

The emergence of the new over-riding objective of financial stability

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INTRODUCTION

The Economic and Monetary Union (EMU) has seen two very different decades. The first started with the introduction of the euro in 1999. Following the carefully planned institutional design described in the provisions of the Maastricht Treaty, a new macroeconomic governance model was established to support the common currency. The resulting framework could be reconstructed as a relatively coherent although incomplete economic constitution for the European Union (EU).¹ With ups and downs, this model worked adequately until the eruption of the financial crisis in 2008. However, in the course of the series of crises that followed –financial, economic, sovereign debt and finally the one resulting from the Covid-19 pandemic– this constitutional model was fundamentally transformed.² Although its main objectives were largely maintained, the subsequent institutional choices and safeguards of the model became all under enormous pressure and were substantively, when not formally, altered. How was this constitutionally possible?

In this chapter we argue that financial stability lies behind this drastic change in European integration, as from 2010 onwards it became an over-riding objective not only for the EMU but also for the whole EU. Initially a political concept lacking a clear legal definition, financial stability

¹ Manfred E. Streit and Werner Mussler, 'The Economic Constitution of the European Community: From "Rome" to "Maastricht"' (1995) 1 *European Law Journal* 5; Wolf Sauter, 'The Economic Constitution of the European Union' (1998) 4 *Columbia Journal of European Law* 27.

² Fabian Amtenbrink, 'The Metamorphosis of the European Economic and Monetary Union' in Damian Chalmers and Anthony Arnall (eds), *The Oxford Handbook of European Union Law* (Oxford University Press 2015); Christian Joerges, 'The European Economic Constitution and its Transformation Through the Financial Crisis' in Dennis Patterson and Anna Södersten (eds), *A Companion to European Union Law and International Law* (Wiley Blackwell 2016); Herwig C. H. Hofmann, Katerina Pantazatou and Giovanni Zaccaroni (eds), *The Metamorphosis of the European Economic Constitution* (Edward Elgar 2019); Klaus Tuori, *The European Central Bank and the European Macroeconomic Constitution: From a Central Bank of Stability to a Central Bank of Crisis* (Cambridge University Press 2021).

gradually made its way into the EU legal order by appearing in international law treaties such as the Treaty on Stability, Convergence and Governance in EMU (TSCG) and the European Stability Mechanism (ESM) Treaty, finding its way to EU primary law through the new Article 136(3) TFEU and getting fully entrenched into the EU legal order through the CJEU's reasoning. Because of its versatility, financial stability has justified very different measures when addressing the financial and sovereign debt crises, from innovative monetary policy programs to new financial assistance mechanisms granting help to Member states in distress to reinforced control over national budgets within the context of the new European Semester. When approached together, these measures, result in an overall inconsistent framework that can only be coherently reconstructed if financial stability is considered the keystone. Moreover, the over-riding nature of the financial stability objective makes it problematic when other aims and objectives are deemed to contradict with it – something that is even likely to happen. In particular, a firmly-anchored financial stability objective may pose further major challenges for advancements in the protection of social rights.

The chapter starts with a short introduction to the European economic constitution, and in particular to its new macroeconomic layer that provided the constitutional basis for the EMU. The focus is on the series of crises starting in 2008 that put key elements of this macroeconomic constitution in doubt. In the second section, we show how the financial stability objective first emerged as a pressing political objective that explains major changes in economic governance. The third section shifts the focus to EU law, explaining how the financial stability objective found its legal expression. The chapter concludes with some constitutional considerations on the relation and compatibility of financial stability with other competing objectives – among which the social ones are prominent.

THE IMPACT OF THE CRISES: THE GRADUAL UNRAVELLING OF THE EUROPEAN ECONOMIC CONSTITUTION

EU Treaty provisions and subsequent secondary law dealing with economic integration establish a framework particularly suitable for being reconstructed as an economic constitution – a coherent setting for economic performance where political decisions of systemic nature are uploaded to a constitutional level.³ Hence, it is possible to consider that the provisions of the Treaty of Rome focusing on the four economic freedoms and arranging competition and state aid rules already

³ Although the theoretical construction of the economic constitution has a German ordoliberal origin (see Josef Drexler, 'The European Economic Constitution and Its Relevance to the Ordo-Liberal Model', (2011) 4 *Revue Internationale de Droit Économique* 419), it has arguably found a neutral perspective that corresponds to the approach followed here.

established an economic constitution. In their pursuit of an internal market, the CJEU and the Commission as the competition authority developed those provisions relying on the rights and freedoms that the Treaty equipped individual economic actors with (even against their own governments), subsequently increasing the coherence and effectiveness of the legal framework for economic integration. Because of its scope of mainly individual economic actions, this original economic constitution could be labelled as microeconomic.

A fundamental change took place with the Maastricht Treaty: by establishing a common currency, it created a new layer of the economic constitution specifically dealing with macroeconomic integration.⁴ Hence, European integration continued to pursue the general objective of advancing the internal market, but it did so alongside the new macroeconomic objective of maintaining price stability through an independent central bank in charge of a single, and thus indivisible, monetary policy. The resulting macroeconomic framework had a set of complementary institutional choices and safeguards intrinsic to the European economic constitution's peculiar nature – among them the non-bailout provision or the prohibition of public financing by the ECB, to guarantee Member States' responsibility over economic policy decisions. Arguably, during the first decade of EMU the whole framework functioned in a way that respected not only the provisions of the Maastricht Treaty but also the broader principles of the European economic constitution.

However, the economic reality put EMU and its constitutional model to extreme tests. Unforeseen crises hit developed countries, starting in 2008 with a financial crisis that turned into an economic crisis and, in the euro area, also into a sovereign debt crisis in 2010. The euro area was in a slow process of recovery when in early 2020 the Covid-19 pandemic crisis struck. Both Member States and EU institutions have been deeply involved in resolving these various crises with an increasing set of measures that have pushed the boundaries of EU macroeconomic competences into uncharted directions and have affected the EU's institutional setting in many different ways. These measures, accompanied as well by omissions of specific rules, have raised concerns about their constitutionality in light of individual Treaty provisions and in particular of the fundamental features of EMU's constitutional architecture, both with regard to its objectives and also its institutional choices and safeguards. The upshot is that through this series of measures and omissions, each addressing a punctual difficulty or a particular macroeconomic challenge, EMU's constitutional framework has lost its coherence. Hence, a process of gradual disentangling of the economic constitution took place on a case-by-case basis. In the rest of this section we present an overview of

⁴ On the two layers of the economic constitution see Kaarlo Tuori and Klaus Tuori, *The Eurozone Crisis: A Constitutional Analysis* (Cambridge University Press, 2014).

this unravelling, revising how the principles (essential features) of the economic constitution (both its objectives and safeguards) were affected by the measures addressing the various crises.

A. Effects on the microeconomic layer of the economic constitution

Starting from the principles of the microeconomic layer of the economic constitution, the objective of *advancing the internal market* was largely respected within the euro area during the crisis. As a matter of fact, it indirectly justified exceptional measures preventing the break-up of the euro area, such as the European Central Bank's (ECB) selective purchases of Member States' government bonds.⁵ Accordingly, the internal market objective inadvertently mutated into an implicit euro area stability objective. Meanwhile, the fate of the internal market objective for the EU as a whole was different. The involvement of the ECB and euro area governments in the management of the euro crisis made the demarcation between the EU and the euro area more profound, negatively affecting the internal market objective for the whole EU. In the same vein, the transfer of banking supervision responsibility to the ECB created a borderline within the internal market for financial services on the basis of an assumed conflict between the internal market and euro area stability objectives. Finally, the initial response to the pandemic had a thorough impact on the internal market by imposing severe restrictions on the free movement of workers and leading to the re-emergence of national borders. Furthermore, while the economic policy response to the pandemic took an EU perspective, the monetary policy and financing backstop extended only to the euro area.⁶

The internal market objective is supported by another microeconomic principle, already anchored on the Treaty of Rome, guaranteeing free and undistorted competition. The Maastricht Treaty expanded the effects of this principle to the macroeconomic layer of the economic constitution by demanding from economic policy-makers that they broadly to sign up to the demands of *an open market economy and free competition*. However, most of the measures adopted during the crises have demonstrated a diminishing trust in the ability of the market mechanism to provide correct or desired pricing and allocation decisions within the euro area economy. For example, the ECB operational framework replaced the euro area interbank markets.⁷ Moreover, the various financial assistance mechanisms currently at their disposal, from ESM rescue packages to pandemic-related financial aid,

Commented [EA1]: You don't talk about another "principle" in the previous paragraph, but about the "internal market objective" and an "euro area stability objective".
Do you intend to make a distinction between principle/objective, or are you using them interchangeably?

Commented [MOU2R1]: The logic is that principles include objectives, safeguards and institutional choices. It might not come across perfectly, but it could perhaps be too much to explain it extensively here.

⁵ In particular, the Securities Market Programme (ECB decision of 14 May 2010 ECB/2010/5 and the press release of 10 May 2010: ECB decides on measures to address severe tensions in financial markets) and the Outright Monetary Transactions Programme (OMT), in ECB Press Release, 'Technical features of Outright Monetary Transactions' 6 September 2012.

⁶ The Pandemic Emergency Purchase Programme (PEPP). Decision (EU) 2020/440 of the European Central Bank of 24 March 2020 on a temporary pandemic emergency purchase programme (ECB/2020/17).

⁷ Tuori, *The European Central Bank and the European Macroeconomic Constitution* (n 2).

have lessened the dependence of euro area Member States on markets for their financing. Finally, the reaction to the pandemic crisis also affected the notion of undistorted competition through the relaxation of state aid rules.⁸ Although adopted on a temporary basis, at the time of writing these measures have been amended already three times, broadening their scope and extending their time of application.

B. Effects on the macroeconomic layer of the economic constitution

The crises had even sharper effects on the macroeconomic layer of the economic constitution. However, regarding the *price stability objective* that guides economic and monetary policy activities in the EU (Article 3(3) TEU), the impact was relatively minimal. Nominally, the objective fared well during the crises, with inflation remaining below the ECB target –if anything erring on the downside. As a matter of fact, guaranteeing price stability was always mentioned among ECB’s formal justifications for all the measures it adopted, including its selective bond purchases and its quantitative easing programme, the Public Sector Purchase Program (PSPP). However, the exact routes through which the purchases affect consumer prices remain somewhat ambiguous. The Pandemic Emergency Purchase Program (PEPP) added complications from this perspective with its explicit additional function of government financing backstop.⁹ From a legal perspective, this new function could be deemed problematic, especially bearing in mind that the German Federal Constitutional Court (FCC) considered in its controversial *Weiss* judgement that price stability had only a limited role in explaining the PSPP.¹⁰ In all, it remains to be analysed whether the ECB measures during the crises were more motivated by financial instabilities rather than, or at least on top of, by price stability considerations.

A critical element in the Maastricht Treaty is the formal detachment of monetary policy, an EU exclusive competence, from all the other *economic policies*, which *remain national responsibility*—although with imposed safeguards against unsound fiscal policies. The main reason was that Member State sovereignty in economic policy contained substantial national discretion that risked causing moral hazard problems with negative repercussions for other Member States and for the euro area. The role of markets within EMU’s design was to provide discipline, but mostly as a last resort. Therefore, safeguards took the shape of institutional constraints such as the obligation to

Commented [EA3]: Could you specify the macroeconomic principles you are referring to as a way of example?

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⁸ See the communication from the Commission on a *Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak* (2020/C 91 I/01).

⁹ See, in particular, the Introductory and statement and Q&A session with the President of the ECB Christine Lagarde, Frankfurt am Main, 4 June 2020.

¹⁰ FCC 2 BvR 859/15.

avoid excessive government deficits,¹¹ with means to correct them should they nevertheless occur,¹² and the non-bailout clause that prohibited shared liability for government debt (Article 125 TFEU). However, these safeguards were ill-suited to face crisis as deep and as devastating on Member States' public finances as the one that took place from 2008 onwards. This started an evolution in EU macroeconomic management that is yet to find a consistent form, as is most lately demonstrated by the pandemic responses. The main issue is the role that, against the original framework, financial assistance played in the reaction to the several crises. The transfer of financial resources and the accompanying guarantees and safeguards led to a fundamental and largely unresolved contradiction between the increased importance of national fiscal policy, demanding sufficient leeway for national governments, and the potential negative externalities for other Member States. As a consequence, the monitoring of national fiscal policies from the European level gain more prominence and imposition of strict constraints, eventually leading to actual sanctions.

But this was not the only change regarding the distinction between ECB monetary policy and Member State economic policies, for which the *narrow mandate of the ECB, excluding political value judgements*, is also instrumental. This narrow central banking model was the ultimate protection for national economic policy competences, which embodied the principle of conferral and assumed that the ECB could be controlled by judicial means. However, this model did not survive the various crises. Unconventional monetary policy programs were integral part to every response to each new crisis development, but every single new measure had far deeper influence on societies than was the case earlier – a point also stressed in the FCC *Weiss* judgment. The ECB's new explicit tasks such as banking supervision, and also implicit tasks and responsibilities including acting at the forefront of pandemic responses, have redefined the borderlines between the EU and national competences.

Finally, the institutional choices and safeguards that completed EMU's overall architecture hardly remained unscathed during the crises. Hence, although the *independence of the central bank* was not formally jeopardised, it was affected by financial stability and public finance problems that have fundamentally changed the role of the ECB and its relationship with Member States. For example, the measures ranging from giving favourable treatment to government bonds in monetary policy operations to outright purchases of sovereign bonds under heavy pressure from the markets, as well as designing and monitoring rescue plans as part of the Troika, put the ECB in a position far

¹¹ Stability and Growth Pact.

¹² The excessive deficit procedure set out in Article 126 TFEU and further specified by Regulation 1467/97.

closer to individual Member States' problems than its independent status would recommend.¹³ Connected to this, the *prohibition of public financing* (Article 123 TFEU), instrumental for ECB's independence since it prevents the bank from taking a creditor role towards (certain) euro area governments, came as well under challenge. In first term because, with the PSPP, the Eurosystem (ECB and the National Central Banks) became the largest creditors of all the euro area Member States,¹⁴ and later on because the PEPP provided an effective backstop for the financing of governments. Consequently, the current amount of government bond holding by the Eurosystem central banks has also reached new heights,¹⁵ which could also compromise the autonomy of ECB's decision-making if repayment was at stake.

In sum, very few of the original constitutional principles were left untouched by developments and decisions during the crises. The whole EMU economic constitutional architecture as reconstructed in the European macroeconomic constitution was shaken to the core. The requirements of coherence and internal logic were no longer met, which in turn could have implications for the accountability and legitimacy of the EU and particularly of the ECB. However, the effects of this change go much further than the core elements of the macroeconomic constitution. For example, we will suggest that the emergence of the financial stability objective as even an over-riding objective of the EU will have implications in areas such as the social policy and social rights. In order to understand this development, we first need to see how financial stability became a pressing political objective in the EU.

FINANCIAL STABILITY AS A PRESSING POLITICAL OBJECTIVE

It is our understanding that during the crises the objective of financial stability was the main driver of EU and particularly euro area economic policy. Accordingly, most of the changes and developments explained above derive, directly or indirectly, from it. The emergence of this new political objective can be timed in the period when it became apparent that the euro area framework for maintaining stability had failed with risks of even devastating consequences such as disentangling of EMU. Since then, the need for financial stability developed in parallel to the increasing

¹³ Klaus Tuori, 'From expert to politician and stakeholder? Constitutional drift in the role of the ECB' in John Erik Fossum and Agustín J. Menéndez (eds), *The European Union in Crises or the European Union as Crises?* (ARENA 2015).

¹⁴ The PSPP holdings amounted to 2,274 bln euros in August 2020. See updated figures in <https://www.ecb.europa.eu/mopo/implementation/omt/html/index.en.html>. For most countries, the PSPP accounted close 30% of outstanding government debt already by the end of 2018. <https://fingfx.thomsonreuters.com/gfx/editorcharts/EUROPE-MARKETS-ECB/0H001PBWS6DF/index.html>

¹⁵ By the end of September 2020, the total holdings of the Eurosystem in public sector debt is appr. 2800 bln euros. See previous fn and <https://www.ecb.europa.eu/mopo/implementation/pepp/html/index.en.html>

disturbances on the euro area, a gradual evolution that we succinctly reconstruct in this section.

The financial crisis from Autumn 2008 onwards already posed serious questions about the ability of the framework to maintain economic and financial stability, when the euro area, as well as most developed economies, was faced with an unprecedented financial turmoil and a subsequent economic decline. In this situation, the ECB alongside most other central banks fought financial instability mainly by supporting the interbank markets. Many government-led institutions, in the EU and elsewhere, aimed to ease the situation through bank recapitalisations and closures. All around the globe, fiscal policy was also heavily utilised. In the EU, national responsibility over public finances remained intact, but fiscal policy coordination nevertheless intensified. During this first phase of the crisis, the euro area and the ECB followed the constitutional model of the European economic constitution and behaved according to a narrow central banking model guided by the price stability objective. Fiscal policy and financial stability considerations were becoming important issues, but, apart from liquidity in the interbank markets, they were a national responsibility.

It was the sovereign debt crisis in early 2010 that precipitated fundamental questions concerning the EMU and even raised fears for its very existence. The EMU proved a dysfunctional economic area addressing a number of systemic problems through a patchwork of punctual solutions. Moreover, in comparison to other major economies, the euro area was the least able to find a sound footing for its recovery. The sovereign debt crisis was thus a turning point. This shift was clear in the area of financial stability: microeconomic concerns about national financial stability, including banking sector problems, became incorporated into much broader stability considerations, including fiscal imbalances and even worries over the stability of the euro area as a whole. Pressing and unprecedented euro area macroeconomic stability concerns took over from the national as well as from the EU microeconomic level approaches. Consequently, a European Systemic Risk Board was established *in order to contribute to the prevention or mitigation of systemic risks to financial stability in the Union*.¹⁶ Under its umbrella, three new authorities were in charge of monitoring risks in financial institutions (European Banking Authority), pension systems (European Insurance and Occupational Pensions Authority) and financial markets (European Securities and Markets Authority). But these institutional arrangements were not enough to contain the crisis.

Hence, during the period 2010-2014 the survival of the euro area was threatened by fears of contagion, by links between banks and sovereigns and even by ad hoc measures failing to provide

¹⁶Article 3 of Regulation 1092/2010.

sustainable relief.¹⁷ Consequently, (financial) stability became the main objective of the euro area economic governance. This objective has two combined rationales: on the one hand, the management of economic shocks and, on the other hand, the prevention of further risks.¹⁸ Accordingly, these two complementary strategies were operationalized through a bulk of EU and particularly euro area rescue measures granted to Member States in financial distress (shock management) in exchange of a number of guarantees over the soundness of their national fiscal policies (risk prevention). Rescue measures were gradually given more solid institutional forms through the establishment of the European Financial Stability Facility (EFSF) and the ESM, whereas, in return, strengthened mechanisms for the coordination of national economic policies were introduced under the European Semester. Within this new framework, potential macroeconomic imbalances were also monitored in order to prevent stability risks, creating the conditions under which, in line with this policy, the ECB could intensify its involvement in fighting stability threats, expanding with each new program the scope of its monetary policy to the point of overcoming any previous constraints.¹⁹ The ultimate step in this parallel evolution, making explicit the close connection between shock management and risk prevention, is the strict conditionality imposed specifically on those Member States receiving financial assistance.²⁰ This conditionality plays out mainly through a Memorandum of Understanding (MoU) between the ESM and the assisted country, in which the conditions, often in the form of adjustment programme, are agreed upon. The leverage resulting from ESM's financial assistance capability was also key for swaying Member States towards agreements deemed necessary for the new macroeconomic framework. First of all, the signing of the TSCG was a precondition for new ESM assistance programmes. In that context, the stability of the euro area as a whole was linked to the new fiscal policy constraints, as 'the need for governments to maintain sound and sustainable public finances (...) is of essential importance to safeguard the stability of the euro area as a whole, and accordingly requires the introduction of specific rules, including a balanced budget rule'.²¹ Second, the ESM was also used as leverage to trans-nationalise euro area banking supervision, putting the Single Supervisory Mechanism in the hands of the ECB.

During the period 2015-2019, the euro area experienced a slow recovery based on the consolidation of these measures, somehow reassuring markets against uncertainties and eventual

¹⁷ Member States' bilateral loans to Greece as well as the ECB's SMP and 3-year LTROs could be assessed negatively with regard to their longer-term consequences.

¹⁸ Gianni Lo Schiavo, *The Role of Financial Stability in EU Law and Policy* (Kluwer Law International 2017), 52 ff.

¹⁹ As mentioned in the previous section, for example, in the form of the SMP, OMT and quantitative easing programmes (PSPP).

²⁰ As required by the newly introduced Article 136(3) TFEU and expressed in the preamble and Articles 3 and 12.1 of the ESM Treaty.

²¹ Preamble, Treaty on Stability, Coordination and Governance in the Economic and Monetary Union.

volatilities. However, financial stability considerations, although not urgent and pressing anymore, were nonetheless a source of concern. Firstly, because the euro area was still considered ill-equipped to face new troubles and, consequently, perception was that EMU's design needed to be *completed*. In particular, because the parallel development of financial assistance and increased control over national budgetary policies was not enough to counterbalance malfunctions resulting from EMU's basic asymmetry between monetary and fiscal competences. And, secondly, because after the urgent management of the crisis courts had to address a number of legal claims on the legality of the measures adopted, moving the focus from the political to the legal domain. This was evident by the wide attention paid by all sort of political and economic actors to the rulings of the CJEU in the *Gauwailer* and *Weiss* cases. Lawyers (and judges) were nevertheless aware of the fact that a number of less widely-known legal technicalities (among which a number of decisions on the Banking Union, on the legal standing of parties against ECB programs or Eurogroup decisions, or on the reach and scope of fundamental rights, to name but a few) could also have a colossal impact on the financial position of certain Member States and consequently aggravate the overall financial situation by reactivating doubts in the markets. As we will explain in the next section, the legally undetermined concept of financial stability played a critical role in the argumentation of courts validating the measures adopted during the crisis.

Finally, by 2020, the pandemic and the urgent and unexpected measures that had to be adopted consolidated the *modus operandi* and the rationale by which financial stability could impose itself over any other objective if the circumstances are pressing enough. The initial community reactions were largely operationalised by the ECB. It explicitly provided the backstop for government financing as well as also aimed to ensure the flow of credit to the household and particularly corporate sectors, including temporary relaxations of credit and even supervisory standards. As to medium- and long-term reactions, at the time of writing, the substantial amount of money to be funnelled towards Member States through the Next Generation EU package (€750 billion) depends on the structural funds of the Union's regional policy. However, despite the legal basis for these programs is independent from economic policy coordination, the current Commission proposal under negotiation establishes a direct connection with the European Semester and the performance of national economies, thus reviving the link between shock management and risk prevention characteristic of financial stability.

The evolution here described also bore consequences for the broader constitutional architecture of EMU along the lines described in section 1. The resulting framework can only be coherently reconstructed if financial stability considerations are elevated to a guiding position.

Arguably, the overall euro area economic framework, through a series of interlinked decisions and programs was given a new, even overriding, objective of financial stability of the euro area as a whole, which could become the main objective for the new European economic constitution.

THE RECEPTION OF FINANCIAL STABILITY IN EU LAW

The pressing political need of financial stability was transferred to the legal system not only resulting from the legal justification for the establishment of new institutions, but also through the introduction of the concept of financial stability in the provisions of the Treaties and, ultimately, in the legal reasoning of the CJEU. Importantly, financial stability became the key argument for the validation of the decisions adopted to tackle the crisis and, consequently, conditionality, the link between financial stability's double rationale (crisis management and risk prevention), was formalized and became part of EU law, too.

A. The emergence of the legal objective of financial stability of the euro area as a whole

European rescue measures from 2010 onwards become difficult to justify constitutionally in the existing legal framework. Here, the new objective of restoring financial stability provided a seemingly feasible solution to the constitutional problems related to the new institutional structures providing financial assistance to Member States. The starting point, in Spring 2010, was a loan agreement with Greece that was motivated on the grounds of safeguarding the financial stability of the euro area as a whole. The initial rescue packages for Greece relied on bilateral loans from the euro area Member States and loans from the International Monetary Fund (IMF). Although European institutions were active and provided much of the framework for the assistance, formally the actual rescue packages took place outside EU law. In contrast, the financial stability objective was incorporated in EU law in May 2010, when it motivated the establishment of the European Financial Stability Mechanism as the 'Union stabilisation mechanism to preserve financial stability in the European Union' in a situation that could 'present a serious threat to the financial stability of the European Union as a whole.'²² As a matter of fact, the mechanism was managed by the Commission and based on a Council regulation.²³

²²Statement on the support to Greece by Euro area Members States MEMO/10/123, 11 April 2010, http://europa.eu/rapid/press-release_MEMO-10-123_en.htm. Press Release: Statement by IMF Managing Director Dominique Strauss-Kahn on Greece, April 11, 2010 Press Release No. 10/143, <http://www.imf.org/en/News/Articles/2015/09/14/01/49/pr10143> and Statement by Commissioner Rehn on Greece, http://ec.europa.eu/economy_finance/articles/eu_economic_situation/2010-04-29-statement-commissioner-rehn-on-greece_en.htm.

²³ Council Regulation (EU) No 407/2010 of 11 May 2010 establishing a European financial stabilisation mechanism OJ L 118, 12.5.2010. Preamble (1) and (5).

The initial stages of the financial stability objective were legally based on a combination of Articles 122(2) and 125 TFEU. In particular, Article 122(2) TFEU was the legal basis to incorporate the financial stability of the EU as a whole to EU law, because it foresaw ‘the possibility of granting Union financial assistance to a Member State in difficulties or seriously threatened with severe difficulties caused by exceptional occurrences beyond its control.’²⁴ However, this initial approach to allow the rescue measures through (extensive) textual interpretations risked becoming problematic for the coherence of the legal framework as breaching the principle of national responsibility over economic policies, and therefore the mechanism was considered as merely temporary.

B. Financial stability promoted through international agreements

The financial stability objective made firmer inroads to the EU legal order with the combination of the amendment of the TFEU through the simplified revision procedure²⁵ and the ratifications of the ESM Treaty and the TSCG. The TFEU amendment added a new paragraph to Article 136 under which the Member States whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard ‘the stability of the euro area as a whole’. It must be noted that, under this drafting, this is an undetermined legal concept enabling political power to act whenever it considers these circumstances exist. Importantly, the new paragraph required the granting of any financial assistance under the mechanism to be made subject to strict conditionality. According to the CJEU, this was required to ensure that the mechanism will ‘comply with European Union law.’²⁶ At the same time, the European Council stated Article 122(2) TFEU would no longer be needed nor should it be used for such purposes.²⁷ The Union measures were, for the euro area, replaced by a more appropriate Member States’ mechanism to safeguard the financial stability of the euro area as whole – in principle more in accordance with EMU’s design allocating such competences at national level. The two international treaties, the ESM and TSCG Treaties, placed the objective of financial stability of the euro area outside EU law, although EU primary law now allowed, even encouraged, setting up of a stability mechanism and pursuing a new objective for the euro area of financial stability.

The ESM Treaty provoked up to that point the clearest legal discussion of the objective of

²⁴Ibid., Preamble (1).

²⁵ European Council Decision of 25 March 2011 amending Article 136 of the Treaty on the Functioning of the European Union with regard to a stability mechanism for Member States whose currency is the euro (2011/199/EU). O.J. L 91/1.

²⁶ Case C-370/12 *Thomas Pringle v Government of Ireland and Others* [2012], para 72.

²⁷ European Council Decision of 25 March 2011 amending Article 136 of the Treaty on the Functioning of the European Union with regard to a stability mechanism for Member States whose currency is the euro (2011/199/EU). O.J. L 91/1.

financial stability of the euro area as a whole. The Council decision on the Treaty amendment clarified that the ESM ‘will provide the necessary tool for dealing with such cases of risk to the financial stability of the euro area as a whole as have been experienced in 2010, and hence help preserve the economic and financial stability of the Union itself.’²⁸ The ESM could assist the Member States if it was indispensable to safeguard the financial stability of the euro area as a whole and of its Member States again with a further qualification that this assistance was made subject to strict conditionality. A few features deserve attention. First, Article 136(3) TFEU referred to stability of the euro area as a whole, not financial stability. In a literal reading, the two concepts are not the same, although no clear distinction has so far emerged in the interpretation of the ESM Treaty. Second, the euro area interrelations meant that ‘severe risks to the financial stability of Member States whose currency is the euro may put at risk the financial stability of the euro area as a whole.’²⁹ Hence, the primary cause for the financial stability of the euro area as a whole was perceived to stem from financial instability of individual Member States. Third, the activation of the ESM needed to be indispensable to ‘safeguard financial stability of the euro area as a whole and of its Member State’, although the threshold of the assessment is somewhat looser of ‘the existence of a risk to the financial stability of the euro area as a whole or of its Member States’.³⁰

The TSCG also relied on the concept of the stability of the euro area as a whole. In fact, its signing was a precondition for new ESM assistance programmes, thus being complementary strategies. Furthermore, ‘the need for governments to maintain sound and sustainable public finances and to prevent a general government deficit becoming excessive is of essential importance to safeguard the stability of the euro area as a whole, and accordingly, requires the introduction of specific rules, including a ‘balanced budget rule’ and an automatic mechanism to take corrective action’.³¹ In accordance with this objective, the TSCG made a peculiar inroad to national legislation through the obligation to impose the balanced budget rule preferably at the constitutional level. However, the TSCG is as close of being EU law as is possible without a formal inclusion. Article 16 TSCG states that, after five years, the substance of the Treaty was to be incorporated into the EU legal framework, and Article 8 TSCG allows contracting parties to subject any failure to comply with the requirement of introducing binding correction mechanisms to tackle significant observed deviations from the budgetary medium-term objective to CJEU’s review. Therefore, the TSCG

²⁸Preamble (4) of the European Council Decision of 25 March 2011 amending Article 136 of the Treaty on the Functioning of the European Union with regard to a stability mechanism for Member States whose currency is the euro, 2011/199/EU.

²⁹ Recital 6 ESM Treaty

³⁰ ESM Treaty.

³¹ Preamble to the TSCG.

imposed important new financial stability motivated elements in national and EU law without formally being neither. National discretion and sovereignty, for example, in the areas of social rights were constrained by EU or euro area financial stability needs without any balancing or even deliberations.

C. Financial Stability of the euro area as a whole in the case law of the Court of Justice

Finally, with regard to EU law, the most extensive discussion on the concept of the financial stability of the euro area as a whole took place in the CJEU's *Pringle* judgment. Interestingly enough, concerns about potential implications for financial stability were key when deciding to substantiate this case through the accelerated procedure.³² In the actual ruling, among the issues discussed by the CJEU was the relationship between the objectives of the ESM and those of the different TFEU provisions on macroeconomic integration. Hence, when compared with the monetary policy primary objective of price stability (Articles 3(1)(c) TFEU and 127 TFEU), the CJEU concluded that safeguarding the stability of the euro area as a whole is clearly distinct from the objective of maintaining price stability,³³ although it might have repercussions on the stability of the currency. Therefore, the granting of financial assistance to a Member State did not fall within the scope of monetary policy. With regard to Articles 123 and 125 TFEU (prohibition of monetary financing of governments and no-bailout clause, respectively), the CJEU noted these provisions are essentially of a preventive nature, while the ESM is to manage an already existing financial crisis. Despite the close connection between these two constitutive dimensions of financial stability, the CJEU concluded that the objectives of these articles were not identical, perhaps attempting to find a suitable practical solution rather than a legally compelling argument based on the underlying substance of the issue. A similarly difficult legal reasoning related to Article 122(2), which had been used as legal basis for the EFSM. The CJEU stated that as 'the mechanism envisaged is to be permanent and that its objectives are to safeguard the financial stability of the euro area as a whole means that such action cannot be taken by the Union on the basis of that provision.'³⁴ The permanence of the mechanism but also its objective of safeguarding financial stability of the euro area as a whole separated the EFSM and the ESM, and subsequently Article 122(2) could not be used as a legal basis for the ESM, which therefore did not encroach on the EU competences conferred by the article. Furthermore, Article 122 TFEU did not imply that the Union has exclusive competence to grant financial assistance to a Member State even on a temporary basis. Quite the contrary, Article 136(3) TFEU 'confirms that Member States have

³²Order of the President of the Court in Case C-370/12 *Thomas Pringle v Government of Ireland and Others*, 4 October 2012, EU:C:2012:620

³³ Case C-370/12 *Thomas Pringle v Government of Ireland and Others* [2012], paras. 56 and 57.

³⁴*Ibid* para. 65.

the power to establish a stability mechanism and is further intended to ensure, by providing that the granting of any financial assistance under that mechanism will be made subject to strict conditionality, that the mechanism will operate in a way that will comply with European Union law.³⁵

Some further discussion on financial stability concept took place with regard to Article 125 TFEU. It was argued that such provision did not prohibit all the financial assistance by the EU or its Member States. One reason was that Article 122(2) explicitly allowed such assistance without making a derogation to Article 125.³⁶ Hence, the relevant question was to ask what kind of assistance was compatible with Article 125 TFEU. Here, the CJEU considered that the objective of this provision was to ensure that the Member States remain subject to the market pressure, encouraging them to ‘maintain budgetary discipline’.³⁷ Most importantly, this ‘contributes at Union level to the attainment of a higher objective, namely maintaining the financial stability of the monetary union.’³⁸ This leads to the conclusion that Article 125 prohibits (only) such financial assistance that reduces incentives for budgetary discipline. The CJEU saw that both the non-bail-out clause and the ESM aimed at maintaining stability, the former preventively and the latter once a crisis nevertheless occurred.

Meanwhile, the role of Article 124 TFEU (banning privileged access of public authorities to financial institutions) with regard to monetary policy measures that have had a financial assistance nature has not been tested. For the ECB’s selective bond purchases, the motivation was never formally related to financial stability or assistance as such, but to the (mal)functioning of the monetary policy transmission mechanism. The actual difference between the two might have been limited, but this was not assessed by the CJEU in the *Gauweiler* case. Finally, the COVID-19 measures could be somewhat different as even the ECB measures contained an explicit backstop function for the Member State bond issuance, which is practically equivalent to financial assistance. However, should it be challenged, this would most likely be on the basis of the prohibition of central bank financing of governments (Article 123 TFEU).

Against this background, the concept of financial stability of the euro area as a whole could be seen to have some specific features in EU law. First, ensuring financial stability through financial assistance falls under economic policy (not monetary policy), a Member State competence that was

³⁵*Ibid* para. 72.

³⁶*Ibid* paras 120, 130 and 131.

³⁷*Ibid.* para 135.

³⁸*Ibid.* para 135.

constrained by EU economic governance framework.³⁹ Safeguarding financial stability is fundamentally different from maintaining price stability, so it is not an underlying objective of common monetary policy. However, the reading of the financial stability objective that stressed both its non-monetary policy nature and thus its belonging to Member States' economic policy was not followed by the ensuing decisions, actions, and statements taken by the EU institutions (including the ECB) and Member States. Hence, there is a disconnection between the CJEU's legal interpretation of the rules of the Treaty and the practical implementation of those rules. Second, the objective of financial stability is read as an underlying objective of Article 125 TFEU and also Article 122(2), and perhaps could be an underlying objective of some other Articles as well. Hence, it is also an EU objective but not an exclusive EU objective. However, and third, maintaining financial stability needs to respect the safeguards of Member States fiscal responsibility, which for the ESM took place through the conditionality of financial assistance. Fourth, financial stability of the euro area as a whole includes existential questions concerning the euro currency but potentially also concerning the leaving of one country from the euro area. Fifth, risks to financial stability of the euro area as a whole can stem from problems in individual countries.

CONCLUSIONS: A NEW ECONOMIC CONSTITUTION WITH FINANCIAL STABILITY AS MAIN RATIONALE?

The key problem with financial stability as a legal objective is that it is based on an elusive capitalist liberal economic concept that lies at the intersections between macroeconomics, public finances, financial markets, and financial institutions. It may and has been defined in many ways, as even EU statements, legal acts and judgments addressing it convey different underlying perceptions of financial stability or stability of the euro area as a whole. Unsurprisingly, this lack of precise definition has allowed the concept of financial stability to be used to rationalise many actions. The means of safeguarding financial stability since the eruption of the crises have indeed contained a very broad range of topics including austerity measures to improve public finances, macroeconomic adjustment programmes to repair lost competitiveness even through lowering wages, control over budgetary processes in the form of a European Semester, capitalisation of banks and other institutions as well as central bank financing of governments and banks.

It follows from this that the objective of financial stability can be evoked when something is perceived to jeopardise economic or financial viability of a Member State or a broader area. The further feature of the financial stability objective in the EU context is that it is used to rationalise and even legitimise

Commented [EA5]: Could you elaborate a bit here?

Commented [EA6]: Maybe part of this reflection could be brought at the introduction, since one keeps wondering how "financial stability" is understood or should be understood in this context

³⁹ *Ibid.*, para 59-60.

measures that are deemed necessary but contradict existing mandates and constraints. It is therefore fundamentally a crisis concept that has not been properly understood in the context of EU law and that deserves further analysis. A few remarks and suggestions could be made.

Financial stability has some serious caveats as a legal objective particularly in EU law. The importance of teleological interpretation used by the CJEU in its case law raises a major problem with the relationship of the financial stability objective with other objectives and principles. Given its opaqueness, it is almost impossible to balance financial stability with other objectives, such as price stability or social policy objectives. It appears to be either over-riding or irrelevant. For the European economic constitution as a constitutional architecture that aims at coherence and some form of internal logic, the current use of financial stability objective is problematic. Related to this, the objective of financial stability has also a very different functional nature when it is used to tackle a situation at hand (managing shocks) and when it rationalises measures that more generally are perceived useful for the maintenance of financial stability (preventing risks). In the situation of serious financial instability, the measures have a tendency of becoming over-riding.

For the European economic constitution as a constitutional architecture that aims at coherence and some form of internal logic, the current use of financial stability objective is problematic. As a new objective, it is yet to find its place and have a well-defined content. However, as it is used to rationalise many, even far-reaching measures, it can become harmful for the rule of law. Similarly, the fact that it cannot easily be balanced with other objectives or principles makes it a problematic element in a constitutional model. In particular, the conflicts with social rights do not open useful value discussions, as arguably can be the case with conflict between social rights and economic freedoms. Rather, the social rights have to bend as soon as financial stability argumentation is evoked.⁴⁰ In this regard, it is but the final step in a long trend by which European integration has gradually eroded the different elements of the social state, which traditionally guaranteed social rights through fundamental rights, social policies and public services.⁴¹

Interestingly, some authors consider that the European Semester, especially as performing during the last five years, has created a new opportunity for the protection of social rights.⁴² This is

⁴⁰ Francesco Costamagna, 'National social spaces as adjustment variables in the EMU: A critical legal appraisal', (2018) 2-3 *European Law Journal* 163.

⁴¹ Fernando Losada, 'European integration and the transformation of the social state: from symbiosis to dominance', in Toomas Kotkas and Kenneth Veitch (eds), *Social Rights in the Welfare State: Origins and Transformations* (Routledge 2017).

⁴² Jonathan Zeitlin and Bart Vanhercke, 'Socializing the European Semester: EU social and economic policy co-ordination in crisis and beyond' (2018) 2 *Journal of European Public Policy* 149.

nonetheless debatable, because uploading to the European level the discussion about the content of social policies will only result in the protection of social rights becoming questioned on the basis of longer-term stability needs. However, the national responsibility and discretion should allow value discussions at the national level, at least in theory, as the stability needs are mostly related to expected aggregate outcomes that can be achieved with very different policy combinations.

In sum, the emergence of the financial stability of the euro area as a whole became the main objective and rationale for most new elements in the Community macroeconomic framework. We would argue that in EU law financial stability is fundamentally a crisis concept that has been used to rationalise and legitimate measures that were deemed necessary but lacked well-defined underlying authorisations or even contradicted existing mandates and constraints. While it has seemed to have been useful in judicial reviews of crisis measures, it also triggers serious caveats as a constitutional objective. The financial stability objective's relationship with other objectives, including price stability or social policy objectives, is unclear, which makes balancing between them almost impossible. In practice, it could have translated the use of political discretion even into an overriding legal objective, which would constitute a disruption in the legal order and thus be detrimental to the rule of law within the EU.

A further step took place in 2020 with the covid-19 pandemic and the measures to alleviate the consequences of containment of virus. The pandemic created new types of instability well beyond the economic sphere, where the initial reaction was mainly at the national level. At the EU level, the ECB provided the most active and immediate support, first and foremost, by guaranteeing favourable funding conditions for the Member States as well as financial support to companies, households, and – first and foremost – to banks. This was followed by an agreement by EU leaders on a €750 billion recovery effort in the form of direct aid to Member States as well as loans. The Next Generation EU package combines rebuild support after the pandemic with investment support for the green and digital transitions. The pandemic is likely to be both an enormous challenge to the EU and EMU in its own right. Furthermore, it is likely to elevate the issues related to financial stability to the central stage again, once the most urgent crisis phase is over. The question of financial stability of the euro area as a whole and the social dimension mostly at the national level will become a factor that defines the functioning of the European economic constitution and the relationship between the EU, euro area and the Member States for the next decade.

