

MONETARY UNION: A COMPLEMENT TO THE SINGLE EUROPEAN MARKET OR
A NEW DIMENSION TO INTERNATIONAL PERSONALITY? - Dr. jur. Klaus Peter Follak

1. Introduction

The European Community and the Single Market have always attracted an astonishing interest from other parts of the world. This may be due to the economic strength of over 340 million customers and the related impact it has on world trade. It may also be due to it being a new ongoing process which is to result in the creation of a region which has free economic relations and which is also subject to supranational legislation. These reasons are sufficient to recommend themselves for reference when other countries are trying to facilitate their cross-border relations. What started as pure inter-governmental co-operation is now supposed to end as an independent institution with international personality. With this in mind, there is now to be a new legal structure in the form of a monetary order.

2. The single market

The European monetary system (in its current shape) and the European capital market should be addressed in the context of a common financial sector which facilitates free cross-border payments and capital transactions. In other words, they are to be part of the single common market (Article 8a of the EC Treaty). The integration¹ of financial markets is seen as one of the means which would pave the way for economic and monetary integration. For the single market to operate, cross-border supply should ensure similar conditions of competition whilst cross-border demand would require equivalence in standards regarding services and products. Therefore, the abolition of discrimination on the ground of nationality and residence is insufficient. Other targets should include:

- harmonisation of the legal framework as far as the supply of financial services is concerned;
- harmonisation of the stock exchange; and
- harmonisation of taxation regarding capital transactions.

This is because freedom of payments and capital movements means the freedom of cross-border payments and capital transactions, and the integration of capital markets means the harmonisation of related regulations.

The liberalisation of cross-border payments, subject to the liberalisation of underlying transactions (eg capital

¹ Smits, Free Movement of Capital and Payments, European Law Review 1986, pp. 456; Mizzau (ed.), The Policy of Liberalization of International Monetary and Financial Relations, Milan 1986; Hahn/Follack, Kapital - und Zahlungsverkehr (Dausen, ed., Handbuck des Europaischen Wirtschaftsrechts), Munich 1993.

transfers or exchange of goods, services and labour) is based on Article 106 of the EC Treaty. Freedom of payments is therefore part of the basic Community freedoms and is applied directly.

As regards the freedom of capital movements, Article 67(2) is the only rule of the EC Treaty which is applied directly. The extent of this freedom is set by the Directive of 26 June 1988². Consequently, current payments related to capital movements are free and cross-border transactions between EC countries (but not third countries) are also free. The freedom includes the related freedom of cross-border transactions but excludes the internal deregulation of individual national markets. There is one exception: in the regulation of the national market, the principle of non-discrimination has to be applied and regulations must be applied to domestic and other EC nationals equally.

The basis of the harmonisation of national regulations has been provided by Article 100a of the EC Treaty. The main areas of harmonisation in the financial field are as follows:

- banking regulation;
- insurance services;
- investment bonds and similar units; and
- stockmarkets.

The principles of harmonisation may be circumscribed as follows:

- harmonisation of minimum requirements;
- homecountry control on the basis of homecountry legislation and a European-wide extension of licences for financial institutions;
- competition between the individual national financial systems; and
- mutual recognition (which is expected to follow automatically due to the mechanisms of competition).

The legal structure of the Single European Market is based on the Single European Act (known as "Europe 1992") and rests on two factors. First, it is determined by the direct application of the EC Treaty insofar as the so-called basic economic freedoms are concerned (ie the so-called primary Community law). Secondly, it is based on Community law-making (viz the so-called secondary Community law) which is in the form of Council Directives. These Directives are transformed and then incorporated into individual national legal systems.

3. The present monetary system³

Unlike the current state of the mutual recognition of national regulation on a minimum harmonisation basis, economic and monetary union would require the convergence of monetary and economic policy which hitherto had not

² EC OJ 1988, L 178

³ Zehetner, European Monetary Cooperation (Bernhardt, ed., Encyclopedia of Public International Law, Vol. 6, pp. 184), Amsterdam 1983.

been part of the Single European Market. If it happened, this would result in a quantum leap. Although the liquidity and monetary policy was excluded from the Europe 1992 measures, it is subject to the future harmonisation process which is related to the European Currency Unit.

Article 6 EC Treaty only provides for an obligation to co-ordinate national economic policies. The obligation is subject to the principles on price stability and the equilibrium of balance of payments, and these principles are legally binding. Article 104 sets economic targets known as the "magic polygon". These refer to high employment, stable prices, the balance of payments equilibrium, and trust in the stability of the currency. But these principles, albeit legally binding, have been applied by the EC Court of Justice as mere guidelines upon which political decisions rest. According to the Court's practice, they are not sufficiently concrete upon which the enforcement of specific actions may be relied. Further, neither are they sufficient to serve as a basis for the monetary measures of the Community.

In accordance with this prevailing practice of the EC Court of Justice in the interpretation and application of the principles, the EC Council's power in relation to economic policy and adequate measures under Article 103 may not be extended to monetary policy.

Article 105 (1) requires the national governments of the EC to secure co-operation between their central banks and co-ordination of economic policies. Article 107 makes exchange rate parities a national responsibility, although exchange-rate policies are to be treated as a matter of common interest (Article 107, (1)). Consultation is obligatory in the event of intended changes to the exchange rate.

The only institutional basis in the monetary field which is specifically mentioned in the EC Treaty is the Monetary Committee (Article 105(2)). The aim of this Committee is to co-ordinate monetary policies.

The Single European Act confirms that monetary policy generally remains a national responsibility whilst further developments in economic and monetary policy are dependent on formal amendments pursuant to Article 102a of the EC Treaty. The Treaty also introduces a new perspective which addresses the following:

- economic and monetary union as a target;
and
- co-operation in order to secure the convergence of economic and monetary policies.

The above is still the basis for the European Monetary System (EMS). As a matter of fact, it had been developed pragmatically and independently of the EC institutions, as an answer to the demands of changing economic needs. Thus, the facilitation of cross-border financial relations and the attempt to keep currencies stable may

be seen as the targets of monetary competition and monetary integration.

These targets are actually considerably older than the Community. Historically, the forerunner was the European Payments Union (EPU), which was established in 1950 as an intergovernmental organisation with law-making and executive enactment powers. Its laws and enactments were addressed to member states. The EPU itself was a type of clearing house which facilitated the collective settlement of pecuniary claims between creditors and debtors in different currency areas. The result was that:

"by the end of the 1958 the EPU mechanism had made all Western European currencies transferable between themselves...Conditions were created which enabled most of the OEEC countries to extend...the intra-European transferability of their currencies to their external convertibility with the dollar and then to replace the EPU...by the application of the Articles of Agreement of the International Monetary Fund⁴."

It was the Bretton Woods system which had secured the convertibility of all currencies by means of their fixed parity to the US\$ (or gold), and which was maintained by the interventions of national monetary authorities. By contrast, the EC Treaty did not include any specific monetary targets. Following the collapse of the world monetary order in 1971-1973, a group of European countries established monetary co-operation between European countries, known as the "snake". The "snake" was based on the Basle agreement of participating governments and central banks. It established a 2.25% floating band which was maintained by interventions and supported by drawing on a fund for monetary co-operation. However, the system required any settlement to be on a monthly basis.

Following the enforcement of the new version of Article IV of the IMF Articles of Agreement on 1 April 1978, the European Monetary System (in effect from 13 March 1979) was set up. The EMS has always been considered as an establishment of the European Community. However, although the European Court of Justice had stated that the target of free cross-border relations required fixed exchange rates, its basis in Community law was unclear for many years.

Established in conformity with Article IV (2b) (ii) of the IMF Articles of Agreement, this hybrid legal basis required acts by the European Council, the EC Council, the EC Commission, and the Board of Governors of the European Monetary Co-operation Fund (EMCF). It also needed an agreement between the central banks of the EC members. The prevailing opinion is that any agreement

between the central banks would be subject to public international law, not Community law. On the other hand, the French Conseil Constitutionnel⁵ has stated that the Council Decision⁶ on the establishment of the EMS was merely a political declaration.

From an economic perspective, the EMS is a regional system which uses fixed exchange rates and which comprises the member states of the EC, with the exception of Greece and Portugal which are not participating in the exchange rate mechanism as yet. The system is maintained by means of three instruments, viz.

- the European Currency Unit (ECU),
- an exchange-rate mechanism; and
- a credit mechanism.

The ECU⁷ is defined as a basket comprising determined amounts of the currency of the member states in the Community. The name is actually somewhat misleading because it is not a currency. Further, there are only three categories of legal holders, viz.

- member central banks,
- the European Monetary Co-operation Fund (EMCF), and
- other central banks and international monetary institutions.

The legal functions of the ECU are restricted. It acts as a denominator for the exchange rate mechanism; it is a basis for a divergence indicator (viz an indicator which shows the deviation of a currency's market rate from its ECU-defined central rate); it is a unit of account in the intervention and credit mechanism; and it is a means of settlement between the monetary authorities in the EC.

Apart from these legally defined functions, the ECU serves as a unit of account in private business operations, eg in the increasing market of ECU bonds⁸. This function, albeit encouraged by the EC Commission, is kept strictly outside the EMS. As long as a centralised monetary authority does not exist, any unification of the official and the private ECU circuits would result in the undermining of the individual national central banks' money market instruments. Therefore, claims within the private ECU clearing system consisting of the BIS⁹, the ECU Banking Association and the SWIFT system have to be settled on a daily basis. Otherwise, the BIS would take

⁵ Conseil Constitutionnel Decision of 29 December, 1978.

⁶ 5 December, 1978.

⁷ Gold, A New Universal and a New Regional Monetary Asset: SDR and ECU, *Osterreichische Zeitschrift für Öffentliches Recht und Völkerrecht* 1983, pp. 117; Gramlich, *The European Currency Unit - A Foreign Currency*, *Rivista di diritto valutario e di economia internazionale* 1988, pp. 305; Hahn, *The European Currency Unit (ECU) and the Special Drawing Right (SDR): Legal Aspects of a Worldwide and a Regional Basket Unit* (Sarcevic/Volken, ed., *International Contracts and Payments*, 1992, pp. 1).

⁸ Half of which has been issued by public entities.

⁹ Giovanoli, *The Role of the Bank for International Settlement in International Monetary Cooperation and its Task Relating to the European Currency Unit*, *International Lawyer* 1989, pp. 841.

over the role of lender of last resort, ie the role of a European central bank without a related legal basis.

The exchange-rate mechanism consists of the "monetary grid" which gives each member currency a fixed value vis-a-vis the other members, usually measured by its parity against the ECU. The value, or rather a band of value, is maintained by interventions of the national central banks.

The credit mechanism may be divided into two categories of facilities: viz one category which is used for the operation of the exchange rate mechanism and another which is related to balance of payments deficits. The very short-term facility of not more than 2.5 months is restricted to intervention purposes. In case of intervention in relation to the official limit, drawings may be made without the consent of the central bank of the currency of intervention. In other cases, the related central bank may express its disapproval. The short-term facility of not more than 3 months may include balance of payments financing. The medium-term facility, with a duration of 2-5 years, is based on Article 108 of the EC Treaty. However, none of these facilities may be used for purposes of economic and structural policy, eg social cohesion.

The EMS institutions are made up of the Monetary Committee¹⁰, the Committee of Governors of the central banks of the member states of the EC¹¹, the EMCF and the BIS.

The Monetary Committee is the only one which is directly connected to EC primary law (Article 105 (2) of the EC Treaty). But it has an advisory status only.

The Committee of Governors of the central banks of the member states of the European Community was set up by a Council decision on 8 May 1964 and is not subject to the instructions of any Community organ. Its purposes are to foster co-operation between the EC central banks and co-ordinating more closely the monetary policies of the EC members.

The European Monetary Co-operation Fund has a technical function only: viz settlement of borrowing and lending which is related to interventions by the exchange-rate mechanism. Apart from its function in the private ECU clearing system, BIS serves as the agent of the EMCF.

None of these institutions is established with a decision-making power. This is because legally, both exchange rates and monetary policy are reserved for national discretion. Therefore, realignments (viz central rate changes) are fully within the various governments' competence. The decision making process is

¹⁰ At the beginning of the third stage, it will be replaced by the Economic and Financial Committee.

¹¹ With the beginning of stage 2, it will be dissolved (Art. 109f(1) of the EC Treaty).

reserved for the various central banks and the EC Commission and it operates on a unanimity basis.

Current operations (viz interventions related to borrowings or lendings) aimed at securing the exchange rates set by the governments, fall within the national central banks' responsibility. So far, the monetary environment of "Europe 1992" still prevails and is meant to result in the free movement of capital and financial services throughout what was once twelve national markets. However, the Single European Act - the legal basis for the environment stage - has also provided a mandate "for the further development of the Community" in the monetary field. This finally resulted in the well-known Maastricht Treaty on European Union of 7 February 1992.

4. On the way to Monetary Union¹²

A few milestones on the way to Maastricht should be mentioned. Following the "Report on Economic and Monetary Union in the European Community" which was submitted to the European Council on 17 April 1989 by the so-called Delors Committee, the Council set in motion two intergovernmental conferences: viz one on political union and the other on economic and monetary union. Various drafts in 1990/1991 finally eventuated in the Maastricht framework.

4.1 The European Union¹³

The expression, "the European Union", may sound more far-reaching than it actually is. As a matter of fact, this political and economic union is no more than a strengthening of related co-operation, as competence regarding economic policy still remains within national responsibility. The new version of Article 103 of the EC Treaty related to economic policies provides co-ordination within the Council. It is this body which formulates broad guidelines, adopts recommendations and performs overall assessment and monitoring.

In contrast, the related competence of the future monetary union (new Article 73 of the EC Treaty) will be transferred to the Community. The future institutional system to be created, made up of the European System of Central Banks (ESCB) and the European Central Bank (ECB), will therefore exercise the Community's competence under Community law¹⁴. Moreover, a strict timetable of implementation will apply.

¹² Hahn, *The European Economic Community as a Currency union: From the European Monetary System towards a European Monetary Authority*, *Rivista di diritto valutario e di economia internazionale* 1989, pp. 728; Tietmeyer, *EMU - Prospects and Perspectives*, Deutsche Bundesbank, Press Excerpts no. 24, 25/3/1992, pp. 1.

¹³ Treaty on European Union, EC OJ 1992, C 224/1; Bleckmann, *Der Vertrag über die Europäische Union*, *Deutsches Verwaltungsblatt* 1992, pp. 335; Hade, *Die Europäische Wirtschaftsrecht* 1992, pp. 171; Hahn, *Der Vertrag von Maastricht als völkerrechtliche Übereinkunft und Verfassung*, Baden - Baden 1992.

¹⁴ National competences will be restricted to the field where only specific countries are concerned, eg the French Franc Zone.

The European Union does not create a new supranational body nor a federal state¹⁵. In the documents, the clear intention of the parties was to leave alone the basic structure of the Community¹⁶. This is the case although a federal organisation will be created in the monetary field. On the other hand, "...a monetary union presupposes a constitutional organisation which is or approximates that of a single (federal) state"¹⁷. Thus, a minority opinion holds that through the transfer of monetary competence, the EC becomes a state, but which is limited to the monetary field¹⁸.

4.2 Status of states in the Monetary Union

An overview of the timetable of implementation is necessary before an outline of the quality of the institutional structures is given. The basic idea was to set in motion a unified process in the sense that the decision to install the first stage represented a decision to install the project in its entirety. However, the strict timetable will only apply to the Monetary Union, and not to that part of the Treaty which is related to economic policy and the political union.

The start of stage 1 on 1 July 1990 had been fixed nearly three years prior to the Maastricht Treaty by the Madrid European Council resolution of 27 July 1989. The program for the other stages, however, are defined in the Maastricht Treaty.

The coincidence of the starting point with the date of the enforcement of the liberalisation of capital movements demonstrates a close connection between the Monetary Union and the financial services sector of the Single European Market. This connection underpins the contractual obligation to implement the related liberalisation of such movements. Some issues concerning stage 1 include the following: (i) the adaptation of national regulations on the drawings of central bank credits by the public sector to the restrictions that are defined in the Maastricht Treaty; and (ii) the setting up of programs to secure future convergence in the monetary field, particularly regarding price stability and orderly public finances.

Stage 2 will begin on 1 January 1994 (new Article 109e of the EC Treaty) and is restricted to the monetary field. During this period, co-operation between the national central banks is to be enhanced. There will also be the establishment of a European Monetary Institute (EMI) under new article 109f of the EC Treaty which has advisory and co-ordinating functions. However, monetary competence will remain with the original national authorities and it will not be subject to any obligatory agreement on monetary policies during this stage. Also,

¹⁵ Hahn, loc. cit (FN 13). p. 38.

¹⁶ Banque de France, Exercice 1993, Compte Rendu presente a M. ie President de la Republique au nom du Conseil General de la Banque de France par M. Jacques de Lavoisiere, Gouverneur, pp. 85.

¹⁷ Mann, *The Legal Aspect of money*, 5th ed., 1992, pp. 509.

¹⁸ Bishop, 1992 and Beyond, (The Salomon Bros., European Business Analysis November 28, 1990), pp. 1.

there will be the harmonisation of monetary jurisdiction pursuant to new Article 108 of the EC Treaty and in accordance with stage 3. An obligation to avoid excessive government deficits is provided for under new Article 109e (4). The liberalization of capital movements will be cemented. The basic regulations of the Capital Movements Directive¹⁹ will therefore obtain an immediate normative basis in primary Community law (new Article 73g (2) of the EC Treaty). The freedom of capital movements and payments is to be combined in a new chapter of the EC Treaty. This related liberalisation does not stop with the prohibition of all restrictions on the movement of capital and on payments between member states (Article 73b of the EC Treaty).

The aim is "...to achieve the objective of free movement of capital between Member States and third states to the greatest extent possible..." (Article 73c of the EC Treaty). In this respect, the state on 31 December 1993 will be frozen in that new measures on the movement of capital to or from third countries can only be introduced by the Council, where "unanimity shall be required for measures...which constitute a step back in Community law as regards the liberalization of the movement of capital to or from third states" (new Article 73c of the EC Treaty). In the context of the basic prohibition of all restrictions on capital movements and payments (new Article 73b of the EC Treaty), national competence in this field is restricted to safeguard measures on capital movements and payments to or from third states (new Article 73g of the EC Treaty). It is therefore clear that third countries will enjoy the same liberalisation as member states did before the Capital Movements Directive came into force.

With the start of phase 3, the quantum leap from co-operation and co-ordination to the Community-wide central direction of monetary policy by an independent institution, devoted exclusively to monetary stability, will take place. This means the establishment of the European Central Bank (ECB) and the European System of Central Banks (ESCB), and the introduction of a single European currency, the ECU²⁰ (new Article 3a, 109g, 109l of the EC Treaty). The start of stage 3 is conditional upon certain requirements being met which are mainly related to monetary stability.

Monetary stability is defined as part of "necessary conditions for the adoption of a single currency" (Article 109j of the EC Treaty).

The formal proceedings of stage 3 may start in 1996 (new Article 109j of the EC Treaty). If a qualifying majority of the European Council states that the majority of members meets the above-mentioned criteria, stage 3 may enter into force Community-wide. Should this not be the case, primary law (Article 109e(1) of the EC Treaty) requires that stage 3 will irrevocably start on 1 January

¹⁹ EC OJ 1988, L 178

²⁰ Hahn, A Single Currency and a Single Central Bank? Michigan Journal of International Law 1990, pp. 121.

1999 but only in relation to those members which meet the convergence criteria according to the Council's resolution (new Article 109j(4) of the EC Treaty). As for the remaining members, the present EMS in the shape of stage 2 would continue to exist²¹.

4.3 Basic principles of the Monetary Union

The Monetary Union will comprise four principles:

1. autonomy and independence of the European Central Bank and the European system of central banks;
2. a two-tier institutional system comprising the European Central Bank and the national central banks;
3. exclusive jurisdiction of Community institutions over monetary policy; and
4. absolute precedence of price stability (new Article 105(1) of the EC Treaty; Article 2 of the ESCB Statute).

4.3.1 Principle 1 - institutional autonomy

As regards institutional autonomy, the ECB, the ESCB and the national central banks will be independent of instructions from member states and the political bodies of the Community (new Article 107 of the EC Treaty; Article 7 of the ESCB Statute). Reporting commitments are basically restricted to the annual report of the EC Council, the Commission and the Parliament, which may debate it (new Article 109(3) of the EC Treaty; Article 15.3 of the ESCB Statute). At present, all related central banks with the exception of Germany and Netherlands, and to a certain extent Italy, are subordinate to their governments.

4.3.2 Principle 2 - the two-tier system

The two-tier system (new Article 106(1) of the EC Treaty) comprises the establishment of the European Central Bank on the one hand and the continued existence of national banks on the other hand. However, these banks will become subordinate to the ECB (see new Article 106(3) of the EC Treaty). Article 106(3) states that: "The national central banks are an integral part of the ESCB and shall act in accordance with the guidelines and instructions of the ECB". (Also see Article 14.3 of the ESCB Statute). However, in order to not undermine the autonomy of the whole system, institutional independence will be extended to the national central banks, which are secured by primary Community law (new Article 109e(3), 107, 109 of the EC Treaty).

4.3.3 Principle 3 - monetary sovereignty

Monetary sovereignty viz the power to create money, will reside with the ECB. Moreover, exclusive jurisdiction over monetary policy is to comprise money market surveillance, rule-making and decision-making, including

²¹ So-called "Member States with a derogation" (new Art. 109k of the EC Treaty).

general and individual corrective measures (new Article 108 of the EC Treaty; Article 3.4 of the ESCB Statute). The ECB has to be consulted on any proposed national or Community act in its field of competence and may submit opinions (new Article 102 of the EC Treaty; Article 25 ESCB Statute). The ECB will have the exclusive right to authorize the issue of banknotes within the Community (new Article 105 of the EC Treaty) and will regulate minimum liquidity requirements and payment systems.

In the field of prudential supervision of the financial system, however, a clear quantum leap from harmonisation to convergence is not apparent. The Council may confer upon the ECB specific tasks in this area (new Article 105(6) of the EC Treaty; Article 3.3 of the ESCB Statute), and has an obligation to "...contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system" (new Article 105(5) of the EC Treaty). But the final outcome of convergence in the field of banking supervision seems undecided.

Apart from that, the ESCB will hold and manage the official foreign reserves of the member states and conduct foreign exchange operations consistent with the provisions of Article 109 of the EC Treaty. However, the prerogatives of the EC political organs on external relations will be reserved, particularly their power to fix exchange rates. This may lead to certain target conflicts. Compared with the present situation, there is still a long way to go, because the basic means for influencing money market operations are in the hands of the national governments eg enactment and modification of the bank rate in France and in the UK.

4.3.4 Principle 4 - monetary stability

At first glance, the precedence of monetary stability seems to be established on a fairly secure basis. Following the Monetary Union, there is to be no assumption of responsibility by the Community for the public debts of member states (new Article 104b).

Community financial assistance to member states in difficulty is regulated by new Article 103a(2) of the EC Treaty. Overdraft facilities or any other type of credit facility with the ECB or with the central banks of the member states in favour of Community or national public institutions will be prohibited. Purchases of related debt instruments or any privileged access by Community or national public institution to financial institutions will also be prohibited (new Article 104 of the EC Treaty; Article 21 of the ESCB Statute).

Primary Community law (new Article 104a of the EC Treaty) sets guidelines on reasonable budget policy, the ratios of which are fixed in a Protocol annexed to the Treaty²². The limit on the annual new indebtedness of all public entities of a country is 3%, and on their overall

indebtedness the limit is 60% of the GDP. The Council may decide on sanctions against unreasonable deficits incurred by member states (new Article 104c(11) of the EC Treaty). Apart from this sanctioning authority and the provision regarding financial aid, all these regulations will be applied from the start of stage 2. This means that from 1 January 1994, a member state's credit-worthiness will determine its ability to borrow.

However, a considerable excess of public expenditure over income in many states may make the indirect financing of habitual deficits indispensable, especially when the Treaty's authorisation clauses of protective measures, in case of a Member's difficulties as regards its balance of payments, will be phased out with the start of phase 3 (new Article 109h, 10(i) of the EC Treaty). This problem is obvious when analysing the recent Edinburgh Summit.

4.4 Institutions of the Monetary Union and their functions

4.4.1 The EMI

During phase 2, the transitional period, the European Monetary Institute (EMI) will be established with legal personality under public international law (new Article 109f(2) of the EC Treaty). It will inter alia take over the former European Monetary Co-operation Fund (EMCF).

The EMI will be directed and managed by the EMI Council (new Article 109f of the EC Treaty; Article 9 of the EMI Statute). There will also be a Governor from outside the national central banks who is to be unanimously appointed by the governments (new Article 109f(1) of the EC Treaty). However, an extensive catalogue of advisory and co-ordination functions may be used to exercise considerable political power in practice (new Article 109(f) of the EC Treaty; Articles 2 and 4 of the EMI Statute).

The most important operational and technical functions of the EMI are as follows:

- taking over the functions of the European Monetary Co-operation Fund (Article 1 of the EMI Statute);
- clearing of positions resulting from interventions by national central banks;
- administering the EMS financing facilities;
- receiving monetary reserves and issuing ECUs in return;
- holding and managing foreign exchange reserves (as an agent for national central banks);
- promoting the efficiency of cross-border payments; and
- facilitating the private use of the ECU and securing the ECU clearing of ECU.

Other functions are of an advisory nature (mainly see Article 5 of the EMI Statute). They are:

- those advisory functions of the future ECB (on the basis of a 2/3 majority);
- the initiation of consultations on banking supervision (especially on the stability of financial institutions and markets);
- consulting with the EC Council and the authorities of member states prior to law-making proposals in the monetary field (from a German point of view, this would include the fixing of the discount rate); and
- developing instruments for the future ECB.

In accordance with the nature of its advisory functions, the EMI will mainly deliver opinions, make recommendations and adopt guidelines for the future ESCB, viz take measures which do not have any binding force. In contrast, within its operational functions, the EMI may make decisions which are addressed to the national central banks and which are binding upon those to whom they are addressed (Article 15 of the EMI Statute).

The EMI will be established with a budget set by the national central banks and will enjoy an independence similar to that of the future ECB. According to Article 8 of the EMI Statute, "In exercising the powers and performing the tasks and duties conferred upon them by the Treaty and this Statute, the Council of the EMI may not seek or take any instructions from Community institutions or bodies or governments of Member States".

The members of the EMI Council will act in accordance with their responsibilities. Like the future ECB, the EMI will have to supply the EC Council, the Commission and the Parliament with an annual report.

4.4.2 ESCB/ECB²³

The functions of the ESCB and the ECB will operate within its monetary jurisdiction (new Article 105 of the EC Treaty; Article 3.1 of the ESCB Statute). They are:

- defining and implementing the monetary policy of the Community;
- conducting foreign exchange operations in accordance with Article 109 of the EC Treaty;
- holding and managing the official foreign reserves of the member states; and
- promoting the smooth operation of payment systems.

Other tasks and duties will be:

- advisory functions (new Article 105(4) of the EC Treaty, Article 3.3 of the ESCB Statute);
- collection of statistical information (Article 5 of the ESCB Statute);
- contributing to the conduct of policies regarding prudent supervision of credit institutions; and
- stabilising the financial system (new

²³ Hahn, The European Central Bank, Common Market Law Review 1991, pp. 783.

Article 105(5) of the EC Treaty; Article 3.3 of the ESCB Statute).

There is a range of monetary instruments and technical functions and they are based on the ESCB Statute. Examples include:

- operations relating to customer (viz the public) accounts with the ECBH and national central banks (Article 17);
- open market and credit operations (Article 18);
- setting minimum reserves on credit institutions (Article 19);
- other instruments of monetary control, to be decided by a 2/3 majority of the ECB Governing Council (Article 20); and
- supplying facilities and regulations regarding payment systems (Article 22).

The organs of the ESCB are the Executive Board, the Governing Council, and an Extended Council (new Article 109a of the EC Treaty; Article 10-13 of the ESCB Statute). The Executive Board consists of a President and a Vice-President, both appointed unanimously by the member states on the recommendation of the EC Council and four other members. The Executive Board will mainly be responsible for the day-to-day business viz the implementation of monetary policy in accordance with the guidelines and decisions laid down by the Governing Council. The Governing Council will comprise the Executive Board and the Governors of the national central banks. It shall formulate the monetary policy of the Community, including decisions on monetary objectives, key interest rates and the supply of reserves within the ESCB.

Normally, decisions will be made on a majority basis. However, matters concerning ECB capital, transfers of monetary reserves and the distribution of profits and losses will require voting according to participation in the share capital.

The Extended Council comprises the Governors of non-participating national central banks and has a competence which is restricted to the remaining EMS.

4.5 Legal structure

The legal structure of the Monetary Union is somewhat complex and may cause certain problems relating to ranking and conflict.

On the one hand, there is a dualism in the EC Treaty and the Statutes of the ESCB/ECB and EMI, both appearing as Protocols annexed to the Treaty. As regards the ESCB Statute, only certain articles of a more technical nature may be amended following the procedure found in (new) Article 106 of the EC Treaty. These articles, subject to amendment, are found in the EC Treaty (new Article 106 of the EC Treaty). But a similar procedure is not found in the EMI Statute (see new Article 109f(1) of the EC

Treaty), which means that this Statute is subject to the unanimity rule. However, the provisions in the EC Treaty and the related Statutes which deal with institutional matters and competences of the ESCB and the EMI are similar.

On the other hand, there exists a convergence Protocol which supplies guidelines for the enforcement of stage 3 viz the Monetary Union stage. Details relating to the guidelines are still dependent on an EC Council resolution which has to be adopted unanimously. Therefore, the circumstances for the enforcement of stage 3 have yet to be finally defined and in practice, this matter is still within the responsibility and competence of the governments of member states.

Which laws apply to the ECB and the ESCB? Following the general clause viz Article 35 of the ESCB Statute, acts of the ECB including its relationship with the EC, member states and national central banks, shall be subject to the jurisdiction of the European Court of Justice. This is provided in the EC Treaty. Some of the matters dealt with include:

- actions by the ECB for the purpose of protecting their prerogatives (new Article 173 of the EC Treaty);
- proceedings in areas fully within the ECB's field of competence (new Article 175 of the EC Treaty);
- validity and interpretation of acts by the ECB (new Article 177b of the EC Treaty);
- fulfilment by national central banks of obligations under the EC Treaty and the ESCB Statute (new Article 180d of the EC Treaty); and
- regulation by the ECB (new Article 184 of the EC Treaty).

The ECB also has the right to initiate legal proceedings. However, it is unlikely that the European Court would be inclined to define guidelines for monetary and currency policy, which, following standing practice, would be reserved for politically competent organs.

There are specific rules governing competence. For example, in cases between the ECB and its debtors, creditors or other third parties, national courts shall decide, provided the European Court is incompetent (Article 35.2 of the ESCB Statute). In this regard, rules of private international law will apply, or if non-existent, will have to be created. Contractual and non-contractual responsibilities of the national central banks shall be subject to the national legal system (Article 35.3 of the ESCB Statute) and the European Court may have competence to arbitrate depending on arbitration clauses found in contracts of the ECB (Article 35.4 of the ESCB Statute).

Regarding the legal personality of the monetary institutions, the following rules apply. The EMI, the monetary institution of the second stage, will be established as a separate entity in public international

law (new Article 109f(1) of the EC Treaty; Article 14 of the ESCB Statute). Following basic principles of public international law, the extent and character of the legal entity in relation to third countries will depend on the actual activity involved rather than on the legal personality of the EMI²⁴.

Within the Monetary Union (stage 3), a separate legal personality will be accorded to the ECB (new Article 106(2) of the EC Treaty; Article 9 of the ESCB Statute) and the national central banks, but not to the ESCB. According to the EC Treaty and the Statute, the ECB will be established in the following manner:

- it will exist in member states with full personality in their national legal systems; and
- in relation to the EC Communities, member states, international organisations and third states, the ECB will have an international personality. However, this is limited, depending on the quality and extent of relations and transactions which the parties directly or indirectly apply in international law²⁵. For instance, the ECB may decide how the ESCB should be represented in international co-operations, and the ECB may participate in international monetary institutions.

5. Open questions

In spite of the fact that it is the result of a protracted negotiation process, the Maastricht Treaty leaves open some questions and includes contradictions. These were caused by compromises, rather than by hidden agendas of the parties. These problems have become evident during the implementation process, particularly in cases where economic problems exist.

5.1 Ratification

Ratification by the UK is still outstanding, although from a strictly legal point of view, referendums are only required in Denmark and Ireland. In the other countries, a parliamentary vote²⁶ is sufficient. Theoretically, the failure to ratify by one party would make the Treaty void and trigger additional negotiation between the remaining parties (Article R of the Maastricht Treaty). However, in relation to Denmark, an allowance was made to opt out of the defence force and European citizenship at the recent Edinburgh Summit²⁷. This concession might result in a second and positive referendum in that country. The Danish and British right of opting out of

²⁴ Hahn, loc. cit (FN 13), pp. 58.

²⁵ Hahn, loc. cit (FN 13) pp. 66. Also, note Art. 6 of the Statute.

²⁶ Although parliamentary approval was given, final ratification will be delayed due to pending decisions by the German Constitutional Court.

²⁷ There might be serious doubts as to whether the legal form of the concession - a "Conclusion of the Presidency" (of 22 October 1992) as opposed to an amendment to the Treaty - would be legally sound.

the Monetary Union prior to the third stage,²⁸ however, leaves a realistic possibility that the final Monetary Union may not comprise all EC members.

5.2 Convergence criteria

Even if the above formal barriers are overcome, the question remains as to how many members will meet the convergence criteria required to enforce stage 3 of the Monetary Union. An analysis of these convergence criteria, defined as "necessary conditions for the adoption of a single currency" (new Article 109j(2) of the EC Treaty) is both legally and economically complex.

But since the enforcement of the final Monetary Union hinges on it, an in-depth treatment of the subject seems necessary.

The basic details of the convergence criteria are set by primary Community law (new Article 109(1) of the EC Treaty). They are:

- a high degree of price stability, viz a rate of inflation close to that of the three best performing member states in terms of price stability;
- sustainability of the government's financial position, in accordance with new Article 104c(6) of the EC Treaty;
- observance of the normal fluctuation margins following the exchange rate mechanism of the EMS for at least two years, without devaluing against the currency of any member state;
- durability of convergence, reflected in long-term interest rate levels; and
- the development of the ECU.

These criteria are developed further in the "Protocol on the Convergence Criteria Referred to in Article 109j of the Treaty Establishing the European Community" which is annexed to the Treaty.

5.3 The principle of subsidiarity

In relation to other national competences which remain, the Edinburgh Summit points to a return to national power²⁹. This tendency may find a legal basis in the Maastricht Treaty itself. Basically, the denial of any collective assumption of one member state's debts is a key to maintaining power at national level³⁰. Moreover, with a new article 3b, the principle of subsidiarity has been introduced into the EC Treaty. Given the nature of the negotiations, the intention to set limits to the competence of the Community is obvious and this may lead

28 see the Protocol on Certain Provisions Relating to the United Kingdom of Great Britain and Northern Ireland and the Protocol on Certain Provisions Relating to Denmark. The Protocol related to Denmark had been less far-reaching, but its provisions were extended at the Edinburgh Summit (see FN 27).

29 Over 20 proposed Directives will be eliminated, but on the other hand, it was resolved to press ahead with the implementation of a couple of outstanding Directives.

30 Bishop, loc. cit (FN 29).

the European Court to interpret competences in a more restrictive manner than in the past. Furthermore, with regard to the Monetary Union, one might argue that according to the Maastricht Treaty, the national central banks will keep those of their original competences which have not been explicitly transferred to the ECB.

However, the principle of subsidiarity in Article 3b of the EC Treaty cannot be applied to the Monetary Union³¹. On the one hand, the ESCB lies within the exclusive competence of the EC. On the other hand, the principle of subsidiarity is only applied to the EC and its organs, and not to the ECB which is an independent EC institution.

5.4 Autonomy of monetary institutions

The autonomy of the ECB and the comprehensive nature of its jurisdiction in the monetary field may come under pressure with the granting to the EC Council competence to determine broad guidelines for economic and Monetary Union (Title 1 Article D of the Maastricht Treaty). The statement of F Mitterand on French television on September 1992³² is an example of an extremely extended interpretation in this direction. If his interpretation is adopted, the ECB has to apply the Council's decisions on economic policy to the monetary field. As a result, the ECB's role is merely one of execution rather than decision-making. However, this view cannot be sustained by the Maastricht Treaty which clearly states that: "The basic tasks to be carried out through the ESCB shall be: to define and implement the monetary policy of the Community..." (new Article 105(2) of the EC Treaty). Thus, it is envisaged that the annual reporting of the ECB to the Council, the Commission and the Parliament will trigger controversy and discussion.

In spite of the above, the function of the EMI in stage 2 may be subject to an extended interpretation, because limiting national competences was not explicitly excluded in the related negotiations. One basis for the influence of the EMI lies in its right to make statements prior to law making in the monetary field.

5.5 Exchange rate policy

The Council's competence to fix or to agree on exchange rates or the exchange rate system may cause some problems³³. However, the related EC competence will not be applied earlier than the third stage.

31 Art. 14.4 of the ESCB Statute says clearly that "National central banks may perform functions other than those specified in the Statute..." on their own responsibility. This means that monetary policy is reserved to the ESCB and hence is not subject to the principle of subsidiarity.

32 Deutsche Bundesbank, Press Excerpts no. 61, 9/9/1992, pp. 1.

33 A similar situation has been successfully mastered by the Deutsche Bundesbank for many years. See Gold, Exchange Rates in International Law and Organisation, Chicago/Washington DC 1988.

Article 109m of the EC Treaty provides: "Until the beginning of the third stage, each Member State shall treat its exchange rate policy as a matter of common interest. In so doing, Member States shall take account of the experience acquired in co-operation within the framework of the EMS...and shall respect existing powers in this field". In the Monetary Union, exchange rate policy will be treated as a matter for the EC political organs, and the ESCB has to conduct foreign exchange operations which are consistent with the provisions of Article 109 (new Article 105(2) of the EC Treaty). Within this framework, the Council has the following powers and functions:

- it may conclude formal agreements on the exchange rate system for the ECU in relation to non-Community currencies;
- it may adopt, adjust or abandon the central rates of the ECU within the exchange rate system;
- it may formulate general orientations for exchange rate policy;
- it shall decide the arrangements for the negotiation and conclusion of agreements concerning monetary or foreign exchange regime matters, which will be binding on EC institutions, the ECB and member states; and
- it shall decide on the position of the Community at the international level as regards issues of particular relevance to economic and monetary union.

Foreign reserve assets, as opposed to fixing exchange rates, will be treated as within the ECB's monetary jurisdiction. The national central banks will provide the ECB with foreign reserve assets up to an amount equivalent to ECU 50 billion and may hold and manage IMF reserve positions and SDRs. Moreover, operations in foreign reserve assets above a certain limit and which remain with the national central banks shall be subject to approval by the ECB (Article 30/31 of the ESCB Statute). However, national governments will remain the owners of their foreign reserve assets, subject to Article 30/31.

With regard to foreign exchange rates, it shall be on the basis of a single common currency similar to that of the EMS. Thus, competence to fix exchange rates is reliant on the EC's relationship with third countries and the "monetary grid". The internal EC exchange rate mechanism will therefore cease to exist.

5.6 Monetary sovereignty, economic policy and other principles of primary EC law

A constant matter of concern is the basic contradiction between fiscal and monetary sovereignty between the Monetary Union on the one hand and national responsibility for economic policies on the other hand. This may result in the undermining of the ECB's main target by the continued existence of national competence

in relation to economic policy. Therefore, the inter-relationship of the monetary order with other principles of primary community law should be upheld and not be neglected.

The primary objective of the ESCB shall be the maintenance of price stability. Without prejudice to the objective of this price stability, the ESCB shall support the general economic policies in the Community with a view to contributing to the achievement of the objectives of the Community as laid down in Article 2 (new Article 105(1) of the EC Treaty; Article 2 of the ESCB Statute). The priority of price stability shall extend to both monetary policy and exchange rate policy (new Article 3a(2) of the EC Treaty).

There is also the separate existence of economic policy which is based on the close co-ordination of member states' economic policies, the internal market and the definition of common objectives which are conducted in accordance with the principle of an open market economy with free competition (new Article 3a(1) of the EC Treaty). The basic guideline of this economic policy is supplied by the new definition of "magic economic polygon" in Article 2 of the EC Treaty involving the harmonious and balanced development of economic activities, sustainable and non-inflationary growth respective to the environment, a high degree of convergence of economic performance, a high level of employment and social protection, the raising of the standard of living and the quality of life, and economic and social cohesion and solidarity.

The outcome of these inter-relationships will depend on the political process, because at present, general terms of primary law requiring definition are begin defined by the political organs of the EC and member governments. Since economic policy is reserved for the member states generally, antagonism will exist between the ESCB, ECB and the national governments.

5.7 Fiscal and monetary sovereignty

A similar antagonism may arise between fiscal sovereignty, which is reserved for the national governments, and the monetary jurisdiction of the ESCB. Fiscal sovereignty is the freedom to spend and tax as a country sees fit³⁴. Within the Monetary Union, there does not exist any collective assumption of one member state's debts. In contrast, the monetary unions of Australia and Canada had to import capital during their formative periods and in Germany, financial transfer mechanisms are a substantial part of the German federal constitution. As to how the Monetary Union will perform given these experiences is yet to be seen. In Australia and Canada, such circumstances required the offer of assistance to the constituent states of the federation³⁵.

The lack of any collective budgetary guarantee connected with the budgetary discipline laid down in Article 104c of the EC Treaty and the separation of monetary policy from fiscal policy will mean that the power of the member states to borrow will exclusively depend on their credit-worthiness. Further, it is the independence of monetary jurisdiction which ensures that public debts cannot be financed by money printing. However, the EC budgetary stability which is based on Article 104 of the EC Treaty will be under permanent pressure from demands for support programs, which may be accompanied by EC budget interventions. The Protocol on Economic and Social Cohesion which is annexed to the Treaty has addressed some arguments in this area. The aims of the related Cohesion Fund, for example, are a "...greater margin of flexibility in allocating financing from the Structural Funds..." and "...willingness to modulate the levels of Community participation... with a view to avoiding excessive increases in budgetary expenditure in the less prosperous Members States". The result may well be a more or less permanent transfer of financial means to the less resourceful member states. Although such transfer cannot be based on legal principles applying to federal state structures, the ratification process of the Maastricht framework has already resulted in considerable financial aid and structural fund programs at the recent Edinburgh Summit.

6. Outlook

Although the Monetary Union is still in doubt following the Edinburgh Summit, the preceding economic development, particularly in the tumultuous early 1970s, has demonstrated that a stable monetary basis is necessary for free trading.

The present EMS and its clearing system have provided a workable basis for the minimum harmonisation of financial markets resulting in the Single European Market. But the tumultuous period of the seventies may have an effect on and jeopardise achievements, not on the legal but on the economic level. Since the Maastricht Treaty, the Italian lire and the British pound had to retreat from the exchange rate mechanism; the Spanish peseta had to be devalued twice; and another realignment seems likely, since the weakness of the French franc and the Danish crown have resulted in the loss of the competitive edge in those countries.

Given this background, the development from the EMS to the economic union as an instrument of monetary and economic policy therefore seems desirable. Moreover, although the result of Maastricht will be far reaching especially in harmonisation, further development of the economic union will inevitably result in common economic policies and avoid basic system contradictions.

This is also the case in relation to the extension of national banking supervision and a common overall supervision of financial markets and their integration.

Following a statement of the Governor of the German Bundesbank, Schlesinger, a single currency as a target by the end of this century seems rather ambitious, keeping in mind that only two or three countries have met the standards required for a Monetary Union at the moment. But reasonable alternatives do not exist³⁶. Thus, the proposed EC Summit to be held mid-1993 will have to address the underlying economic problems, particularly the current pressure on the EMS and the related interest-rates, the problems related to German re-unification, the permanent recession in the UK, and the massive government debt in Italy.

Finally, it is noteworthy that at the beginning of 1993, the Single Market came into force without any resolution on two issues viz (a) the location of the EMI, necessary for stage 2 of the Union; and (b) the formation of a central stock exchange.

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³⁶

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