 2020 may have made the adoption of NGEU easier for the former, and may allow for more far-reaching reforms to be conducted for the latter. See also P. Dermine's contribution to this book.

institutional dynamics that led to the adoption of these crisis measures either,<sup>1332</sup> but focuses instead on the dynamics as they result from the implementation of these tools.

### 1 Post-euro crisis interinstitutional balance

The instruments adopted to counter the euro crisis have been the object of numerous publications to date<sup>1333</sup>, and there is no space to examine them all in depth here. For present purposes, it suffices to cover their main distinctive characteristics and to highlight those features of the adopted measures that had a strong impact on the E(M)U's institutional framework.

To safeguard the common currency and the European economies, a myriad of measures designed on a case-by-case basis were implemented as the crisis evolved (rather than a detailed and well-crafted plan having been defined from the outset and implemented in an orderly fashion). As a result of this reactive approach, of political opposition by the United Kingdom primarily, and of legal constraints inherent in the EU's legal framework, a series of measures enshrined both in EU law and in inter se agreements among the EU Member States were adopted, and innovative solutions had to be found.<sup>1334</sup> As detailed below, this evolution, even if it partially developed outside the EU's legal order, did affect its interinstitutional balance because, among other things, EU institutions were borrowed, for instance, in the framework of the European Stability Mechanism (ESM)<sup>1335</sup>, and because, on the other hand, the European Parliament was sidelined.<sup>1336</sup>

When considering the E(M)U's interinstitutional balance as it was after the euro crisis from a general standpoint, it first appears that, overall, supranational and international institutions and bodies (including the Commission and the ESM Board of Governors) were largely reinforced to the detriment of the individual Member States. This is because strong conditionality came to underpin the whole logic of the measures adopted.<sup>1337</sup>

As a result of this and of the strong enhancement of supranational oversight over national budgets (of euro area Member States especially)

<sup>&</sup>lt;sup>1332</sup> See Closa Montero, C., González de León F. and Hernández González, G. (2021); Dias Pinheiro, B. and Fromage, D. (2020).

<sup>&</sup>lt;sup>1333</sup> See e.g. footnote 1327 and, among many others, Beukers, T., de Witte, B. and Kilpatrick, C. (2017); and de Witte, B. (2015); loannidis, M. (2016).

<sup>&</sup>lt;sup>1334</sup> This approach gave rise to numerous legal issues and indeed to litigation before EU and national courts, most famously in the *Pringle* and the *Gauweiler* cases. Case C-370/12, *Pringle*, EU:C:2012:756 and Case C-62/14, *Gauweiler*, EU:C:2015:400.

Bauerschmidt, J. (2019), Chapter 8; Craig, P. (2013).
On the borrowing of the EU institutions in the ESM and on the resulting issues of

democratic accountability, see Markakis, M. (2020).

<sup>&</sup>lt;sup>1337</sup> See, e.g., on the conditionality regime, Ioannidis, M. (2014); and on conditionality in the framework of ESM financial assistance specifically, see e.g. Forsthoff, U. and Lauer, N. (2020).

following the introduction of the "European Semester" for economic policy coordination in 2011, the Commission's role and standing in the EMU were also strongly reinforced. For instance, the introduction in the Council of the "reverse qualified majority voting procedure" in the imposition of sanctions should have reinforced the Commission's powers<sup>1338</sup>; as also should have the reinforcement of the supranational coordination and surveillance over national budgetary and fiscal policies. However, soon after this framework was tightened as a result of the adoption of euro crisis law (the legislative six-pack and two-pack, and the Treaty on Stability, Coordination and Governance (TSCG)), its inherent flexibility was put to good use by the Commission<sup>1339</sup>, leading to its discretionary application of the rules in place being put under scrutiny and sometimes criticised.<sup>1340</sup> Hence, the Commission could initially have been perceived as having been strongly reinforced within the EMU. However, in practice, its strengthening was less pronounced because it has not applied the revamped rules and sanction mechanisms in as automatic and strict a manner as could have been anticipated when the reforms were first introduced.

The same is certainly not true of the Eurogroup (an informal body); nor of euro area-specific forums, which have undoubtedly been reinforced during and following the euro crisis. For instance, the Eurogroup was given certain functions in the context of the framework of the European Semester.<sup>1341</sup> Its perfect correspondence with the ESM's Board of Governors also led to its de facto strengthening.

Finally, the European Parliament's prerogatives were only marginally reinforced in the EMU field in comparison to the reallocation of powers to the benefit of the supranational level that followed the euro crisis. It has been guaranteed the possibility to enter into an "economic dialogue" with other EU institutions, but does not have any decision-making powers in the framework of the European Semester.<sup>1342</sup> Furthermore, where Member States had acted outside of the EU's legal framework, representatives from the European Parliament were only invited as observers during the negotiations of some of the inter se agreements.<sup>1343</sup> No powers have been

<sup>&</sup>lt;sup>1338</sup> On this procedure, see Palmstorfer, R. (2014).

<sup>&</sup>lt;sup>1339</sup> European Commission (2015).

<sup>&</sup>lt;sup>1340</sup> Leino, P. and Saarenheimo, T. (2019).

<sup>&</sup>lt;sup>1341</sup> The Eurogroup is for example involved in the yearly monitoring of euro area Member States' draft budgetary plans (Articles 6 and 7 Regulation (EU) No 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area (OJ L 140, 27.5.2013, p. 11).

<sup>&</sup>lt;sup>1342</sup> On the European Parliament's prerogatives in respect of the EMU, see Fasone, C. (2014); Fromage, D. (2018); Maricut-Akbik, A. (forthcoming).

<sup>&</sup>lt;sup>1343</sup> On this see Bauerschmidt, J. (2019), pp. 306-307.

guaranteed to it in the implementation phase.<sup>1344</sup> Note that the prerogatives attributed to national parliaments at EU level are also rather weak since they are limited to the capacity for those parliaments whose Member States are facing difficulty to engage in an economic dialogue.<sup>1345</sup> The possibility for them to be involved otherwise in the European Semester depends on national arrangements, and thus varies widely across the Member States.<sup>1346</sup>

2

# The measures adopted in response to the COVID-19 crisis and their implications for the E(M)U's interinstitutional balance

The previous section offered a description of the E(M)U's institutional framework as it stood when the COVID-19 crisis broke out. The fact that, as previously mentioned, some reforms were under discussion as well at that time should not be omitted. Admittedly, the changes that would most certainly have had the strongest or, at least, most visible and immediate impact on the E(M)U's institutional framework including the "Communitarisation" of the ESM and the TSCG, and the creation of the post of European Minister for Economy and Finance – all of which had been proposed by the Commission in December 2017<sup>1347</sup> – were bound to remain wishful thinking, even before the pandemic occurred.<sup>1348</sup> However, a reform of the ESM Treaty was ongoing, the necessity to introduce changes to the Stability and Growth Pact had become undeniable, and Brexit – which gave rise to important changes to the balance between euro area and non-euro area Member States – had just happened.

As emphasised at the outset of this contribution, the measures adopted to try to limit the damage caused by the COVID-19 crisis to the European

<sup>&</sup>lt;sup>1344</sup> Admittedly, in the past, informal practice contributed to compensating for this shortcoming in the case of the ESM since the possibility to hold an economic dialogue with the President of the Eurogroup – who also chairs the ESM – was used by the Parliament to scrutinise the actions pursued in the framework of the ESM. However, this practice has been discontinued in recent years. Article 13 of the TSCG envisages that the European Parliament and national parliaments organise a conference "in order to discuss budgetary policies and other issues covered by this Treaty". This has nonetheless not led to a systematic involvement of parliamentary conference should still be praised as it has allowed national parliaments and the European Parliament to benefit from exchanges on EMU-related matters more generally.

<sup>&</sup>lt;sup>1345</sup> This possibility exists for instance where a euro area Member State is submitted to enhanced surveillance because it is experiencing, or seriously threatened with, difficulties with respect to its financial stability. See Article 3(9) of Regulation (EU) No 472/2013 of the European Parliament and of the Council of 21 May 2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability (OJ L 140, 27.5.2013, p. 1).

<sup>&</sup>lt;sup>1346</sup> Hagelstam, K, Lehofer, W. and Ciucci, M. (2018).

<sup>&</sup>lt;sup>1347</sup> European Commission (2017).

<sup>&</sup>lt;sup>1348</sup> Dermine, P. (2019).

economy have been numerous and of a varied nature.<sup>1349</sup> Having compared their effects on the E(M)U's institutional framework, it appears that there have been elements of *continuity* as well as *new dynamics*.

With the notable exception of the ESM Pandemic Crisis Support - of which (euro area) Member States have so far not made use - the measures implemented have been introduced in the form of EU-wide solutions.1350 This choice of the Member States is most welcome, for it has the potential to make the measures' implementation more efficient and less cumbersome because it is less differentiated. It could also contribute to improving the perception that EU citizens have of the EU (if these solutions are successful, and if their positive results are largely and adequately advertised). For the purpose of the present analysis though, the most positive effects are the fact that the institutional design through which they are to be implemented is much less complex than the one that had to be defined with respect to euro crisis law. Furthermore, even if, as detailed further below, national parliaments and the European Parliament are still in a weak position, it remains the case that all the standards and principles of EU law apply. This fact alone undoubtedly puts the European Parliament in a better position than it was in those cases in which, during the euro crisis, Member States resorted to inter se agreement instead of acting within the realm of EU law. Beyond this, the fact that, this time around, EU solutions were favoured has led to the reinforcement of EU institutions, generally.

When considering the balance of powers between the Commission and individual Member States, it appears that the NGEU and its main instrument, and the Recovery and Resilience Facility Regulation<sup>1351</sup> (hereinafter the 'RRF Regulation') more specifically, have confirmed the Commission in its key role in the oversight and the control of Member States' budgetary and fiscal policies. In fact, its capacity to influence has probably even been strengthened. This is because the implementation of the RRF Regulation is closely linked to the European Semester. Indeed, the European Semester has been defined as "the framework to identify national reform priorities and monitor their implementation".<sup>1352</sup> Member States must for instance take account of relevant country-specific challenges and priorities in defining their national recovery and resilience plans.<sup>1353</sup> On that basis, they may then apply to the Commission for grants or loans. Additionally, the reporting on the achievement of the recovery and

<sup>&</sup>lt;sup>1349</sup> Note that given the limited size of the EU's budget, it is the Member States, not the EU, that have borne the largest share of the burden in this endeavour.

<sup>&</sup>lt;sup>1350</sup> On the reduction of the gap between euro area Member States and the EU27, see also B. de Witte's contribution to this book.

 <sup>&</sup>lt;sup>1351</sup> Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility (OJ L 57, 18.2.2021, p. 17).

<sup>&</sup>lt;sup>1352</sup> Recital 4 of the RRF Regulation. This link was emphasised again by the Council of the European Union in November 2021. Council of the European Union (2021).

<sup>&</sup>lt;sup>1353</sup> Article 17(3) of the RRF Regulation. This is replaced by the challenges and priorities identified in the framework of macroeconomic adjustment programmes or where they benefit from the facility providing medium-term financial assistance for Member States' balances of payments (Article 17(5) of the RRF Regulation).

resilience plans is set to happen as part of the European Semester.1354 Most importantly, where a Member State incurs an excessive deficit (that would be detected in the course of the ordinary European Semester procedures), the Commission must propose the suspension of existing commitments or payments under the RRF Regulation to the Council.<sup>1355</sup> As a result of the existence of these mechanisms whose activation would have tangible (economic) consequences for the Member States, the Commission is in a stronger position vis-à-vis the individual Member States than it was in the context of the European Semester before it was used to channel the implementation of the RRF Regulation since no sanctions were, for instance, provided for in the event that Member States did not implement the country-specific recommendations addressed to them. Put differently: even at this early stage in the implementation of the RRF Regulation, it is already safe to assume that the country-specific recommendations will indeed be followed to a greater extent by the Member States from now on; whilst they had previously been mostly ignored.<sup>1356</sup> In contrast to this ex post procedure, the preliminary phase (i.e. the original assessment of the national recovery and resilience plans) appears to follow the same logic as that which exists in the European Semester (euro area and country-specific recommendations), and whereby the Commission prepares an assessment that is later adopted by the Council. Note that the Commission's influence may not be as limited as it may seem at first sight because it has important means at its disposal to have a say in the design of the recovery and resilience plans ex ante. On the one hand, the Commission may exercise its influence by using the Technical Support Instrument, through which it can help those Member States that request it in the design and the implementation of reforms.<sup>1357</sup> On the other hand, and in any event, the RRF is fostering a dialogue of unprecedented intensity between Member State governments and Commission services. As a consequence of this. the Commission influences the content of the recovery and resilience plans before receiving them. This probably also explains why they were in many cases approved smoothly by the Council in the first iteration of this process.

Be that as it may, the merely preparatory role assigned to the Commission in the assessment of the recovery and resilience plans stands in stark contrast with the Commission's initial proposal, in which it had proposed that it alone would decide on the recovery and resilience plans by means of a Commission decision.<sup>1358</sup> Member States were nonetheless not ready to give up their powers. This choice may well be understandable from a political perspective – after all, the implementation of the recovery and resilience plans may lead to important changes in the Member States and is, in any case, likely to attract political attention. However, one argument for the attribution of this competence to the Commission lies in the fact that,

<sup>&</sup>lt;sup>1354</sup> Article 27 of the RRF Regulation.

<sup>&</sup>lt;sup>1355</sup> Article 10 of the RRF Regulation.

<sup>&</sup>lt;sup>1356</sup> Angerer, J., Grigaitė, K. and Turcu, O. (2020), p. 7.

<sup>&</sup>lt;sup>1357</sup> Regulation (EU) 2021/240 of the European Parliament and of the Council of 10 February 2021 establishing a Technical Support Instrument (OJ L 57, 18.2.2021, p. 1).

<sup>&</sup>lt;sup>1358</sup> Article 17 of the proposal for a regulation of the European Parliament and the Council establishing a Recovery and Resilience Facility COM(2020) 408 final.

this time around, it is *EU money* that is disbursed in the framework of a facility established on the basis of the third paragraph of Article 175 TFEU, as opposed to the coordination of Member States' budgetary and fiscal policies as was the case under the European Semester in its original form. In the framework of EU Structural Funds, the Commission is commonly in charge, while the EU legislator (the Parliament and the Council) defines and approves the pieces of secondary legislation that establish the Funds, and is involved in the annual budgetary procedure.

A comparison of the balance of powers between the (supranational) Commission and the Member States acting collectively before and after the start of the COVID-19 pandemic shows that, on the whole, the balance now tips in favour of the Member States. Not only have they kept the last word in the *ex ante* assessment of the recovery and resilience plans. They have also (symbolically) kept the last word in the ex post assessment of the recovery and resilience plans; that is, when the adequate implementation of the plans is controlled to allow the disbursement of the funds.<sup>1359</sup> An "emergency brake" procedure is explicitly provided for in the RRF Regulation.<sup>1360</sup> As per the established procedure, the Commission determines whether the plans have been implemented satisfactorily once it has asked the Economic and Financial Committee for its opinion on the basis of its own preliminary assessment. Considering that the Member States, the Commission and the ECB may each appoint up to two members to the Economic and Financial Committee<sup>1361</sup>, Member States are extensively involved in this procedure. However, their main power lies elsewhere. Recital 52 of the RRF Regulation specifically states that if one or more Member State(s) consider(s) that "there are serious deviations from the satisfactory fulfilment of the relevant milestones and targets, they may request the President of the European Council to refer the matter to the next European Council". The Commission may then not authorise the disbursement of the funds or the loans until "the next European Council has exhaustively discussed the matter". Formally, the Commission's powers are preserved<sup>1362</sup>, but it is hard to imagine that it could go against the will of the EU institution that brings together national Heads of State or Government. This "emergency brake" is contained in the recitals of the RRF Regulation, which are devoid of any binding effect. However, even in the absence of explicit recognition of this possibility in the RRF Regulation, Member States always have the right (as in other areas of EU action) to refer any matter they see fit to the European Council. Hence, its importance

<sup>&</sup>lt;sup>1359</sup> Note that, in this regard, the RRF Regulation departs from the logic that commonly operates within the EU and whereby the control of the Member States operates on the basis of the expenses having been effectively incurred. In this case, Member States also have the obligation to achieve a pre-established result.

<sup>&</sup>lt;sup>1360</sup> Recital 52 of the RRF Regulation.

<sup>&</sup>lt;sup>1361</sup> Article 134(2) TFEU.

<sup>&</sup>lt;sup>1362</sup> In fact, as noted by Advocate General Sánchez-Bordona, "[t]his involvement of the European Council... would not be compliant with the primary legislation if it had binding legal effect, because there is no provision in the Treaties that confers such powers on it". Opinion of Advocate General Sánchez-Bordona in Case C-156/21 Hungary v European Parliament and Council of the European Union, EU:C:2021:974, para. 258.

might appear to be negligible. Nonetheless, in my view, the fact that Member States felt the urge to specifically mention it in the RRF Regulation should be interpreted as a sign of their willingness to retain control, and as a sign that some Member States distrust others. The approval of the Rule of Law Conditionality Regulation<sup>1363</sup> further confirms this. The approval of this Regulation – an instrument that allows the Commission to protect the EU's budget and that Member States sitting in the Council could activate easily (qualified majority voting) – seemed to point towards the strengthening of the Commission's powers. Member States nevertheless accepted that the Commission should not adopt the guidelines necessary for the implementation of the mechanism if a case is pending before the Court of Justice of the European Union. They are thus bound to play a predominant role, at least at that first stage.

Regarding the Eurogroup, the assessment is more nuanced. The Eurogroup was called to play a key role (in inclusive format) in the EU's immediate reaction to the pandemic, when responses to it had to be designed.<sup>1364</sup> However, contrary to what was the case at the time of the euro crisis, the Eurogroup has not been attributed any specific role in the implementation of the adopted measures. This is only logical given that NGEU or SURE are EU-wide instruments; they are not euro area-specific. Note that this resort to the Eurogroup in inclusive format as a preparatory organ is problematic for a series of reasons. It is arguably an abusive use of this informal forum whose role it is supposed to be to allow euro area ministers to "discuss questions related to the specific responsibilities they share with regard to the single currency".<sup>1365</sup> In fact, to bring together all EU27 ministers is to bypass (or even to circumvent) the Council. It allows ministers to benefit from a regime of secrecy that a discussion in a Council meeting would not provide, and which makes democratic control more difficult to ensure at both European and national level. Perhaps Member States needed some leeway to discuss more openly and in more reduced circles during the crisis in which the response to the pandemic had to be designed. After all, it may even be preferable for ministers to come together under the auspices of the Eurogroup instead of holding their discussions in even more informal settings since at least a minimum of information is made available when Eurogroup meetings take place. Nevertheless, and as will be further elaborated upon in the conclusion, as a rule, Member States should refrain from abusively resorting to (especially, inclusive) Eurogroup meetings.

Lastly, the role attributed to the European Parliament and national parliaments is still weak, as it was in the area of the EMU prior to the COVID-19 crisis. As was the case with the original European Semester, the European Parliament's consent is not required in respect of the implementation of the RRF Regulation. The European Parliament is to

<sup>&</sup>lt;sup>1363</sup> Regulation (EU, Euratom) 2020/2092 of the European Parliament and of the Council of 16 December 2020 on a general regime of conditionality for the protection of the Union budget (OJ L 433I, 22.12.2020, p. 1).

<sup>&</sup>lt;sup>1364</sup> Fromage, D. (2020), p. 404.

<sup>&</sup>lt;sup>1365</sup> Article 1 of Protocol (No 14) on the Eurogroup.

enter into a (mere) recovery and resilience dialogue with the Commission to discuss, for instance, the state of recovery, resilience and adjustment capacity in the EU; the Member States' recovery and resilience plans, their assessment, and their implementation; the disbursement of funds and loans or their suspension; and generally "any other relevant information and documentation provided by the Commission to the competent committee of the European Parliament in relation to the implementation of the Facility".<sup>1366</sup> However, the European Parliament is in a stronger position under the RRF Regulation than it was under the European Semester. This is because the recovery and resilience dialogue sessions - which are now merged with the economic dialogue procedure - are to be organised on a very regular basis (every two months)<sup>1367</sup>, and because the European Parliament has been guaranteed very large, all-encompassing rights of information (it shall, among others, receive all the "[i]nformation transmitted by the Commission to the Council or any of its preparatory bodies in the context of this Regulation or its implementation" when the Commission transmits it to the Council).<sup>1368</sup> National parliaments, on the other hand, are still largely dependent on the arrangements that may be made at the national level: they are only indirectly mentioned in the RRF Regulation in a reference to Member States' obligation to include in their recovery and resilience plans "a summary of the consultation process, conducted in accordance with the national legal framework, of local and regional authorities, social partners, civil society organisations, youth organisations and other relevant stakeholders, and how the input of the stakeholders is reflected in the recovery and resilience plan".1369

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# Looking ahead: potential long-lasting consequences and desirable evolution of the E(M)U's institutional framework

There is little doubt that trying to predict what may happen in the post-COVID-19 period – in general and in terms of the future of the EMU – is anyone's guess at this stage, be it only because the evolution of the sanitary situation is uncertain or because the success of the RRF Regulation should not be taken for granted. The evolution in the interinstitutional dynamics described in this contribution could very well change, in particular if a starker distinction between the EU27, on the one hand, and the euro area, on the other, should arise again. This would certainly prompt Member States to systematically resort to the Eurogroup

<sup>&</sup>lt;sup>1366</sup> Article 26 of the RRF Regulation.

<sup>&</sup>lt;sup>1367</sup> Article 26(1) of the RRF Regulation.

<sup>&</sup>lt;sup>1368</sup> Article 25(2) of the RRF Regulation.

<sup>&</sup>lt;sup>1369</sup> Article 18(4), point (q), of the RRF Regulation (emphasis added). Two surveys conducted among national parliaments show that in the round of the first submission of the recovery and resilience plans their involvement was limited. However, this situation could improve in the future as national parliaments realise the importance of being involved and design the necessary procedures to this end. COSAC (2021), pp. 11-16; and Dias, C. et al. (2021), p. 21.
again, and it could also be an incentive for them to act outside of the EU legal framework.

What is already clear at this stage is that the NGEU programme could only be agreed on, on the condition that it remained a one-off, temporary, measure – for legal reasons<sup>1370</sup> as well as political ones.<sup>1371</sup> The question then arguably becomes how the E(M)U's institutional framework should continue to evolve once the measures adopted to counter the COVID-19 crisis have lapsed, and in particular whether a return to the *status quo ex ante* is desirable.

An evolution towards the reinstatement of the E(M)U's governance framework as it existed before the pandemic is certainly not desirable, as several of its shortcomings have already become apparent and as, in my opinion, it would be important that *three important issues* be addressed.

The *first* one relates to the question of *democratic control*; that is, the adequate and commensurate involvement of both national and European organs of democratic representation, and their effective cooperation. Indeed, the mechanisms in place do not allow for democratic accountability to be adequately ensured.

A first step on the way towards an improvement of this situation could consist in the enhancement of the initiatives of interparliamentary cooperation both between the European Parliament and national parliaments, and between national parliaments. The "Article 13 interparliamentary conference" could serve as a platform to reach this objective. This could help to compensate for the information gap that they suffer from, and would provide them with an opportunity to learn from each other (cross-fertilisation potential). In fact, in view of the intrinsically hybrid nature of the NGEU, and especially the RRF, which is at the crossroad between EU and national competences in EMU, and considering that parliaments have only been attributed a very limited role in the framework of the RRF, it would be desirable that interparliamentary cooperation in this domain be urgently strengthened.

Next, to guarantee the adequate involvement of national parliaments especially, it would be desirable that they be guaranteed, directly at EU level, rights of information and of minimum involvement. As has been the case for legislative proposals or planning documents since the entry into force of the Lisbon Treaty<sup>1372</sup>, the documents exchanged in the framework of the European Semester should automatically be transmitted to national parliaments as well. This would not be too much of a burden for the EU

<sup>&</sup>lt;sup>1370</sup> As underlined in the opinion delivered by the Council's Legal Service. Council of the European Union (2020).

<sup>&</sup>lt;sup>1371</sup> Some of the Member States (primarily those colloquially known as the "frugal States") have been adamant in their opposition to any form of transfer union.

<sup>&</sup>lt;sup>1372</sup> Article 12 TEU and Article 1 of Protocol (No 1) to the TEU on the role of national parliaments in the European Union

institutions and it would make national parliaments' conduct of their scrutiny significantly easier.

Finally, the ESM should be submitted to tighter democratic control. In that respect, the recent reform of the ESM Treaty may certainly be viewed as a missed opportunity. One can only hope that the informal use to this end of the possibility to invite the Chair of the Eurogroup to appear before the European Parliament on the occasion of an economic dialogue will be available again in the future, especially if the ESM is to be resorted to again.

The second issue that, in my view, deserves attention is that of the *co-existence of the EU27 and the euro area*; such co-existence has led to the parallel functioning of euro area-specific bodies (the Eurogroup, the Euro Summit) and EU institutions (the Council of the European Union, the European Council). As illustrated above, the Eurogroup (in inclusive format) has been used abusively.

At this stage, it is unclear whether the EU27 and the euro area will continue to come closer together or whether, on the contrary, euro area-specific initiatives will be adopted again in the future. In any event, however, there is little doubt that this distinction between Member States is there to stay, be it because one of them (Denmark) is not bound to join, or because others are unwilling to join for political reasons (Poland, Sweden).

If a reform of the Treaties were an option, a formalisation of the Eurogroup or the creation of a Eurogroup parliamentary chamber could be envisaged, although neither of these options would be free from drawbacks either.<sup>1373</sup>

At this stage, however, more restraint in the (abusive) use of the Eurogroup that has been witnessed over the past years would already improve this unsatisfactory state of affairs. The resort to Eurogroup meetings, in particular in inclusive format, should be limited to those cases in which it is strictly necessary. Moreover, informal arrangements in the form of a euro area-specific sub-committee in which MEPs from all Member States would be involved could already help to alleviate the absence of a small-scale forum specialised in euro area matters within the European Parliament.

The *third* issue that should be addressed going forward is the *parallel existence of EU law and intergovernmental agreements*, and especially the ESM, because it has created institutional duplication, complexity and opacity.

A "communautarisation" of the TSCG and the ESM has already been proposed in the past by the Commission, but to no avail. It is unlikely that euro area Member States will accept losing control of the ESM now that it is to serve as a backstop to the Single Resolution Fund, considering how

<sup>&</sup>lt;sup>1373</sup> For an overview, see Fromage, D. (2019).

sensitive and economically important the issue of the rescue or the death of a credit institution can be for individual Member States.

However, even if the ESM remains outside the EU legal framework, informal mechanisms in the form of exchanges of views and transmission of information could in any case allow national parliaments and the European Parliament to be better and more equally involved.

As this contribution has shown, the balance of powers between E(M)U institutions has been constantly evolving over the past decade. The euro crisis disturbed the institutional order established by the Lisbon Treaty only a very short time after it entered into force. The numerous measures adopted to safeguard the common currency and European economies then provoked many more changes and imbalances. The response to the COVID-19 crisis prolonged this trend, though it arguably added even more uncertainty than had previously existed.

During the COVID-19 crisis, several taboos were lifted and differences that were thought to be unreconcilable were overcome. It has, however, also become more and more evident that integration in the field of EMU has advanced further, without the institutional framework in place, and especially mechanisms of democratic control, being adequately upgraded. It is high time that all necessary measures be taken for this lacuna to be filled, not least because post-COVID-19 economic recovery and the necessity to make the EU's economies more resilient to future challenges will certainly demand that new massive economic programmes be implemented jointly by all or some of the Member States (i.e. euro area Member States) at EU level.

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# The COVID-19 crisis – a Hamiltonian moment for Europe?

By Rhoda Weeks-Brown\*

# 1 Introduction

The COVID-19 pandemic was a massive and unprecedented exogenous shock that took a significant toll on the people and economies of the European Union (EU), as it did everywhere else around the globe. In response, the EU and its Member States have executed a bold and ambitious response to cushion the severe socio-economic impact of the pandemic, while taking into account the region's unique institutional, historical and political situation.

The International Monetary Fund (IMF), for its part, has also implemented a bold and flexible response to the unprecedented COVID-19 pandemic in order to meet the needs of its 190 member countries, while staying true to the institution's mandate and core purposes.

I will give an overview of the EU's response and the IMF's views on key aspects of that response that are relevant for this session. I will also discuss key aspects of the IMF's response and its parallels with that of the EU.

# 2 European response

The EU implemented an impressive crisis response to address the unique challenges of the COVID-19 pandemic. These measures are well known, so I will only summarise them here:

 The activation of the general escape clause of the Stability and Growth Pact (SGP), which allows for a temporary departure from the normal operation of fiscal rules, and for the adoption of a state aid temporary framework, enabling national governments to put in place far-reaching levels of fiscal support.<sup>1374</sup>

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<sup>&</sup>lt;sup>1374</sup> Specifically, for the preventive arm of the SGP, Regulation (EC)1466/97, Articles 5(1) and 9(1) state that "in periods of severe economic downturn for the euro area or the Union as a whole, Member States may be allowed temporarily to depart from the adjustment path towards the medium-term budgetary objective, provided that this does not endanger fiscal sustainability in the medium term".

- Deployment of existing European safety nets to complement national responses, including the instrument to Support Mitigating Unemployment Risks in Emergency (SURE), the European Investment Bank Pan-European Guarantee Fund and the European Stability Mechanism Pandemic Crisis Support.
- One-off measures to increase the EU's central fiscal capacity, particularly the NextGenerationEU Recovery and Resilience Facility (NGEU), composed of loans and grants financed in part by common debt issuance at EU level.<sup>1375</sup> These measures have been designed with a focus on today's historic challenges – public health, digitalisation and climate change.

In the same vein, EU institutions seized the urgency of the situation to tackle ambitious EU-level policy objectives, including the transition to a carbon-free economy, not only through the NGEU, but also the EU Taxonomy Regulation, the EU Green Bond Standard, the EU's climate-related disclosure framework and the proposal for a Carbon Border Adjustment Mechanism (CBAM) to address carbon leakage from selected traded carbon intensive products, complementing the existing EU Emissions Trading System.

In the context of rising debt vulnerabilities<sup>1376</sup>, efforts have also been made to build on pre-existing initiatives to support frameworks for sovereign and private sector debt resolution, such as the commitment of European Stability Mechanism (ESM) members to introduce single-limb collective action clauses, and the implementation of the EU Directive for Preventive Restructuring Procedures.

<sup>&</sup>lt;sup>1375</sup> See NextGenerationEU. The Next Generation EU Recovery and Resilience Facility is based on Article 122 of the Treaty on the Functioning of the European Union (TFEU) that allows the European Council, on a proposal from the Commission, to 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". The recovery instrument based on Article 122 TFEU identifies recovery measures and allocates the borrowed funds to various EU programmes. The separate Own Resources Decision authorises the full amount of the borrowing, to be used for exceptional expenditure and for loans to Member States. It also organises the repayment of the amounts used for expenditure under the future EU's Medium Term Financing Framework (MFF). The repayment will be entered into the EU budget in the year it takes place (as of 2028, until 2058). The EU programmes receive the resources and lay down the rules for their implementation.

<sup>&</sup>lt;sup>1376</sup> See, e.g., Gaspar, V., Medas, P. and Perrelli, R. (2020), Global Debt Reaches a Record \$226 Trillion, IMF Blog.

# 3 IMF views on EU response

## 3.1 Fiscal rules

IMF staff has long argued that the current EU fiscal rules are excessively complex, resulting in weaker compliance and more discretionary enforcement over time.<sup>1377</sup> Some more specific concerns are that the framework is procyclical, that it complicates monitoring and public communications, and that it creates risks of inconsistency and overlap, resulting in unintentional violations, increasingly discretionary enforcement and loopholes.<sup>1378</sup> IMF staff has also identified the failure of many high debt countries to reduce debt ratios during the benign pre-pandemic period as a specific consequence of the limited enforcement and compliance under current fiscal rules.

IMF staff is developing concrete proposals related to the new fiscal rules to contribute to the consultation launched by the European Commission in October 2021 on the EU's economic governance framework. The key principles include the following:

- The new fiscal rules should foster sustainability while allowing macroeconomic stabilisation. Staff are assessing having an expenditure growth rule as an operational instrument with a debt anchor that takes into account the pandemic's impact on interest rates and starting debt levels. Early analyses suggest this could lead to a steady reduction in the debt ratio over time, while having fewer negative impacts on growth than strict application of the current rules for high debt countries.
- Essential ingredients for success will include new fiscal rules that are well designed and have a clear articulation of the fiscal objectives to be addressed, as well as ownership and a political commitment to actually follow the rules. IMF staff has also emphasised the importance of institutional reforms in this context, including further strengthening of both national fiscal councils and of the European Fiscal Board.<sup>1379</sup>

Some commentators have called for a move away from quantitative fiscal rules to enforceable fiscal standards of a more qualitative nature that would leave room for judgment.<sup>1380</sup> Such an approach would be similar in key respects to the IMF's debt sustainability analysis framework, which involves

1379 ibid.

<sup>&</sup>lt;sup>1377</sup> Keynote Address by Vitor Gaspar: Future of Fiscal Rules in the Euro Area (January 28, 2020), IMF Speech.

<sup>&</sup>lt;sup>1378</sup> See IMF (2022), *Euro Area Policies: Staff Report on the 2021 Consultation on Common Euro Area Policies*, available at www.imf.org

<sup>&</sup>lt;sup>1380</sup> See, e.g., Blanchard, O., Leandro A., and Zettelmeyer, J. (2021), Redesigning EU Fiscal Rules: From Rules to Standards, Peterson Institute for International Economics Working Paper, No. 21-1. Broadly speaking, a country-specific assessment is contemplated to determine whether the standards are met, and with disputes to be adjudicated by an independent institution such as the European Court of Justice.

a probabilistic and very country-specific assessment of debt sustainability that comprehends different "zones" (green, grey, red).<sup>1381</sup>

Given the considerable time that is expected to be required to reform the fiscal rules, IMF staff has also noted that a time-bound transitional arrangement could be desirable. Delays in reforms taking hold could arise both from the time it is likely to take to reach agreement on key features of the reform and from the implementation process itself – particularly if legislative changes are needed. One approach to transitional arrangements would be to suspend application of the current debt benchmark and use existing flexibility to limit adjustment to that consistent with the expenditure growth rule, excluding NGEU-financed spending.<sup>1382</sup>

### 3.2 Central fiscal capacity

IMF staff has long supported reforms to strengthen the euro area architecture including the euro area fiscal union.<sup>1383</sup> In 2018, IMF staff advocated for the creation of a central eurozone fiscal capacity for macroeconomic stabilisation that would help countries smooth both country-specific shocks (which monetary policy could not address) and common shocks, especially when monetary policy is constrained and fiscal space is limited in some countries.<sup>1384</sup> The specific proposal was to have a standing fund that would be financed by annual contributions to build assets in good times and that would be authorised to make non-discretionary and non-permanent transfers to support countries in bad times.<sup>1385</sup>

More recently, IMF staff has noted that a central fiscal capacity and/or a green investment fund would complement the fiscal rules.<sup>1386</sup> Noting the substantial public investment needed to achieve the 2050 carbon emissions reduction target, even taking into account NGEU and EU Green Deal funds – and the multi-faceted pitfalls of excluding such investments from the fiscal rules – the specific idea is a green investment fund at EU level that would help countries meet common climate goals more efficiently.

<sup>&</sup>lt;sup>1381</sup> IMF Debt Sustainability Analysis for Market-Access Countries and IMF Debt Sustainability Analysis for Low-Income Countries, availabe at www.imf.org

<sup>&</sup>lt;sup>1382</sup> IMF (2022), Euro Area Policies: Staff Report on the 2021 Consultation on Common Euro Area Policies, available at www.imf.org

<sup>&</sup>lt;sup>1383</sup> Blanchard, O., Leandro A., and Zettelmeyer, J. (2021), Redesigning EU Fiscal Rules: From Rules to Standards, *Peterson Institute for International Economics Working Paper*, No. 21-1.

<sup>&</sup>lt;sup>1384</sup> Arnold, N.G, Barkbu, B.B., Ture H.E., Wang, H. and Yao, J. (2018), A Central Fiscal Stabilization Capacity for the Euro Area, IMF Staff Discussion Note, No. 18/03; and Berger, H., Dell'Ariccia G. and Obstfeld, M. (2018), The Euro Area Needs a Fiscal Union, IMF Blog.

<sup>&</sup>lt;sup>1385</sup> The paper discusses various mechanisms to prevent permanent transfers including requiring countries that receive transfers in bad times to pay a "usage premium" on the transfers once its economy recovers, as well as having a cap on cumulative new transfers per country.

<sup>&</sup>lt;sup>1386</sup> IMF (2022), Euro Area Policies: Staff Report on the 2021 Consultation on Common Euro Area Policies, available at www.imf.org

For example, such a fund could finance and prioritise investments that achieve the largest carbon reduction at the lowest cost and could also coordinate projects that require cross-country investments.

Of course, such a central fiscal capacity, whether for macroeconomic stabilisation or green investments, has yet to come to fruition. And some have argued that only a significant exogenous force like the pandemic (one commentator called it a "cosmic disturbance")<sup>1387</sup> could overcome longstanding concerns about moral hazard to garner sufficient support for reforms such as the NGEU. The NGEU is intended to help speed up recovery, facilitate resource reallocation and promote progress on longstanding structural issues<sup>1388</sup>, and could be seen as evidence that fiscal integration is especially fundamental in times of crisis. It could also be seen as evidence that public goods and common priorities, such as accelerating the green and digital transitions, are not only appropriate but desirable to address from a fiscal perspective at EU level.

More generally, the NGEU's financing through common EU borrowing, with additional EU-level revenues ("own resources") to be raised to help with repayment<sup>1389</sup>, is a game changer: first, because it is a demonstration of how the EU can leverage its budget in times of crisis to provide swift and effective relief to Member States; and second, because it lays the ground for a new European safe asset for both domestic and international investors.

Separately – and while noting the EU's strong public financial management and anti-corruption controls – IMF staff has also emphasised how important it is that NGEU funds adhere to the strictest standards of transparency and accountability. The new European Public Prosecutor's Office is seen as critical in this regard, notably for its role in investigating any misuse of NGEU funds. Staff has also emphasised certain critical governance reforms (some of which have been prominent in the IMF's emergency lending) that will contribute to high-quality investments and to detecting abuse, including enhancing transparency of beneficial ownership in procurement, AML/CFT information exchange and audit mechanisms.

### 3.3 Other reforms

An important but sometimes forgotten part of fiscal analysis is the key structural reforms on the revenue side that have the potential to bolster both the EU's and its Member States' budgetary capacities and to support economic recovery from the pandemic – while putting the EU in a position

<sup>&</sup>lt;sup>1387</sup> Eichengreen, B. (2020), Europe's Hamilton Moment, Milken Review.

<sup>&</sup>lt;sup>1388</sup> IMF (2021), Concluding statement, Euro Area: Staff Concluding Statement of the 2021 Mission on Common Policies for Member Countries.

<sup>&</sup>lt;sup>1389</sup> Possible future own resources have been identified to include digital, climate and financial transaction levies, subject to "substantial further technical work and political cooperation". See European Parliament (2021), *Next Generation EU Borrowing: A First Assessment*.

to tackle challenges such as climate change, digitalisation and inequality. These include the following:

- The Commission's legislative proposal for a carbon border adjustment mechanism (CBAM)<sup>1390</sup>, which will equalise the price of carbon between domestic products and imports and ensure the EU's climate objectives are not undermined by "carbon leakage" (where, as a result of the EU's more robust carbon pricing policies, production of carbon intensive products relocates to countries with less ambitious policies). These revenues would accrue directly to the EU budget. While IMF staff's preferred approach to carbon pricing as a mechanism for reducing greenhouse gas emissions is through an international agreement on a carbon price floor<sup>1391</sup>, we have also recognised the role of border carbon adjustment mechanisms for countries with existing carbon pricing mechanisms.<sup>1392</sup>
- The Commission's announcement of a renewed proposal for reforming business taxation in the EU, Business in Europe: Framework for Income Taxation (BEFIT)<sup>1393</sup>, the features of which, such as common EU rules for determining the corporate tax base, are similar to ideas presented earlier by the IMF to strengthen corporate taxation in the global economy.<sup>1394</sup>

Moreover, the historic agreement recently reached by the G-20/OECD Inclusive Framework on reforming the international corporate tax system provides a unique opportunity and a renewed impetus to further integrate the 27 different corporate tax systems currently in existence in the EU.

Beyond fiscal reforms, important reforms are also being undertaken in Europe regarding debt architecture issues that will contribute to further economic resilience.

 With respect to sovereign debt resolution, the amendments to the ESM Treaty to allow a phasing in of "single-limb" aggregation clauses – which are broadly in line with the enhanced collective action clauses whose key elements were endorsed by the IMF's Executive Board in 2014 – are a significant step towards strengthening the international

<sup>&</sup>lt;sup>1390</sup> European Commission (2021), *Proposal for a regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism.* 

<sup>&</sup>lt;sup>1391</sup> Gaspar, V. and Parry, I. (2021), *A Proposal to Scale Up Global Carbon Pricing*, IMF Blog.

<sup>&</sup>lt;sup>1392</sup> Parry, I., Dohlman, P., Hillier, C., Kaufman, M., Kwak, K., Misch, F., Roaf, J. and Waerzeggers, C. (2021), Carbon Pricing: What Role for Border Carbon Adjustments?, IMF Staff Climate Note, No. 2021/004.

<sup>&</sup>lt;sup>1393</sup> European Commission (2021), Communication from the Commission to the European Parliament and the Council on Business Taxation for the 21st Century.

<sup>&</sup>lt;sup>1394</sup> IMF (2019), Corporate Taxation in the Global Economy.

sovereign debt architecture and further harmonising market practice around the globe.<sup>1395</sup>

With respect to *private sector debt resolution*, countries' implementation of the European Directive for Preventive Restructuring Procedures is a crucial opportunity to ensure insolvency systems are up to the task if a "wave" of corporate insolvencies were to occur as support mechanisms are withdrawn.<sup>1396</sup> IMF staff has also recommended that policy support to the corporate sector should become more targeted as the recovery takes hold, underpinned by viability assessments and with support varying depending on the amount of policy space available and the nature of the firm.<sup>1397</sup>

### 3.4 A Hamiltonian moment?

So, in the light of these recent developments, is the COVID-19 crisis a Hamiltonian moment for Europe? Current reforms certainly could be seen as movement in that direction in a way that makes sense for Europe's unique political, legal and institutional arrangements. But ultimately only Europeans can determine what the nature of their union should or will be.

Of course, even the nation that originated the "Hamiltonian moment" did not get it all done in one step. For example, the initial federal taxing power in the United States focused on customs and excise taxes and only after a very long time did it evolve to cover a range of other taxes, including significant income taxes (individual and corporate), payroll taxes and estate taxes. And despite the starting point of the federal government taking over specific debt of the states, states in the United States still bear ultimate responsibility for their finances (though they have access to what amounts in some cases to be very significant federal transfers).

As an American colleague recently reminded me, it took about one hundred years for Americans to transition from treating the "United States" as a plural noun to treating it as a singular noun in oral and written communication. And, in any event, Europe is not a nation.

<sup>&</sup>lt;sup>1395</sup> The new Euro CACs (the "2022 CACs") have two voting options – single-limb (aggregated) and series-by-series (non-aggregated) voting. The voting threshold for the single-limb cross-series modification is set at 66 2/3% of aggregate outstanding principal (the threshold for the International Capital Markets Association CACs is 75%). The 2022 CACs will be phased in over a ten-year time horizon by requiring euro area countries to issue a certain minimum percentage of their newly issued sovereign bonds with 2022 CACs (45% in 2022, increasing to 90% in 2033 and onwards).

<sup>&</sup>lt;sup>1396</sup> The Restructuring Directive seeks to introduce a minimum standard among EU Member States for preventive restructuring frameworks available to debtors in financial difficulty and to provide measures to increase the efficiency of restructuring procedures. These new standards, once implemented, will represent a move for EU Member States further in the direction of a debtor-in-possession-type insolvency regime, similar to that found under Chapter 11 in the United States.

<sup>&</sup>lt;sup>1397</sup> IMF (2022), Euro Area Policies: Staff Report on the 2021 Consultation on Common Euro Area Policies, available at www.imf.org

A more general lesson from the "Hamiltonian moment" in early US history is that it takes a threefold cord – of politics, sustainable public finance and financial stability –to spur innovation and growth.<sup>1398</sup>

Looking ahead, a deeper European fiscal union will require political will, multifaceted legal and institutional reforms, pooling of sovereign power and strong accountability mechanisms.<sup>1399</sup> To be politically feasible, a deepening of the fiscal union would presumably also need to be predicated on effective mechanisms to address longstanding concerns about moral hazard and incentivise fiscal discipline.

Ultimately, I would argue that the process, whether in the United States or Europe, is not about arriving at a *moment*. Rather, it is about *movement*. Sometimes slower, sometimes faster, *but moving always towards "an ever closer union"* (in the words of the Solemn Declaration on European Union signed at the 1983 Stuttgart Summit).

# 4 IMF response

Similar to the EU, the IMF also had to take decisive steps within its mandate to respond to the pandemic. I will focus here mainly on key reforms related to IMF financing and climate change.

In response to the COVID-19 crisis, the IMF has moved at unprecedented speed to make nearly USD 168 billion available in financing to almost 90 countries to date, through emergency assistance, debt relief and non-emergency financing.<sup>1400</sup> The IMF also temporarily increased key access limits on its financing.<sup>1401</sup> IMF emergency assistance is quick-disbursing one-off lending but, even in that context, borrowing countries have been called upon to make specific governance and transparency commitments as a means to help safeguard the proper use of IMF emergency assistance.

To enable the provision of debt relief to its poorest members, the IMF modified the design of its existing Catastrophe Containment and Relief Trust (CCRT) and expanded its qualification criteria to better cover the

<sup>&</sup>lt;sup>1398</sup> Gaspar, V. (2014), The Making of a Continental Financial System—Lessons from Europe from Early American History, IMF Working Paper, No. 14/183.

<sup>&</sup>lt;sup>1399</sup> Relevant here is the no-bail-out clause in the TFEU (Article 125), which provides that the EU 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. Also, a Member State is not liable for or shall not 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.

<sup>&</sup>lt;sup>1400</sup> IMF COVID-19 Financial Assistance and Debt Service Relief Tracker.

<sup>&</sup>lt;sup>1401</sup> IMF (2020), Enhancing the Emergency Financing Toolkit—Responding to the COVID-19 Pandemic; IMF (2020), Temporary Modifications to the Fund's Annual Access Limits.

circumstances created by the pandemic.<sup>1402</sup> Under the revised CCRT, low income countries experiencing exceptional needs resulting from a qualifying pandemic that have put in place appropriate policy frameworks and responses to the pandemic can request IMF approval of debt relief service on their obligations to the IMF falling due within a period of up to two years. The IMF has now approved grants for debt service relief to 31 of its poorest and most vulnerable members to assist in their efforts to tackle the COVID-19 pandemic.<sup>1403</sup> The total two-year COVID-related debt service relief ending in April 2022 amounts to USD 964 million.<sup>1404</sup>

The IMF also adopted a new special lending facility to address the challenges posed by the pandemic – the Short-term Liquidity Line (SLL). The first new non-concessional lending facility since the reforms adopted in the aftermath of the Global Financial Crisis, the SLL is intended to further strengthen the global financial safety net and serve as a backstop for member countries with very strong policy frameworks and fundamentals, as well as a sustained track record of implementing very strong policies. SLL support can be approved where the country has potential short-term moderate balance of payments difficulties reflected in pressure on the capital account and its reserves as a result of volatility in international capital markets. An innovative feature of the SLL is that it is the IMF's first revolving credit line, with payments to the IMF restoring pro tanto the available access under the liquidity line.<sup>1405</sup>

Three guarters of the new COVID-19 crisis lending from the IMF has come from the Poverty Reduction and Growth Trust (PRGT) - the IMF's vehicle for providing concessional loans (currently interest-free) to low income countries. As the IMF's low income member countries are likely to continue requiring higher levels of external financial support as they recover from the pandemic, the IMF also approved reforms to the PRGT that will allow a better response to the financing needs of low income countries in the next few years. These include raising access limits to concessional financing for all low income countries, removing access caps to concessional financing for poorer countries with strong economic programmes, retention of zero interest rates for all PRGT loans and reinforcing safeguards to protect countries from over-indebtedness. The IMF also approved a two-stage funding strategy for the PRGT to cover resource gaps created by pandemic-related financial support, while preserving its long-term sustainability, and the establishment of new accounts to facilitate donor contributions to the PRGT and reinforce reserve coverage.<sup>1406</sup>

<sup>&</sup>lt;sup>1402</sup> IMF (2020), Catastrophe Containment and Relief Trust: Policy Proposals and Funding Strategy.

<sup>&</sup>lt;sup>1403</sup> IMF COVID-19 Financial Assistance and Debt Service Relief Tracker.

<sup>&</sup>lt;sup>1404</sup> IMF Executive Board Extends Debt Service Relief for 25 Eligible Low-Income Countries, IMF Press Release.

<sup>&</sup>lt;sup>1405</sup> IMF (2020), IMF COVID-19 Response—A New Short-Term Liquidity Line to Enhance the Adequacy of the Global Financial Safety Net.

<sup>&</sup>lt;sup>1406</sup> IMF (2021), Fund Concessional Financial Support for Low-Income Countries— Responding to the Pandemic.

We have also taken significant steps to further strengthen – and support the strengthening – of the international sovereign and private sector debt resolution architecture, given that COVID-19 has led to an unprecedented increase in global sovereign debt levels, and risk of serious debt distress will remain a concern in the years to come. Actions have included:

- Calling on G20 countries to adopt what became the G20's Debt Service Suspension Initiative (DSSI) and also supporting the implementation of that Initiative, which suspended repayment of official debt for 73 low and lower middle income countries through end-2021.
- Supporting the Common Framework for debt treatments beyond the DSSI. The Common Framework is an agreement between all G20 countries, including non-Paris Club G20 creditors, to coordinate on debt treatments for DSSI countries with IMF-supported programmes. In addition to facilitating coordination amongst official sector creditors, it also requires comparable debt treatment from private sector creditors.
- Continuing to encourage and monitor the inclusion of "enhanced" collective action clauses with a single-limb voting mechanism – now included in well over 50% of the outstanding stock of international sovereign bonds. But while this addresses the collective action issue for bonds, it remains the case that some countries, particularly low income ones, still lack access to bond markets. These countries mainly obtain financing under loan agreements that currently require unanimity to restructure payment terms, which can complicate and prolong critically needed attempts to change these terms. IMF staff has therefore been collaborating in a working group led by the G7 to explore the potential inclusion of majority voting provisions for payment terms in loan agreements.
- Working to increase the transparency of sovereign debt. For example, the IMF's debt limits policy, which went into effect earlier this year, requires strengthened debt disclosure on the composition and holdings of debt in all documentation related to IMF financial support, and an expectation that major debt disclosure gaps will be addressed upfront in IMF-supported programmes. We are also supporting member countries' efforts to strengthen their frameworks and capacity for sound public debt management, debt reporting and disclosure. The IMF is also supporting private sector initiatives, like that of the Institute of International Finance, to publish terms of private sector loans.

Beyond sovereign debt, the IMF is also providing advice and assistance to help IMF members strengthen their corporate insolvency and debt restructuring frameworks, including for small and medium-sized enterprises. This task has increased importance currently, given the rise in corporate insolvencies that some countries may face if conditions tighten and after fiscal and other extraordinary measures are withdrawn.

Like the EU, the IMF is increasingly focused on ways to support member countries' efforts to respond to the economic challenges of climate change,

including by increasing resilience. An important dimension has been policy advice in the IMF's routine Article IV consultations with member countries, given the impact of climate change both on individual countries' macroeconomic and financial conditions and on global economic and financial stability.<sup>1407</sup> IMF analysis suggests, for example, that a comprehensive policy strategy to mitigate climate change including through green infrastructure investments could boost global GDP in the first 15 years of recovery from the COVID-19 crisis by about 0.7% on average and create millions of new jobs.<sup>1408</sup>

# 4.1 The SDR allocation and the IMF's own "Hamiltonian" moment?

In a historic move, as part of the pandemic response, the IMF's Board of Governors also approved an allocation of Special Drawing Rights (SDRs) in an amount equivalent to USD 650 billion, the largest in the IMF's history.<sup>1409</sup> This allocation meets the long-term global need to supplement existing reserve assets, and benefits individual members by ipso facto boosting their reserves at a time when, for a large number of countries, private sector funding was scarce or simply not reasonably available.<sup>1410</sup> Of the USD 650 billion equivalent allocation, USD 275 billion went to emerging markets and developing economies and, of this, USD 21 billion went to the IMF's lowest income member countries.

In addition to its power to issue SDRs, and control its "balance sheet" of currencies in the General Resources Account, the IMF also has the authority to administer resources contributed by others, including to make these resources available to benefit member countries in need. Member countries have also previously contributed SDRs to the PRGT administered by the IMF as trustee, to help boost financing for low income countries.

And this is where we can draw a very loose analogy to a Hamiltonian moment.

In the light of the COVID-19 crisis and the climate crisis, and building on the recent SDR allocation, members have expressed interest in – and the IMF is now considering – creating a new IMF-administered instrument, the

<sup>&</sup>lt;sup>1407</sup> See, e.g., IMF (2021), IMF Strategy to Help Members Address Climate Change Related Policy Challenges—Priorities, Modes of Delivery, and Budget Implications; and IMF (2021), 2021 Comprehensive Surveillance Review—Background Paper on Integrating Climate Change into Article IV Consultations.

<sup>&</sup>lt;sup>1408</sup> IMF (2020), World Economic Outlook.

<sup>&</sup>lt;sup>1409</sup> See IMF (2021), Proposal for a General Allocation of Special Drawing Rights for a detailed discussion of the allocation. Under Article XVIII, Section 1(a) of the IMF's Articles of Agreement, SDRs are allocated to help meet the long-term global need to supplement existing reserve assets in a manner that will promote the attainment of the IMF's purposes and avoid economic stagnation and deflation as well as excess demand and inflation.

<sup>&</sup>lt;sup>1410</sup> IMF Governors Approve a Historic US\$650 Billion SDR Allocation of Special Drawing Rights, IMF Press Release.

Resilience and Sustainability Trust (RST), to facilitate the "rechannelling" of SDRs provided by economically stronger member countries. The goal would be to use these resources to help more vulnerable members address long-term challenges that pose a threat to balance of payments stability.<sup>1411</sup> The details have yet to be finalised or approved by the IMF's Executive Board. The broad idea, however, is that the RST would provide financing with longer-term maturities and low interest rates to countries undertaking macro-critical investments and reforms in climate and possibly other areas of vulnerabilities such as pandemic preparedness. Potential beneficiaries will also likely be broader than under the PRGT, to cover also vulnerable middle-income countries and fragile island economies.

Notably, these are precisely the kinds of global public goods for which a "Hamiltonian moment" collective action will often be needed. The kinds of actions for which it is in the collective interest to provide support where appropriate reforms are being undertaken, rather than leaving each country simply to fend for itself.

The establishment of the RST has already won broad endorsement from the IMF's membership during the institution's Fall Annual Meetings. The aim is to have its design finalised and approved by the time of the IMF's 2022 Spring Meetings, and the RST actually up and running by the time of the Annual Meetings in 2022.

# 5 Going forward: sustainable solutions?

In short, both the EU and the IMF took extraordinary steps in the wake of the pandemic to respond to the crisis.

We see these as the jumping off point for continued change.

For the IMF, there is an ambitious agenda going forward. In addition to the key items discussed earlier, more immediate efforts are centred around key risks facing the global economy, including continued divergence between and within countries, supply chain interruptions, and rising inflation. A very prominent issue is also providing policy advice to help member countries navigate worsening global macroeconomic conditions in the face of rising threats of new lockdowns (and resulting economic dislocation) from mutations of the COVID-19 virus. In this context, IMF staff has repeatedly emphasised the important point that, in the current pandemic, *vaccination policy is economic policy*; for example, faster progress in ending the health crisis could add almost USD 9 trillion to global GDP by 2025.<sup>1412</sup>

<sup>&</sup>lt;sup>1411</sup> Pazarbasioglu, C. and Ramakrishnan, U. (2021), Sharing the Recovery: SDR Channeling and a New Trust, IMF Blog.

<sup>&</sup>lt;sup>1412</sup> See, e.g., Fostering a Fair Recovery—Opening Remarks for the Spring Meetings Press Conference by Kristalina Georgieva, IMF Managing Director (April 7, 2021); and Agarwal, R. and Gopinath, G. (2021), A Proposal to End the COVID-19 Pandemic.

In Europe, the new elements in the European fiscal framework have the potential to significantly alter the way that the EU deals with macroeconomic shocks and how the EU budget is financed. The foundations of some of these measures are classified as one-offs, but there is still a question as to whether there will be further fiscal reforms that continue this trajectory. Of course, this is an economic and a political decision for the EU and its citizens. Ultimately, they are the ones whose aspirations – and actions – will provide a definitive answer to the "Hamiltonian moment" question posed to this panel.



# Concluding synopsis

By Chiara Zilioli\*

# 1 Introduction

The theme of the ECB Legal Conference 2021 was continuity and change, and how the challenges of today prepare the ground for tomorrow. These are important themes in legal discourse because law and legal thinking help ensure both continuity and change for individuals, societies and economies and polities. Legal institutions – such as courts, legislatures, and other institutions – help to channel change through formal procedures and precedents at the same time as ensuring continuity. As Heraclitus, the Greek philosopher said, "There is nothing permanent except change".

This year, we had the privilege of listening to three important keynote speeches that touched on these issues.

ECB President Christine Lagarde spoke about change and continuity and the law, and made the important point that although most polities have been extended by the power of the sword, the European Union (EU) has a unique character as a "community of law". She recognised that this is in part the achievement of the Court of Justice of the European Union (CJEU), which has ensured that law acts as a shield to protect the borders of the EU legal system when under attack. She then focused on the tension between the rule of law as an immutable anchor in society and its need to respond to change. She reviewed the evolution of the debate on "originalism" and "realism" in the interpretation of US law, compared with the approach to interpretation taken in EU law, and examined whether lessons from history give us directions for challenges today. In particular she questioned whether the reference to the Treaties as an immutable reality (as drafted by the Herren der Verträge) is tenable in an everchanging world. She argued, following the lesson of Justice Ginsburg, that independent institutions which ground their legitimation on the law should stand ready to adapt to the changes which happen in society. And they should interpret and apply the law consequentially, in the way that best serves the needs of the societies and polities which these institutions are meant to serve.

In the second keynote speech **Frank Elderson** focused on the most important challenge we face today – climate change.

First, he examined the extent to which climate-related human rights may be seen as branches stemming from the tree of fundamental rights. He noted that the adoption of the Universal Declaration of Human Rights and the

Director General Legal Services, European Central Bank, Professor at the Law Faculty of the Goethe University in Frankfurt am Main.

Charter of Fundamental Rights were responses to the atrocities of war in the first half of the 20th century, and suggested that human rights need to respond to the existential challenge posed by climate change in the first half of the 21st century. In this context, he emphasised the central role that lawyers can play, as how the law is interpreted and applied is as important as how it is written. Consequently, lawyers as a community share a huge responsibility towards future generations and the world as a whole.

Frank Elderson then highlighted the extent to which court proceedings are gaining prominence, suggesting that the attitudes of courts are changing as they are increasingly holding companies and governments responsible for not taking sufficient action to address climate change. He referred to decisions taken in recent years in the Netherlands, Ireland and Germany which share a common thread in that they have found a link between human rights and failure to take sufficient action to combat climate change. The extra-territorial implications of recognising the protection of the environment as a fundamental right are also important and point to the need for courts to cooperate and learn from each other across jurisdictions. Courts – like other institutions – have limitations in terms of what they can achieve to protect the environment. He emphasised the importance of developing climate-related fundamental rights, which play an important role in establishing the legal foundations needed to address the challenges posed by climate change.

Thereafter, in the keynote speech that introduced the **Symposium on** proportionality, the President of the Court of Justice of the European Union, Koen Lenaerts, presented in depth his thoughts on the principle of proportionality and the role it has played in the EU legal order. Without repeating all the elements of his rich and insightful speech, which is available online, several core statements stood out for me as particularly important. First, he emphasised the fundamental distinction between the principles of conferral, subsidiarity and proportionality and the important confirmation that proportionality does not play a role in determining whether the EU has a competence to act. This is a consistent methodology that the CJEU has always applied, including in Gauweiler and Weiss, the cases in which it reviewed the legality of the ECB's measures. Second, he confirmed that he saw no room in EU law for an ultimate balancing exercise in which the CJEU would weigh price stability against its possible negative effects on economic and social policy. In this context, he emphasised the importance of ensuring that a judge cannot substitute his or her own judgment for that of the legislature. In the case of the ECB, he recognised that its decisions touch on deeply political and complex areas which justify the CJEU confining its assessment to manifest errors of assessment. He also maintained that the different approach taken by the German Federal Constitutional Court, which includes a third step in the proportionality analysis, might be valid in German constitutional law but cannot be reconciled with the approach developed by the CJEU and enshrined in the Treaty. Finally, he mentioned that it is the respect due to fundamental rights which limits the margin of assessment which EU institutions or bodies enjoy when they adopt an EU act.

Professor Lenaerts' speech highlighted the importance of proportionality for the decisions and activities of the ECB, as well as the complex issues and conflicts to which it gives rise. It was an ideal introduction to our Symposium on the principle of proportionality.

The Symposium itself was opened by **Dieter Grimm**, who analysed the approach to proportionality taken in German law, from which the principle originated. He considered some of the key limits of the principle, including its important focus on cases involving fundamental rights. He mentioned that in the *Weiss* case the German Constitutional Court case applied proportionality beyond fundamental rights because it considered it was applying the European proportionality rules, which have a broader scope of application.

**Diana-Urania Galetta** further considered the reasons why there are differences in the scope of the principle of proportionality in national (German, Italian, French and English) and EU law, arguing that although the CJEU has been influenced by the German model, the EU has developed its own distinctive approach to judicial review based on proportionality.

**Tomi Tuominen** took a different angle, highlighting the difficulties of applying a principle that originated from the protection of individual rights to cases involving economic governance where no specific individual rights are at stake. He argued that the CJEU should develop a separate proportionality test that applies to these cases, which concern the delineation of competences and the substantive content of policy decisions, rather than individual rights, and often involve a considerable amount of discretion.

Vasiliki Kosta presented a taxonomy that focused on the different interests that the principle of proportionality serves, and Iddo Porat examined the issues from a comparative perspective, looking at the role of proportionality in cultures of justification and cultures of authority, where it has a more limited role, as well as the possibly ideological implications of the principle.

Last but not least, **Thérèse Blanchet** explained how the principle is applied by the Council in practice. She provided an insight into the history of how the principle of proportionality has entered the Treaties and the important role the legal service plays in the assessment of proportionality.

Important questions were also raised in the discussion following the Symposium. Let me mention a question, which remains unanswered, on the importance and intensity of the proportionality assessment for the action described by Frank Elderson, which might pursue the secondary objective.

Apart from the Symposium, the conference included five panel discussions.

In the first panel, on "Dialogue between courts: what is the future for legal pluralism?", Ineta Ziemele expressed a firm commitment to the

concept of legal pluralism as an organisational principle for law in the EU and as a competition of ideas arising from the networks of different legal traditions and systems, but noted that this is a work in progress.

**Miguel Poiares Maduro** argued that the CJEU and national constitutional courts need to respect "contrappunto" principles to ensure that their different "melodies" do not become noise, but are harmonised by recognising the core requirements of pluralism.

Juliane Kokott analysed the relationship between EU and national law and the legal consequences that arise from an infringement of EU law by Member States. She noted that although it is becoming more difficult to avoid conflict, this can also be addressed by improving dialogue, including by means of the preliminary reference procedure, and by increased sensitivity on the part of the CJEU to areas of conflict.

The ideas on how the EU could respond to challenges raised by legal pluralism were further developed by **Daniel Calleja**. These included loyal cooperation between the CJEU and national courts, recognition of the importance of national constitutional identities as built into the Treaties and flexibility in the legislative procedure, which allows for carving out exceptions. He concluded that EU law offers Member States sufficient flexibility to accommodate the specificities of their national identities, in a manner that does not fragment or undermine the EU legal system.

In our second panel on **"The fate of the rule of law in the EU"**, Armin **von Bogdandy** explained that the fate of the rule of law in the EU could be to support democratic transitions. He sought to demonstrate how a challenge today (namely systemic deficiencies in some Member States) could trigger a doctrinal innovation (criminal responsibility) that prepares the ground for tomorrow. He suggested that liberal democracy could be strengthened by removing perpetrators, in particular judges who are instruments of political repression. He argued that this proposal is not legal science fiction, but achievable in line with EU and Polish law.

**Renata Uitz** explained how the rule of law is at risk on account of illiberal practices and argued for stronger and more transparent action to defend the independence of national judges. **Michal Bobek** highlighted the fundamental questions that are at stake in the debate about the rule of law. In particular, what is the nature of our Union? Is it one of advanced economic cooperation or a values-based union? And what purpose do these different conceptions serve? Like Renata, he argued that although the CJEU and national courts have a crucial and specialised role to play, other actors at European and national levels cannot abdicate their responsibility to uphold the rule of law.

Laura Codruţa Kövesi, complemented the discussion by noting that, in her experience, where prosecutorial activities are independent and efficient, they can contribute decisively to upholding democratic values in society. The European Public Prosecutor's Office is the EU's first sharp tool to defend the rule of law, albeit only in specific situations, where there is fraud and corruption in the implementation of the EU budget.

Each of the speakers emphasised that each institution has to play its role to support the rule of law, implementing and enforcing existing rules according to its mandate and prerogatives.

In the third panel on the "**Relationship between law and markets**", emphasising the importance of legal rules for the functioning and integrity of financial markets, both for private participants and public institutions, **Katharina Pistor** examined the relationship between law, money and finance. She argued that the law and public money are used for private wealth creation, which is becoming more uneven. The centrality of money for the economy reinforces the need for liquidity support and this limits the space and capacity of politics – including the role of central banks – for other purposes.

Vivien Ann Schmidt then provided a fascinating overview of the influence of neoliberal thinking on political and economic developments. She questioned whether the EU could find a way to democratise and decentralise its governance processes so as to enable its many different varieties of capitalism to flourish through more bottom-up macroeconomic governance and industrial strategies.

**Marco Dani** took a more radical stance in this direction, favouring a deconstitutionalisation of the Treaties to better enable national democratic and social policymaking in a context of intensive economic and political interdependence. He put forward proposals for far-reaching changes to the Treaty provisions governing economic and monetary union.

Finally, **Barbara Balke** gave some practical examples of the tension between the markets and the law, noting that the role of the European Investment Bank has developed over time and requires constant rethinking as economic conditions develop around it.

In the fourth panel, on "**Digitalisation of finance**", **Jan Ceyssens** started the exchange by providing a perspective from his role at the European Commission and outlined the new proposal regarding a distributed ledger technology (DLT) pilot to allow experimentation for DLT securities within the existing framework and a comprehensive regulation for crypto-assets not covered by the existing framework. He identified digital finance as an opportunity for an integrated financial market and for enhancing the EU's open strategic autonomy, but at the same time he noted the importance and challenges of regulating risks in this field.

Thereafter, **Diana Wilson Patrick** examined what a central bank digital currency (CBDC) is and what it is not (a cryptocurrency or stablecoin), providing rich insights into the design and policy considerations taken into account when developing Caribbean CBDCs. Her comments on the effects of CBDCs on financial inclusion and development aid were particularly interesting.

**Katja Langenbucher** provided an overview of how artificial intelligence (AI) scoring and assessment of potential credit risks have developed over time from character judgment to trial and error statistics to a new system relying on alternative credit scoring AI and "alternative data" or non-traditional data. This allows better access to credit for those who do not have a traditional credit history, but raises other concerns relating to data privacy, fair lending, etc. The primary concern she identified is that although a risk-based approach to product regulation might work from a health and safety perspective, it raises many concerns from a fundamental rights perspective.

In the last panel, we addressed the **COVID-19 crisis** that has enveloped us for the past two years, and we focused on whether the measures adopted in the crisis could and/or should be seen as permanent changes to the EU institutional framework, or whether they should be rapidly dismantled once the exceptional circumstances that justified their adoption have passed.

**Bruno de Witte** identified a rediscovery of the EU's macroeconomic competencies in Article 175(3) TFEU and in the domain of macroeconomic policy measures aiming at improving the overall balance of economic development within the territory of the EU – that is, the whole territory of the EU, even though the economic stability of the euro area would specifically benefit from such action.

**Paul Dermine** investigated what the COVID-19 crisis holds for the fiscal pillar of the European Monetary Union (EMU), and for the rules and procedures that now govern the coordination of national fiscal policies in the EU, and the options for reform.

**Diane Fromage** made concrete proposals for the provision of remedies for some of the existing shortcomings in the E(M)U's institutional framework, taking due account of the reforms performed in response to both the euro crisis and the COVID-19 crisis and explored the possible long term effects of these reforms, even if they remain temporary.

**Rhoda Weeks-Brown** concluded by arguing that the road to a more cohesive future is a long one that requires strong political will and it is not a matter of when it is reached, but of getting there.

This brief synopsis cannot do justice to the wealth of the arguments developed in the Symposium and in the five panels. Indeed, in each of the panels we had very lively question and answer sessions which helped to deepen our understanding of the issues we addressed. For their active participation and sharing of ideas I would like to thank all the panellists, all those who contributed by asking questions and all those who attended our conference.

# 2 Some acknowledgements

The ECB Legal Conference 2021 would not have been possible without our panellists and contributors, who generously contributed their expertise in lively discussions. I would particularly like to thank our Board Member, Frank Elderson, for his sponsorship of this event.

Sincere thanks are due to Antonio Riso, who organised this year's conference. Antonio worked very hard initially to put this programme together, and during the conference, kept everything running smoothly, including the production of this book, maintained contacts with speakers and chairs, and ensured this nice outcome. Antonio was supported in the preparation of the conference and of this book by two colleagues in the Legal Services Section – Tončica Radovčić and Monica Bermudez Leyva. They always go the extra mile to ensure the smooth and efficient running of these events. It is thanks to their dedication and energy that we were able to successfully turn this conference into a fully virtual event in 36 hours and to finalise this book, which consolidates the papers delivered at the conference. The book will contribute to the dissemination and sharing of these reflections and of our discussion at the conference.

Last but not least, I would also like to thank the many other colleagues in Legal Services and in technical support, who ensured that the conference ran well and the book could be finally produced. I won't name them all individually, but I am very grateful for their commitment and enthusiasm.

The ECB Legal Conference 2021 included on average 200 participants, peaking at 250. It has been a rich and varied debate and the hope is that through this book the thoughts we shared will be passed on and, like seeds, will grow into other reflections, further ideas and future exchanges, studies and projects on the legal topics that are at the core of European integration. Please share the book with others and take up this invitation to continue the reflection.



# Programme of the ECB Legal Conference 2021

#### Thursday, 25 November 2021

- 08:30 Registration and coffee
- 09:00 Welcome address and opening of the Conference Chiara Zilioli, Director General Legal Services, European Central Bank

#### 09:10 Keynote speech Frank Elderson, Member of the Executive Board, European Central Bank

09:30 Panel 1

#### Dialogue between courts: what is the future for legal pluralism?

For decades, legal pluralism has been the preferred intellectual device in academic and judicial circles to facilitate interaction between the European Union and the national legal orders and their respective courts. Recently, some national courts - including constitutional courts - have challenged decisions of the Court of Justice of the European Union (CJEU) on the basis of arguments which can be described in terms of either alleged ultra vires conduct of the CJEU, or alleged breach by the CJEU of constitutional national identity. These challenges to the decisions of the CJEU, while not compromising the solidity of the system as long as they remain exceptions, nonetheless raise questions regarding the reliability of legal pluralism as a device to ensure effective cooperation through dialogue between courts in the European Union. In the light of recent developments, the panel will also consider whether this doctrine has reached its limits with regard to its capacity to ensure cooperative interaction, or whether changes to preserve the doctrine (and ensure that it delivers positive outcomes for the future) are still possible. The panel will also consider what could replace the doctrine if it is considered to have reached its limits.

#### Chair

Frank Elderson, Member of the Executive Board, European Central Bank

#### **Panellists**

Ineta Ziemele, Judge at the Court of Justice of the European Union Miguel Poiares Maduro, Professor of the School of Transnational Governance at the European University Institute, Florence Juliane Kokott, Advocate General at the Court of Justice of the European Union

Daniel Calleja Crespo, Director-General Legal Service, European Commission

Discussion with questions from the audience

End of Panel 1

11:00 Coffee break

#### 11:20 Panel 2

#### Rule of law: what is the fate of the rule of law in the EU?

The European Union is founded on the principle of the rule of law. What would have appeared as a trivial observation some years ago, has become (at least for some) a contentious issue, probably due to both a lack of agreement among the Union's Institutions and its Member States on the meaning of the principle, and the fact that it is not currently being always enforced in a way that ensures its effectiveness. Both aspects of the issue will be analysed by the panel, which will also review the increasing importance of the principle of the rule of law in academic discussion, as well as in the action of courts and EU institutions.

#### Chair

Edouard Fernandez-Bollo, Member of the Supervisory Board, European Central Bank

#### **Panellists**

Armin von Bogdandy, Director of the Max Planck Institute, Heidelberg Renáta Uitz, Professor of Law, Department of Legal Studies at the Central European University, Vienna Michal Bobek, former Advocate General at the Court of Justice of the European Union Laura Codruța Kövesi, European Chief Prosecutor at the European Public Prosecutor's Office

Discussion with questions from the audience

End of Panel 2

13:00 Lunch

## Symposium on proportionality

#### 14:30 Introductory remarks

Christine Lagarde, President, European Central Bank

14:40 Keynote speech Koen Lenaerts, President, Court of Justice of the European Union

# 15:40 Panel 1

#### Chair

Chiara Zilioli, Director General Legal Services, European Central Bank

#### **Panellists**

Dieter Grimm, Professor for Public law at Humboldt University, Berlin Diana Urania Galetta, Professor of Administrative Law at the University of Milan

Tomi Tuominen, Lecturer at the University of Lapland, Rovaniemi

Discussion with questions from the audience

16:40 Coffee break

#### 17:00 Panel 2

#### Chair

Chiara Zilioli, Director General Legal Services, European Central Bank

#### **Panellists**

Vasiliki Kosta, Assistant Professor of European Law at Leiden University Iddo Porat, Associate Professor of Constitutional Law at the College of Law and Business,

Tel Aviv

Thérèse Blanchet, Director-General, Legal Adviser to the Council of the European Union

Discussion with questions from the audience

#### 18:00 End of Day 1

#### Friday, 26th November 2021

- 08:30 Registration and coffee
- 08:55 Welcome address Day 2 Chiara Zilioli, Director General Legal Services, European Central Bank
- 09:00 Keynote speech Christine Lagarde, President, European Central Bank

#### 09:30 Panel 3

#### **Relationship between law and markets**

To what extent do markets need to be considered (and treated by law) as pre-existing entities which any form of regulation will inevitably alter, rather than by-products of law, where the law is understood as a pre-condition and pre-requirement for the existence of markets? The panel will discuss this question, bearing in mind that the answer to this question has an impact on the legitimacy, scope and limits of the power of public authorities to regulate markets through the exercise of their powers, soft law and/or moral suasion.

#### Chair

Isabel Schnabel, Member of the Executive Board, European Central Bank

#### Panellists:

Katharina Pistor, Edwin B. Parker Professor of Comparative Law at Columbia Law School, New York Vivien Ann Schmidt, Jean Monnet Professor of European Integration at Boston University Marco Dani, Associate Professor of EU and Comparative Public Law at the University of Trento Barbara Balke, Director General and General Counsel at the European Investment Bank

Discussion with questions from the audience

End of Panel 3

11:00 Coffee break

#### 11:30 Panel 4

# Digitalisation of finance: the challenges from a central bank and supervisory perspective

In the last year several legislative proposals presented by the European Commission on digital economy, digital finance and artificial intelligence have been evidence of the increasing importance of these topics for the economy at large, and the financial services sector specifically. The new technologies which are being deployed represent a paradigm shift which may change the shape of all economic activities as we know them. Against this background, the panel will reflect on the consequences of digitalisation for financial services, and whether the proposed legislation is sufficient to deal with the forthcoming challenges, or whether further changes are needed.

#### Chair

Fabio Panetta, Member of the Executive Board, European Central Bank

#### **Panellists**

Jan Ceyssens, Head of the Digital Finance Unit, Directorate-General for Financial Stability, Financial Services and Capital Markets Union at the European Commission

Maria Lillà Montagnani, Associate Professor of Commercial Law at Bocconi University, Milan

Katja Langenbucher, Professor of Banking and Corporate Law at Goethe University, Frankfurt

Diana Wilson Patrick, General Counsel at the Caribbean Development Bank

Discussion with questions from the audience

End of Panel 4

13:00 Lunch

#### 14:30 Panel 5

#### The COVID-19 crisis: a Hamiltonian moment for Europe?

The COVID-19 crisis has been a catalyst for change in many respects. In just a few months, reforms which had not been discussed before, or had been discussed for years without ever gaining momentum, have been implemented at a rather impressive speed, especially considering that the EU is often criticised for its alleged inability to promptly react to challenges. Among the measures which were most relevant for the purposes of the European Economic and Monetary Union and its institutional architecture, are the establishment of an unemployment scheme (the Support to mitigate Unemployment Risks in an Emergency, SURE), of a common budget and common debt issuances in the context of the Next Generation EU recovery plan, and the suspension of certain fiscal rules for Member States. The panel will focus on whether these measures could and/or should be seen as permanent changes to the EU institutional framework, or be rapidly dismantled once the exceptional circumstances which justified their adoption have passed.

#### Chair

Philip Lane, Member of the Executive Board, European Central Bank

#### **Panellists**

Bruno de Witte, Professor of European Union Law at Maastricht University Paul Dermine, Max Weber Fellow at the European University Institute, Florence

Diane Fromage, Marie Skłodowska-Curie Individual Fellow at the Sciences Po Law School Paris

Rhoda Weeks-Brown, General Counsel and Director, Legal Department, International Monetary Fund

Discussion with questions from the audience

End of Panel 5

#### 16:00 Coffee break

- 16:30 Concluding remarks Chiara Zilioli, Director General Legal Services, European Central Bank
- 17:00 End of the ECB Legal Conference 2021


# **Biographies**

#### **Christine Lagarde**

Christine Lagarde has been the President of the European Central Bank (ECB) since November 2019. Between 2011 and 2019 she served as the eleventh Managing Director of the International Monetary Fund (IMF). Prior to that she served as the French Minister of the Economy and Finance from 2007 to 2011, having been Minister for Foreign Trade from 2005 to 2007. A lawyer by background, she practiced for 20 years with the international law firm Baker McKenzie, of which she became global Chair in 1999. In each case, she was the first woman to hold any of these positions.

In 2020 Christine Lagarde was ranked the second most influential woman in the world by Forbes, and she has previously also been listed as one of the 100 most influential people in the world by TIME magazine. She was named Officier in the Légion d'honneur in April 2012 and Commandeur dans l'ordre national du mérite in May 2021.



# **Koen Lenaerts**

Koen Lenaerts is the President of the Court of Justice of the European Union.

He began his career at the Katholieke Universiteit Leuven as a lecturer in 1979, becoming Professor of European Law in 1983. From 1984 to 1985 he was Legal Secretary at the Court of Justice, and from 1984 to 1989 he held the post of Professor at the College of Europe in Bruges. He was a member of the Brussels Bar from 1986 until 1989, when he became a visiting professor at Harvard Law School. He was a judge at the Court of First Instance of the European Communities (25 September 1989 to 6 October 2003) and has been a judge at the Court of Justice since 7 October 2003. He was the Vice-President of the Court of Justice from 9 October 2012 to 8 October 2015 and has been its President since 8 October 2015.

Born in 1954, Mr Lenaerts holds a lic. iuris, a PhD in law (Katholieke Universiteit Leuven), as well as an LLM and an MPA (Harvard University).



# **Barbara Balke**

Barbara Balke has been Director General and General Counsel at the European Investment Bank (EIB) since February 2020.

Ms Balke joined the EIB in 1999 as Legal Counsel Institutional Affairs. From 2001 to 2006 she worked as legal counsel on lending operations in central and eastern Europe. In 2006 she was appointed Head of Division "Central and Eastern Europe, Legal Department – Operations". In 2008 she became Deputy Director of Human Resources. From 2013 to 2019 she held the position of Director of the Corporate Department in the Legal Directorate, where she has also been Deputy General Counsel since 2018.

Before joining the EIB, Ms Balke worked as a German-qualified attorney at Deringer Tessin Herrmann und Sedemund / Freshfields Deringer in Cologne and Brussels, specialising in competition law.

She holds a Dr. jur. (University of Bonn) and an LLM in EU law and commercial law (University of Edinburgh).



# **Thérèse Blanchet**

Since July 2019 Thérèse Blanchet has been Director-General of the Legal Service of the Council of the European Union and Jurisconsult of the European Council and the Council.

She joined the Legal Service in November 1995 as a legal adviser. From 2000 to 2011, she was Adviser to the Director General of the legal service and head of the coordination unit. In May 2018 she was appointed Director of the Justice and Home Affairs Directorate of the legal service.

Having graduated in law at the University of Geneva in 1984, Ms Blanchet was admitted to the Geneva Bar in 1987 and received a master's degree in European law from the College of Europe in Bruges in 1989. She then joined the European Free Trade Association (EFTA), where she was a legal adviser from 1990 to 1995 during the negotiation of the Agreement on the European Economic Area, after which she began her career in the legal service of the Council.

Ms Blanchet has been closely associated with several intergovernmental conferences and Treaty revisions (in particular the Treaty of Amsterdam, the Treaty establishing a Constitution for Europe and the Treaty of Lisbon), their implementation, as well as other important negotiations.



## **Daniel Calleja Crespo**

Daniel Calleja Crespo has been the Director-General of the Legal Service of the European Commission since 15 July 2020.

He started his career in the Commission as a member of the Legal Service, where he worked from 1986 to 1993. During that period he represented the institution in numerous cases before the Court of Justice.

He was Director-General for Environment from September 2015 to July 2020 and Director-General for Internal Market, Industry, Entrepreneurship and SMEs from 2012 to August 2015.

From February 2011 to January 2012, he was Deputy Director-General for Enterprise and Industry and Special Envoy for SMEs. From 2004 to 2011 he was Director for Air Transport in the Directorate-General for Mobility and Transport.

From 1993 to 1999 he worked in the cabinets of several Commissioners, including the President of the European Commission, advising on transport and competition matters, state aid and the application of Community law. Between 1999 and 2004 he was Head of Cabinet of Vice-President Loyola de Palacio – he was in charge of Transport and Energy, where he contributed decisively on a number of key issues.



#### **Jan Ceyssens**

Jan Ceyssens is Head of Digital Finance in the Directorate-General for Financial Stability, Financial Services and Capital Markets Union at the European Commission.

He was previously a member and Deputy Head of the Cabinet of Vice-President Dombrovskis and a member of the cabinet of Vice-President Barnier, and Team Leader for Financial Supervision in the Directorate-General Internal Market and Services.

He graduated in law at Humboldt University in Berlin and holds a master's degree in European Law (King's College London).

He joined the European Commission in 2006, working initially in the Cartels Enforcement Directorate of the Directorate-General Competition. In 2009 he moved to the Directorate-General Internal Market and Services (later renamed Directorate-General for Financial Stability, Financial Services and Capital Markets Union).



# Marco Dani

Marco Dani is Associate Professor of Comparative Public Law at the Faculty of Law, University of Trento. He had previously completed his PhD and served as an assistant professor at the same university. He was Emile Nöel Fellow at the Jean Monnet Center of the New York University (NYU) School of Law (2004-05) and Marie Curie Fellow at the European Institute of the London School of Economics and Political Science (2009-10). He is a member of the editorial board of the newly founded journal European Law Open. He is the author of *II diritto pubblico europeo nella prospettiva dei conflitti* (Cedam, 2013) and of several articles published in leading journals of European and constitutional law. His current research focuses on the impact of European integration on national constitutional orders.



## **Bruno de Witte**

Bruno De Witte is Professor of European Union Law at Maastricht University, co-director of the Maastricht Centre for European Law, and a part-time professor at the Robert Schuman Centre of the European University Institute in Florence.

His main fields of research and publication are constitutional law of the European Union; relations between international, European and national law; protection of fundamental rights in Europe; rights of minorities, language law and cultural diversity in Europe; internal market law and non-market values; decision-making and legal instruments of EU law.



# **Paul Dermine**

Paul Dermine was born in 1989 and trained as a lawyer and a political scientist in Europe and the United States. He holds a joint doctorate cum laude from the University of Maastricht and KU Leuven. His research focuses on the institutional law of the European Union and the governance of the euro area. It has attracted funding and awards from a variety of institutions, such as the College of Europe (Inbev-Baillet-Latour Scholarship), NYU School of Law (Hauser Global Scholarship), the European University Institute (Max Weber Fellowship), the Flemish Research Council (Junior Postdoctoral Scholarship) and the ECB (Junior Legal Research Scholarship).

Mr Dermine's recent work has been published in the Common Market Law Review, the European Constitutional Law Review, the European Law Review, the Journal of Banking Regulation and European Papers. His first monograph *The New Economic Governance of the Eurozone – A Rule of Law Analysis* will be published by Cambridge University Press in 2022.

Since April 2021 he has worked as a référendaire in the chambers of Judge Octavia Spineanu-Matei at the Court of Justice.



## **Frank Elderson**

Frank Elderson was born in 1970 and has served as an executive director of De Nederlandsche Bank since 1 July 2011. In that capacity he is currently responsible for banking supervision, horizontal supervisory functions and legal affairs. He is also a member of the ECB's Supervisory Board. Mr Elderson has participated as an observer in the EU High-Level Expert Group on Sustainable Finance. He is Chairman of the Central Banks and Supervisors Network for Greening the Financial System and Chairman of the Platform for Sustainable Finance in the Netherlands.

Before joining De Nederlandsche Bank's Governing Board, Mr Elderson served as Head of its ABN AMRO Supervision Department (2006-07), as Director of its Legal Services Division (2007-11) and as its General Counsel (2008-11). He received his professional training as an attorney with Houthoff Advocaten & Notarissen from 1995 to 1998. He studied at the University of Zaragoza and graduated in Dutch law at the University of Amsterdam in 1994. He received an LLM degree at Columbia Law School, New York, in 1995.



## **Edouard Fernandez-Bollo**

Following his post-graduate studies at the École normale supérieure de Saint-Cloud in the humanities and social sciences section, and after acquiring experience in several branches of the French civil service, Edouard Fernandez-Bollo joined the Banque de France in 1988. There he held various positions related to banking regulation and licensing, European harmonisation and banking resolution issues.

Mr Fernandez-Bollo became General Counsel of the Commission Bancaire, the French supervisory authority, in 2004 and Deputy Secretary General in 2008. From 2007 to 2020 he was Chair of the Basel Committee's expert group on anti-money laundering and combating the financing of terrorism. From 2010 to 2013 he was Deputy Secretary General of the new Autorité de contrôle prudentiel et de résolution (ACPR), the integrated French prudential supervisor, and from 2014 to August 2019 he was Secretary General of the ACPR, a member of the Management Board of the European Banking Authority and a member of the Basel Committee on Banking Supervision.

Mr Fernandez-Bollo began his five-year term as a member of the Supervisory Board of the ECB in September 2019.



# **Diane Fromage**

Diane Fromage is currently a Marie Skłodowska-Curie Individual Fellow at the Sciences Po Law School, Paris.

She was previously Assistant Professor of European Law at both Maastricht University and Utrecht University, and a Max Weber Postdoctoral Fellow in Law at the European University Institute of Florence. She received her PhD in 2013 from the University of Pavia and Pompeu Fabra University.

Her research focuses on regional and national parliaments in the EU and, more generally, on any other topic related to parliaments in the EU, such as interparliamentary cooperation. She is also interested in independent fiscal institutions, European banking union, EU institutional matters and comparative constitutional law.



# **Diana Urania Galetta**

Diana Urania Galetta is Full Professor of Administrative Law at the Law Faculty of Università degli Studi in Milan; she is also the Director of its Interdisciplinary Research Center on Public Administration (CERIDAP). She received a degree cum laude in Political Sciences (1990) and in Law (1998) at Università degli Studi in Milan, and an LLM cum laude from Osnabrück University (1993). She won research scholarships from the Alexander von Humboldt Foundation (1999-2000 and 2021). She won the "Altiero Spinelli Prize" (first place) for collective work on the codification of administrative procedures, published by ReNEUAL (2018).

Among others:

- Publisher and Editor-in-chief of the online Law Journal CERIDAP https://ceridap.eu/
- Member of the steering committees of the following law journals: Federalismi.it; Rivista Italiana di Diritto Pubblico Comunitario; AmbienteDiritto.it
- Member of: Societas Juris Publici Europei (SIPE); Italian Association of Administrative Law Professors (AIPDA); National Association of German Public Law Professors (*Vereinigung der Deutschen Staatsrechtslehrer* – VDStRL): Italian Association of European Union Law Scholars (AISDUE).
- Member of the steering committee of the Research Network on EU Administrative Law (ReNEUAL) http://www.reneual.eu

From 1991 to 2021 she produced more than 180 publications (books and papers). Topics include Italian and EU administrative law and comparative administrative law.



# **Dieter Grimm**

Dieter Grimm was a judge at the German Federal Constitutional Court from 1987 to 1999. He is Professor of Public Law at Humboldt University in Berlin and also taught at Yale Law School from 2002 to 2017. From 2001 to 2007 he was the Rector of the Wissenschaftskolleg zu Berlin, where he is still a Permanent Fellow. He holds honorary doctoral degrees from the universities of Toronto, Göttingen, Porto Alegre, Bucharest and Bielefeld.

He is a member of the Berlin-Brandenburgische Akademie der Wissenschaften, the Academia Europaea, the British Academy and the American Academy of Arts and Sciences.



# **Juliane Kokott**

Juliane Kokott is one of the eleven Advocates General at the Court of Justice in Luxembourg. Since October 2003 she has overseen about 1,300 cases and has delivered more than 500 opinions covering various aspects of European economic governance, including monetary policy, and banking supervision and resolution. Before joining the Court of Justice, she was a professor at the universities of Augsburg, Heidelberg, Düsseldorf and St. Gallen. She was also a visiting professor at Berkeley Law. Ms Kokott holds degrees from the University of Bonn, American University (Washington D.C.), Heidelberg University and Harvard Law School. She is the author, co-author and editor of a wide variety of publications and has initiated and organised numerous high-level conferences and expert symposia (e.g. Kokott and Mager (eds), Religionsfreiheit und *Gleichberechtigung der Geschlechter* (Freedom of Religion and Gender Equality), Tübingen, 2014). Together with Pasquale Pistone (International Bureau of Fiscal Documentation), she is also co-chair of an International Law Association study group focusing on international tax law (e.g. taxpayer rights, nexus).



## Vasiliki Kosta

Vasiliki Kosta studied law at King's College London, obtaining an LLB in 2006 and an LLM in European Law (with distinction) in 2007. She subsequently pursued her PhD research on "Fundamental Rights in Internal Market Legislation" at the European University Institute (EUI) in Florence. From 2009 to 2011 she also worked as a research associate at the Academy of European Law at the EUI. In 2011 Ms Kosta was a "stagiaire" at the Court of Justice and she undertook a traineeship at the EU Agency for Fundamental Rights in 2011-12. In 2013 she defended her PhD thesis on "Fundamental Rights in Internal Market Legislation" at the EUI. She was an Emile Noël Fellow at the Jean Monnet Center of NYU School of Law in 2017 and in July 2021 she was awarded the Dutch NWO Vidi grant for the project "The EU Fundamental Right to 'Freedom of the Arts and Sciences': Exploring the Limits on the Commercialisation of Academia". Since 2012 she has been Assistant Professor of European Law at Leiden University.



# Laura Codruța Kövesi

Laura Codruța Kövesi is the former chief prosecutor of Romania's National Anticorruption Directorate (DNA), a position she held from 2013 to 9 July 2018. Prior to this, between 2006 and 2012, she was the Prosecutor General of Romania, attached to the High Court of Cassation and Justice. She was the first woman and the youngest Prosecutor General in Romania's history.

In October 2019 Ms Kövesi was confirmed by the European Parliament and the Council as the first European Chief Prosecutor to head the recently created European Public Prosecutor Office (EPPO), (Regulation (EU) 2017/1939).



#### Katja Langenbucher

Katja Langenbucher is a law professor at Goethe University's House of Finance in Frankfurt, an affiliated professor at Sciences Po Law School, Paris, and a long-term guest professor at Fordham Law School, NYC. She has held visiting positions at Sorbonne University, WU Vienna, the London School of Economics, Columbia Law School and Fordham Law School (Edward Mulligan Distinguished Professorship). A Bok Visiting International Professorship at Penn Law, Philadelphia, is upcoming in 2022.

She has published extensively on corporate, banking and securities law. Her research projects focus on bank corporate governance, financial technology (fintech) and artificial intelligence (AI). She is currently working on the European Commission's proposal for an AI Act and what this would entail for credit scoring based on machine learning.

She is a member of the Administrative Council of the German Federal Financial Supervisory Authority (BaFin), a member of the German Federal Ministry of Finance's working group on capital markets law, and a member of the Conseil d'administration of the Fondation Nationale des Sciences Politiques. She was a member of the supervisory board of Postbank (2014-18) and a member of the European Commission's High-Level Forum on capital markets union (2019-20).



# **Fabio Panetta**

Fabio Panetta has been a member of the Executive Board of the ECB since 1 January 2020. He is responsible for International and European Relations, Market Infrastructure and Payments and Banknotes.

Prior to joining the ECB, Mr Panetta was Senior Deputy Governor of the Banca d'Italia and President of the Italian Insurance Supervisory Authority.

He served as a member of the Board of Directors and as a member of the Committee on the Global Financial System of the Bank for International Settlements. From 2014 to 2019 he was a member of the Supervisory Board of the ECB.

Mr Panetta graduated with honours in Economics from LUISS University (Rome). He holds an MSc in Economics from the London School of Economics and a PhD in Economics and Finance from the London Business School.

He has authored books and papers published in international journals such as the American Economic Review, the Journal of Finance, the Journal of Money, Credit and Banking, the European Economic Review and the Journal of Banking and Finance.



## **Katharina Pistor**

Katharina Pistor is the Edwin B. Parker Professor of Comparative Law at Columbia Law School and Director of the School's Center on Global Legal Transformation. Her research and teaching spans corporate law, corporate governance, money and finance, property rights, comparative law and law and development. She has published widely in legal and interdisciplinary journals and is the author and co-author of several books. She is the co-recipient (with Martin Hellweg) of the Max Planck Research Award (2012) and of several grants, including grants awarded by the Institute for New Economic Thinking and the National Science Foundation. She is a member of the Berlin-Brandenburg Academy of Science and the European Academy of Science and a Fellow of the European Corporate Governance Institute. Her most recent book *The Code of Capital: How the Law Creates Wealth and Inequality* (Princeton University Press, 2019) has been praised in the Financial Times and Business Insider.



#### **Miguel Poiares Maduro**

Miguel Poiares Maduro holds the Vieira de Almeida Chair at the Global Law School of Universidade Católica Portuguesa. He is also the Director of the Future Forum at the Gulbenkian Foundation and Chair of the Executive Board of the European Digital Media Observatory. Until the summer of 2020. he was a professor and Director of the School of Transnational Governance at the European University Institute (EUI) in Florence, where he is still a visiting professor. From 2013 to 2015 he was Minister Adjunct to the Prime Minister and Minister for Regional Development in Portugal. Until October 2009 he was Advocate General at the Court of Justice. He received an LLD from the EUI and was winner of the best PhD thesis and best researcher of the Law Department at the EUI. He has been a regular visiting professor at Yale Law School, the Centro de Estudios Constitucionales (Madrid), the Chicago Law School and the London School of Economics. He also teaches at the Universidade Católica and the College of Europe. From July 2016 to May 2017 he was Chairman of the Governance and Review Committee of FIFA. He has been honoured by the President of the Portuguese Republic with the Order of Sant'Iago da Espada for literary, scientific and artistic merit. In 2010 he was awarded the Gulbenkian Science Prize. His most recent book is Democracy in Times of Pandemic (with Paul Kahn).



# **Iddo Porat**

Iddo Porat is an associate professor of law at the College of Law and Business, Israel. He specialises in constitutional law, comparative constitutional law and legal theory. He graduated from the Hebrew University, clerked at the Israeli Supreme Court, and earned his master's and doctoral degrees from Stanford University. He is a recurring visiting professor at San Diego Law School and was a senior fellow at the Center for Comparative Constitutional Studies at Melbourne Law School from 2017 to 2018. He co-authored, with Moshe Cohen-Eliya, the book *Proportionality and Constitutional Culture* (2013).



## **Vivien Ann Schmidt**

Vivien Ann Schmidt is Jean Monnet Professor of European Integration and Professor of International Relations and Political Science at the Pardee School at Boston University, where she served as Founding Director of its Center for the Study of Europe. She also served as Honorary Professor at LUISS Guido Carli University in Rome. Her work focuses on European political economy, institutions and democracy as well as political theory, especially the role of ideas and discourse in political analysis (discursive institutionalism). Her latest book Europe's Crisis of Legitimacy: Governing by Rules and Ruling by Numbers in the Eurozone (Oxford, 2020) was the recipient of an Honorable Mention in the Best Book Award of the European Union Studies Association). Recent publications include the coedited Resilient Liberalism in Europe's Political Economy (Cambridge, 2013) and Democracy in Europe (Oxford, 2006; La Découverte, 2010, French translation), which was named as one of the "100 Books on Europe to Remember" in 2015 by the European Parliament. Recent honours and awards include decoration as Chevalier in the French Légion d'honneur as well as receiving the European Union Studies Association's Lifetime Achievement Award, an honorary doctorate from the Université Libre de Bruxelles, and a Guggenheim Foundation fellowship for her current project on the "rhetoric of discontent", a transatlantic investigation of populism.



# **Isabel Schnabel**

Isabel Schnabel is a member of the Executive Board of the ECB, where she is responsible for Market Operations, Research and Statistics, and Professor of Financial Economics at the University of Bonn (on leave).

Before joining the ECB, she was spokesperson of the Cluster of Excellence "ECONtribute: Markets & Public Policy".

From 2014 to 2019 she served as a member of the German Council of Economic Experts (*Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung*), and in 2019 she was Co-Chair of the Franco-German Council of Economic Experts. In 2018 she was awarded the Gustav Stolper Prize of the Verein für Socialpolitik. She is currently a Council Member of the European Economic Association.

Isabel Schnabel studied Economics at Paris I, Berkeley and Mannheim, where she also received her PhD in 2003.



# **Frank Smets**

Frank Smets is Director General Economics at the European Central Bank since February 2017.

Previously he was Adviser to the President of the European Central Bank since December 2013 and Director General of the Directorate General Research from September 2008. He is professor of economics at UGent and an honorary professor in the Duisenberg chair at the Faculty of Economics and Business of the University of Groningen. He is a Research Fellow of the Centre for Economic Policy Research in London and CESifo in Munich.

He has written and published extensively on monetary, macroeconomic, financial and international issues mostly related to central banking in top academic journals such as the Journal of the European Economic Association, the American Economic Review, the Journal of Political Economy and the Journal of Monetary Economics.

He has been managing editor of the International Journal of Central Banking from 2008 till 2010. Before joining the European Central Bank in 1998, he was a research economist at the Bank for International Settlements in Basel, Switzerland. He holds a PhD in Economics from Yale University.



## **Tomi Tuominen**

Tomi Tuominen, LLM, LLD, is a Lecturer in Law at the University of Lapland (Finland). He is the author of *The Euro Crisis and Constitutional Pluralism: Financial Stability but Constitutional Inequality* (Edward Elgar Publishing, 2021). Journals in which his work has been published include the Common Market Law Review and the European Law Review. He was a visiting PhD student at the Amsterdam Centre for European Law and Governance (2015) and the European University Institute (2017), as well as a visiting postdoctoral researcher at the Europa Institute in Leiden (2019) and the Max Planck Institute for Comparative Public Law and International Law in Heidelberg (2020). In addition to academic publications, he has also provided expert opinions to the Finnish Parliament's Constitutional Law Committee and the Grand Committee (the committee dealing with EU affairs) on issues related to the development of Economic and Monetary Union (EMU). His research focuses mainly on EMU law and comparative constitutional law.



## Renáta Uitz

Renáta Uitz is professor of comparative constitution law at the Central European University (CEU) in Vienna and a research affiliate at CEU's Democracy Institute in Budapest.

Her current work focuses on constitutionalism and the rule of law in the wake of illiberal political practices. She is a PI in the Jean Monnet Network BRIDGE. At CEU's Democracy Institute she is about to start a new collaborative research project entitled "Towards Illiberal Constitutionalism in East Central Europe", funded by the Volkswagen Foundation. Most recently she co-edited *Routledge Handbook of Illiberalism* (forthcoming).



#### Armin von Bogdandy

Armin von Bogdandy has been Director at the Max Planck Institute for Comparative Public Law and International Law in Heidelberg since 2002. He studied law and philosophy before obtaining a PhD in Freiburg (1988) and qualifying as a professor at Freie Universität Berlin (1996). He was President of the OECD Nuclear Energy Tribunal (2006-2014) as well as a member of the German Science Council (Wissenschaftsrat) (2005-2008) and the Scientific Committee of the European Union Agency for Fundamental Rights (2008- 2013). He has held visiting positions at the NYU School of Law, the European University Institute, the Xiamen Academy of International Law, and the Universidad Nacional Autonóma de México, among others. Mr von Bogdandy is the recipient of the Leibniz Prize (2014), the prize for outstanding scientific achievements in the field of legal and economic foundations of the Berlin-Brandenburg Academy of Sciences, the Premio Internacional "Hector Fix Zamudio" of the Universidad Autónoma de México (2015), and the "Mazo" (gavel) of the Inter-American Court of Human Rights (2015). He has been awarded Doctor Honoris Causa from Eötvös Loránd University, Budapest (2020), Universidad Nacional de Córdoba, Argentina (2020/21) and Universidad Nacional de Tucumán, Argentina (2017). His research centres on the structural changes affecting public law, be they theoretical, doctrinal, or practical.



#### **Rhoda Weeks-Brown**

Rhoda Weeks-Brown is General Counsel and Director of the Legal Department of the IMF. She advises the IMF's Executive Board, management, staff and member countries on all legal aspects of the IMF's operations, including its lending, regulatory and advisory functions. During her career at the IMF, she has led the Legal Department's work on a wide range of significant policy and country matters. She has also lectured and written articles and many IMF Board papers on all aspects of the law of the IMF and co-taught a Tulane University seminar on that topic.

Ms Weeks-Brown also served as Deputy Director in the IMF's Communications Department, where she led IMF communications and outreach in Africa, Asia and Europe; played a key role in the transformation of the IMF's communications strategy; and led IMF strategic communications on key legal and policy topics.

Ms Weeks-Brown has a JD from Harvard Law School and a BA in Economics (summa cum laude) from Howard University. Before joining the IMF, she worked in Skadden's Washington DC office. She is member of the Bar in New York, Massachusetts and the District of Columbia and a member of the Supreme Court Bar. She is also a member of the Committee on International Monetary Law of the International Law Association (MOCOMILA) and a member of the Consultative Group for the Sovereign Debt Forum. Ms Weeks-Brown serves on the Boards of TalentNomics, Inc., a non-profit organisation focused on developing women leaders globally, and Results for America, a non-profit organisation working to improve outcomes for communities through results-driven social programmes. She was named one of the top 27 Global General Counsels (2020) by the Financial Times, and one of the top five General Counsels in the area of promoting ethical standards.



## **Diana Wilson Patrick**

Diana Wilson Patrick is the General Counsel of the Caribbean Development Bank (CDB), a multilateral development financing institution based in Barbados providing development finance to 19 borrowing members in the English, French and Dutch-speaking Caribbean. As the CDB's chief legal advisor and a member of the Executive Management, she provides legal support in all areas of the CDB's work, including promoting private and public investment in the Caribbean region and mobilising financial resources from within and outside the region for the CDB's lending programme.

Ms Wilson Patrick is a graduate of the University of Bristol, England, and a member of Lincoln's Inn (called to the Bar – 1987). She has also been admitted to the Roll of Solicitors of England and Wales and is admitted to practise in Jamaica, Barbados, Trinidad and Tobago and Guyana.

Prior to joining the CDB, Ms Wilson Patrick was a partner in the regional law firm Lex Caribbean, where her primary practice was corporate finance, capital markets and mergers and acquisitions.

Ms Wilson Patrick has been a speaker at a number of industry events and has written for several journals, including co-authoring several editions of *The Euromoney Emerging Markets Handbook*.



# Ineta Ziemele

Ineta Ziemele was born in 1970 in Jelgava, Latvia, and graduated in law from Latvijas universitāte (University of Latvia) in 1993. In the same year she began studying the American legal system, the law and politics of the European Communities and political science as a postgraduate at Aarhus University, Denmark, before obtaining a Masters in International Law at Lund University, Sweden, in 1994. In 1999 she completed her studies with a PhD in Law at Cambridge University.

Ms Ziemele began her professional career as a parliamentary assistant at the Latvian Parliament from 1990 to 1992, before working as a consultant to the Foreign Affairs Committee of the Republic of Latvia from 1992 to 1995. She was appointed as an adviser to the Prime Minister of Latvia in 1995, and then held the same position at the Directorate General of Human Rights of the Council of Europe in Strasbourg from 1999 to 2001.

Since 1993 Ms Ziemele has lectured in various departments of Latvijas Universitāte. She also founded the Human Rights Institute of Latvijas Universitāte, of which she was the Director until 1999. She was the "Söderberg" Professor and then visiting professor at Rīgas Juridiskā augstskola (Riga Graduate School of Law), Latvia, where she has held the position of Professor of International Law and Human Rights Law since 2001. From 2001 to 2005 she also lectured at the Raoul Wallenberg Institute at Lund University as a visiting professor. In 2017 she was appointed to the position of Corresponding Member of the Latvian Academy of Sciences.

Ms Ziemele's career in the judiciary began in 2005 with her appointment as a judge at the European Court of Human Rights in Strasbourg, where she also held the position of President of Chamber until 2014. She was appointed as a judge at Latvijas Republikas Satversmes tiesa (Constitutional Court, Latvia) in 2015 and served as its President from 2017 to 2020. She was appointed as a judge at the Court of Justice on 6 October 2020.



## **Chiara Zilioli**

Chiara Zilioli has dedicated her entire working life to the European integration project. In 1989 she joined the Legal Service of the Council of Ministers in Brussels, moving to the Legal Service of the European Monetary Institute in 1995 and subsequently to the ECB as Head of Division in Legal Services in 1998, where she was appointed Director General in 2013.

Ms Zilioli holds an LLM from Harvard Law School and a PhD from the European University Institute. Since 1994 she lectures at Goethe University Frankfurt, at its Institute for Law and Finance and at the European College of Parma, Parma University. In 2016 she was appointed Professor of Law at Goethe University Frankfurt. She has published numerous articles and four books. She is also a member of the Parma Bar Association.

Chiara Zilioli has been married to Andreas Fabritius for more than 30 years; they have four children.





