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## *The new EU monetary and fiscal policy: an international discussion*

Jens-Hinrich Binder\* – Enrico Letta\*\* – Niamh Moloney\*\*\* – Giulio Tremonti\*\*\*\*

edited by

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**Q.** *The non-conventional monetary policy adopted by the European Central Bank (ECB) beginning in 2012 and the proposal of the European Commission (EC) for the Next Generation EU mark a significant loosening of the rigid regime provided by artt. 122-25 of the Treaty on the Functioning of the European Union (TFEU). Are the steps taken by the ECB and the EC only the consequences of exceptional circumstances or will they endure beyond the crisis? Do you consider these steps to be positive or negative?*

**Giulio Tremonti:** I think the current proposals are necessary but not sufficient or conclusive measures for coping with the crisis. I would flag the need to go back in history to reflect on the architecture of the European project.

When the Euro was established by means of the 1998 agreements, two statesmen masterminded the deal: Chancellor Helmut Kohl and French president Jacques Chirac. Their views reflected a political agenda born in the early 1990s (which was still supported by Chirac after 1995), at the time Germany was reunified, a phenomenon that triggered a French willingness to have a larger Euro area so that it would not be alone in a potentially unequal partnership with Germany. Achieving this political objective meant there was no space for a two-speed Europe, and Italy and others, despite their public finances not being in the same position as those of the stronger partners, were allowed to participate from the very beginning of the project. The political de-

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cision of both the German and French leadership to push for a single Europe, a single market, and a single currency approach, implied a belief that the EU would inevitably continue to move toward closer political integration and allowed the Euro to materialize as it was conceived.

Against this perspective, the pledges made under the Stability and Growth Pact seemed enough to ensure a progressive convergence of the European economies. Unfortunately, when, due to a number of recent crises, but also to the failure to create a common political architecture, Europe as a political project stalled, so did the convergence of the economies.

I think the real question here is whether or not the European partners continue to envision a political project (which cannot be reduced merely to the articles of the current TFEU). If they do, we should discuss the future, keeping in mind that TFEU is the result of a hope for a political perspective, and, by definition, should not be considered binding if that perspective is no longer relevant.

**Enrico Letta:** I would like to answer the question by going straight to the point. First, the policy is positive, and second, it was adopted because of the crisis but must become structural at the European level. What happened between May and July, and I say between May and July because I think that in the two months from May 18, the date of the Franco-German meeting that announced the recovery plan philosophy, to the approval by the European Council on July 21, in two months, the European leaders gave birth to a sort of revolution at the European level. It was revolution for many reasons, the first of which is speed. In two months, they were able to do more than the leaders during the previous crisis were able to do in four years. The previous crisis started in 2008 and the true response started in 2012, and when I say true response, I mean the establishment of the European Stability Mechanism (ESM), the new treaties for the stability of Europe, and the “whatever it takes” monetary policy of Mario Draghi. So, four years last time, two months today. So, very, very fast, and I think it was decisive. Can you imagine now waiting four years to reach a solution in 2024? I think we will all be dead before 2024.

The second point is the philosophy of the Next Generation EU, which is not based on transfers of German money to Italy or Dutch money to Spain, for example. The great idea is that we are stronger together. All together, we go to the market, we take money from the market, we take money from Apple or Facebook or Google, we take money from outside, and this money can't be framed as German money or Dutch money, or Spanish, or Italian—it is European money, and that makes the difference.

The third point is that all this money will be distributed according to the rules of solidarity. These rules of solidarity relate to needs and not only to the size of the country. For the first time the EU is addressing a crisis with social measures; that is, the Support to Mitigate Unemployment Risks in an Emergency (SURE) plan announced by the EC<sup>1</sup>, and it is not by chance that this social Europe has come about nine months, one year, after Brexit – that was the true veto from the UK. Can you imagine the negotiations surrounding Next Generation EU, the Recovery Plan, the SURE plan, with Boris Johnson at the table of the 28? This is crazy to think about. So, I think there's a big, big improvement in what the EU is doing, and this is why I say this is a revolution. I don't know if it is enough because now we have to face the second wave of the crisis.

**Niamh Moloney:** I think I will start by profoundly agreeing with President Letta. I think that it's extraordinary what has happened, and I think I will make just two very general points, and then go on to my perspective on all this as a lawyer.

First, I think the EU must be meaningful – if it's not meaningful, it has a crisis of legitimacy, and I think that in the first, very early stages of the crisis, the EU was not meaningful. We had problems with borders, with protective equipment moving across borders, and it seemed so profoundly disconnected from the experience of individuals across the EU. However, I think this extraordinary effort shows the real meaning of solidarity in a really profound sense, and it's so different from the period from 2008 to 2012 when there was a very strong push for safety and so for the home state, so in that sense, I think it's deeply meaningful for the European project.

Just a couple of brief comments looking at it as a lawyer. Yes, if you look at the scale of what's happening and you combine it with the ECB's intervention, it is certainly a significant loosening of the treaty regime, but I think that one of the great strengths of the EU's constitutional settlement is that it is deeply pragmatic, it flexes under pressure like tensile steel, and while the rule of law is fundamental to the European project, these flexible, resilient arrangements can learn under pressure. If it was a very rigid system, it would break under the pressure of change in the EU. And secondly, if one looks at the different treaty provisions over time, they have moved and flexed; the treaty rules that allow us to build institutions, for example, whether the ECB or the agencies, have developed and changed over time. And then I think, thirdly,

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<sup>1</sup> EUROPEAN COMMISSION, COM(2020) 139 final 2020/0057 (NLE).

that there is a sort of incremental legitimization that goes on – a push forward is made, there's a bit of pushback, we may be before the Court of Justice, we look at the Outright Monetary Transactions litigation<sup>2</sup>, there's this incremental loop, and then we embed the different changes.

But there's a fourth question, and I will pause a little on this one. One residual concern I have is the wider lower-for-longer interest rate environment that is related to this wider process of ECB intervention. It may be unavoidable, but it is part of the macroeconomic environment we are in right now. Specifically, it generates consumer protection challenges as two issues are combining at present as a result: the need to search for yield in a low-interest-rate environment and an increase in consumer savings. The ECB reported in the first quarter of this year a significant increase in household savings, and, at the same time, we have households looking for yield. I think we potentially have to monitor this very carefully because, along with these structural economic measures, we have, of course, the EU's push to deepen and activate capital markets, and as part of this, some elements of deregulation. So, we saw just a few days ago, the Council has adopted a dossier of new measures that are somewhat deregulatory in style. We know about the European Recovery Prospectus, which is designed to make it easier for companies to issue shares, but it's a much shorter, simpler prospectus. Will this raise investor protection issues? The second thing the Council has agreed to is deregulating aspects of the famous MiFID II, the cornerstone measure for regulating investment services. One reform in particular that I would highlight is that the Council is proposing to remove the product governance rules from bonds, from debt<sup>3</sup>. Now, maybe that's correct – product governance is certainly a costly form of regulation – but, nonetheless, requiring firms to think about the objectives of their investors, the target market to which investments should be distributed, the risks of the investments – these are very good and profoundly sensible measures. I think that once one introduces exemptions (however narrow), one creates incentives to work around the exemptions. So I have some nervousness that this combination of measures, when one places them in a wider context of loose ECB monetary policy, persistently low interest rates, a push to support the European economy, and search for yield incentives, could be troublesome: Is our regulatory system robust enough to deal with this, particularly given some signs of deregulation? In sum, I think, as lawyer, that I

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<sup>2</sup> CJEU, *Gauweiler et al v. Deutscher Bundestag*, 16 June 2015, C-62/14.

<sup>3</sup> COUNCIL OF THE EUROPEAN UNION, 2020/0152 (COD).

want to sound some notes of caution: this whole system is an ecosystem, and it all has to work together.

**Jens-Hinrich Binder:** I would also join my co-panelists in my rather positive assessment of the measures mentioned in the question. I agree with both President Letta and Niamh Moloney on the immediate assessment of what we've seen so far in the crisis, but I should offer a disclaimer. I am a professor of private law, of commercial and financial law; I am neither an expert in European law nor a financial economist. Therefore, my assessment of these matters is probably the same that you would find in the pages of the *Economist* or the *Financial Times*. From my own perspective as a teacher of financial and commercial law, what is there to add? I think of course that, working in these fields, one cannot help but develop some detailed views on what perhaps should be there, what is missing, and a lot of what I've thought about this question in preparation for this event today very much ties in with what we've just heard from Professor Moloney. I think that what is particularly noteworthy from the perspective of financial law and securities law is the huge role that has been assigned to the state as a whole, to public bodies, to governments, to the ESM, and also to the ECB. This strikes one as being in conflict with the traditional approach to constructing the EU and its predecessor institutions as a market-oriented entity in which public financial support should be the absolute exception, and where markets should take the role of distributing wealth across nations. So while I do agree with whatever has been agreed on so far at the political level, one should bear that in mind, and one should place particular emphasis on Pillar 3 of the EC's proposal entitled, "Addressing the Lessons of the Crisis." And with that in mind, I think it is worth asking, just as Professor Moloney did a few moments ago, whether what we are seeing now is exclusively the response to something that is extraordinary in terms of the public impacts of a pandemic, something that has not been there in the past and will never occur again in our lifetimes hopefully, or whether it is reflective also of structural deficiencies in the existing frameworks. I think there are reasons to assume that in addition to the immediate consequences of the pandemic on national economies, there are still some deficiencies that should not be overlooked, and that should be addressed in due course. And *if* those deficiencies are addressed, perhaps next time around when the next shock occurs, markets could become even more resilient and also more capable of absorbing such shocks or shocks of a similar nature.

So what I am thinking about here? The first thing that comes to mind is something that we are going to take up later in response to the third question –

the lack of harmonization across many fields of financial services activities in Europe. Of course we still see insufficient degrees of integration of national markets, both in the classic banking sector and in the securities markets area. Some of these deficiencies have already been addressed, but there are reasons to believe that there is still work to do. The recent initiative (not so recent anymore) of the EC to develop a European capital market and the Capital Markets Union project<sup>4</sup> is a clear-cut example of that, and another one is the initiative to integrate banking markets yet further.

So, my answer all in all would be twofold: I do believe that a need for non-conventional monetary policy and for extraordinary public financial commitments exists; we are going toward the right solution in this regard. But that need is also reflective – and that’s the first point – of shortcomings in the existing frameworks, in both the regulation of banks and regulation of EU financial markets, and these are yet to be addressed. And at the same time – my second point – this need is likely to lessen if and only if, and to the extent that, these deficiencies can be remedied, but the problem is, in my view, that there are different hurdles here. It is possible, as we have seen, to come up with non-conventional measures on the monetary side as well as on the fiscal side without changes to the Treaty. That has been possible and we have seen that; of course, some parts of that are controversial and some have been challenged by national courts and before the Court of Justice of the European Union (CJEU), but still it is possible, whereas further amendments and further improvements to what we have in place in the way of banking and financial regulation may actually require Treaty changes. And these are, as we all know, much more difficult to accomplish. As a side-note, it will be interesting to see whether the pandemic we are going through right now will actually be a trigger, a catalyst, of changes to the Treaties in this respect.

*Q. The German Constitutional Court's decision about the Public Sector Purchase Program<sup>5</sup> and the heated Italian debate on the strict conditionality provided by art. 136 and the European Stability Mechanism show the hybrid nature of a number of instruments adopted at the European level. In more general terms, both the court decision and the debate confirm that the EU institutional design of both monetary and fiscal policy is incomplete. What would be your reply to those who emphasize the limitations of the options adopted by the EU*

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<sup>4</sup> EUROPEAN COMMISSION, COM(2015) 468 final, and EUROPEAN COMMISSION, COM(2020) 590 final.

<sup>5</sup> BVerfG, Judgment of the Second Senate of 5 May 2020 - 2 BvR 859/15.



*(e.g., the strict conditionality required under art. 136(3) of TFEU for financial assistance provided by the ESM or the milder conditionality provided by the Next Generation EU proposal)? Conversely, what would be your objections to those who overlook the potential that certain steps will result in a stretching of the provisions of the EU treaties? More generally, is a step-by-step approach the only possible way to move forward, or is there room for a more robust approach based on a national sense of common purpose?*

**Giulio Tremonti:** Allow me to go back to my answer to the first question. If we look at the issues from a political perspective, then a partner country may find it acceptable that the Constitutional Court of a member state questions what has been agreed in common, and I would expect the government of that member state to come back with proposals. I may wish that other national courts would have similar rights or that we will finally agree on the supremacy of the EU court, but that is a different issue.

But if we are talking only about a “contract amongst peers” having no long-term political view, then it’s just a treaty between some countries that can be amended and interpreted according to their convenience and should be seen merely as a tool to improve relations between them. A contract stands until the interest of the parties overwhelms it. I think Europe should be more than a contract.

**Jens-Hinrich Binder:** I should start with yet another disclaimer – I’m not a constitutional law expert either and, having been invited to speak to this audience about the German Constitutional Court’s decision, of course my immediate response was: I can’t do it because I cannot possibly claim to be capable of assessing the wisdom of this particular decision and the Constitutional Court’s position more generally. So with that in mind, I won’t even try to explain the reasoning behind the judgment, parts of which I find rather incomprehensible. I am in the minority position in this regard in Germany, so let me perhaps come up with a financial lawyer’s perspective on this. One could certainly say that the European institutional design of the frameworks for both fiscal and monetary policy are incomplete, and perhaps these are so heterogeneous in their different positions that it’s difficult to reconcile them. Of course, private lawyers are used to dealing with provisions in private law contracts that are contradictory and difficult to reconcile, so it might be worth looking at this from a private law perspective. With this in mind, I think that the problems that are replicated in the German court’s decision are basically attributable to two factors.

*First*, the nature of these provisions in the European Treaties is the result of a compromise between entirely different economic and political doctrines that are not really compatible with one another, but were squeezed together in the Treaty wording as the result of the political bargaining that was going on before the creation of the Monetary Union. And *secondly*, and this is related to what I have just said, in my view at least part of the wording of the relevant provisions of the Treaties reflects the political need at the time to pacify orthodox views, including the orthodox views of German politicians concerning what should and should not be accepted as monetary and fiscal policy, especially since Germany might have refused to sign up for the Monetary Union had it become known that the ECB would act in any way different from the traditional path at least purportedly pursued by the Bundesbank since World War II. There is a historical background to this, and I think this is very important. For those who are interested in this, I recommend a book published by a German economist, Markus Brunnermeier, and others, entitled *The Euro and the Battle of Ideas*<sup>6</sup>, a great book which basically analyzes the huge political differences at the time the Monetary Union was established over what should be considered to be the proper role of monetary policy and monetary instruments in setting up public finances.

So, against this background, my reply to the question would, firstly, be a warning against taking the relevant Treaty provisions as anything more than what they are. They should *not* be taken as a clear-cut solution to all problems, and they should *not* be taken at face value, and all Member States would be well-advised to accept that, thanks to their own bargaining at the time, the relevant provisions are characterized by a huge degree of ambiguity, which should perhaps be embraced because it also provides flexibility. If you read the Constitutional Court's judgment, you see a stubborn refusal to accept that, and I think this is what is behind the judgment.

And second, given those differences in terms of policy views on what should be accepted as modern central banking, especially when it involves burden-sharing arrangements between Member States, I really doubt whether anything but a gradual step-by-step approach toward greater flexibility is politically feasible. But at the same time, given the impact of the current pandemic on national economies and national budgets, not just in the South, but also in countries like the Netherlands or, for that matter, Germany, maybe there is hope after all, and maybe at the end of the day, after the crisis, given

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<sup>6</sup> M. K. BRUNNERMEIER, H. JAMES, and J.-P. LANDAU, *The Euro and the Battle of Ideas*, Princeton, Princeton University Press, 2018.

the virus's impact, which also reduces the division between the rich North and less rich South, something like a more consistent approach, a more modern approach, could yet happen.

**Enrico Letta:** I would like to use my time to say just one thing, a point that I strongly believe. Here we are in a seminar at the university level, a little bit outside of the day-by-day political situation or day-by-day life, so it is clear we are trying to exchange ideas in very general terms. But we cannot entirely do this because of what is happening in these days all over Europe – in two hours' time, Macron will announce a new total lockdown in France and in Italy we are close to a new lockdown; Spain is the same and Angela Merkel has sent a very strong message in very strong language. So it is clear that what was part of our discussion in response to the first question is incomplete by definition because we have to consider that we will have to face a second wave. This second wave will be longer than the first. The first wave was very tough and lasted for three months. For Italy, for instance, three months of lockdown means a loss of ten percent of GDP, an enormous loss, but we were thinking that the problem was over and that we were close to a recovery, a re-launch. That is not the case, and the key point is that probably we will have to face a period of lockdown of, I hope, not more than six months, or eight months, or twelve months, in which the idea of the recovery of the economy will be far from the reality.

So, my point is that we have to consider that, in a time of emergency, we need to open a second dossier at the European level, and this is the dossier of the ESM. You mentioned it and I would like to be very clear about what I think. The ESM was part of the decisions taken in July, but the reaction of the European political system showed that these changes were not enough. They were not enough to change the image and reputation of the ESM, which was – I'm afraid – forever tarnished by the Greek situation. This is not just a discussion we are having in Italy – in Spain and in many other countries, it's the same. So, we are living a paradox in which we are fighting in the European parliament with Visegrad countries, with the Netherlands, with the markets, to build up a new basket of €750 billion. This money, as I said at the beginning, is not there, so we have to build it, and we need time to do so, but we don't have time. So my point is that this basket full of money, the money of all of the European countries, around €415 billion, is with the ESM in Luxembourg. The money is there, and it is crazy to keep this money in a corner in this period for political reasons. So, my point is that (and I know that for a webinar this is more of a political statement) it is impossible to face the second wave

without solving the problem of how to access this money and use it immediately. I'm sure it is very complicated in legal terms, and I'm sure that Profs. Moloney and Binder will identify a lot of legal obstacles to doing what I am suggesting, but I think that it is crucial to link the ESM to the Commission, maybe to close the ESM as an intergovernmental institution, to communitarize the ESM, and to transform the ESM within the Commission, using the Commission's method – the communitarian method – under the scrutiny of the European Parliament, to create a new fund, a solidarity fund with this €415 billion, and to use it immediately without conditionality and in terms of grants. I am not saying that because I am Italian. It is rather a problem of how to save the European project, because I am afraid we will not be able to wait until the end of next year; it is not just Italy – it is the same for Belgium, for Ireland, for Spain, for France, even for Germany, I think. So, we have to invent something, and we have to be creative and the only one thing I see is what I have suggested.

**Niamh Moloney:** I would like to add to these two distinguished contributions just a couple of observations. I think first of all, and I will go very carefully here because Prof. Binder is a great German expert, but I think that there is almost a kind of premium that gets attached to the German Constitutional Court whenever it speaks to a European issue. We have these profound rulings like *Brunner*<sup>7</sup> and *Solange I and II*<sup>8</sup> – they sort of carry an aura, a kind of special quality that gets attached to the German Constitutional Court very often.

I think my thoughts are very much in the same direction as President Letta here about how the law works in extraordinary times. I am Irish and the Irish government is spending €18 billion over the next twelve months, extraordinary for the size of our economy, on getting the economy through Covid – it is just throwing money at this situation, and I think politically there's a huge recognition that this is absolutely necessary. But of course in Ireland, politicians are not facing treaty restrictions around that, so one has to think about the fact that, if this is a European problem, there's a sort of disconnect about what can happen quickly at the national level and then these complex, perhaps esoteric restrictions that apply to this urgent need to address a huge economic difficulty for the EU. But legal solutions can be found. If we think back to 2012 and the founding of the ESM, there was a very clever workaround there, as President Letta just mentioned, which was the intergovernmental treaty, so

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<sup>7</sup> BVerfGE 89, 155.

<sup>8</sup> Respectively, BVerfGE 37, 271, and BVerfGE 73, 339.

law was used to find a fix. I think in these highly pressurized environments, there will be a legal way through that – the single resolution mechanism, extraordinarily complex to set up, but it was set up. How do we legitimize these fixes? I would like to go in the direction of President Letta as well in saying that there are checks and balances across the whole European system. We have treaty constraints, yes, and I profoundly agree with Prof. Binder that these are not science, they're not received truth. They are the outcomes of deeply complex and negotiated political settlements and debates about the role of the economy and the role of monetary policy, so one has to regard them in that sense, and if they are overstepped or there's a perception they are overstepped in times of crisis, there are so many other mechanisms of accountability and of legitimacy, and clearly the European Parliament (EP) is a hugely important part of that. We've seen, for example, since the banking union was set up a number of years ago, that the EP has increasingly been bringing the ECB to account; you can see that in all of the different hearings and so on. We also see the national courts, here the German Constitutional Court, the national parliaments, acting as checks and balances in all of this, the CJEU reviewing this, so I think that we should see all of this as a sort of ecosystem, all of whose parts operate together to ultimately provide a political check. I think we have to remember what it is the treaties do – the treaties put in place a rule-of-law check on the European project, but ultimately that has to be reflective of our political situation at any given time. I think here I go to Prof. Binder's point that there is this incremental sense that you push and move on the treaties, usually in response to crisis, and then there is a kind of ecosystem around that which acts as a check and balance. I think it would take an extraordinarily brave CJEU to unravel any of the current measures, and I think that's probably right – that's where legitimacy comes in.

*Q. The EU policy options in the financial sector mark a trend towards centralized supervision and concentration in the banking sector, but are much more moderate for capital markets, which are still significantly fragmented. How would you explain such a dichotomy? What consequences might Brexit have with respect to this two-speed integration process?*

**Giulio Tremonti:** The Euro is the common currency for very different economies that feature substantive differences in fiscal as well as macroeconomic performance. There is no single treasury. The role of the ECB is confined to a very narrow task of ensuring price stability and the overall stability of the system.

When the sovereign debt crisis exploded, it was clearly the consequence of the weakness of the financial system and of the fact that there was (and there still is) a close correlation amongst banking risks (the banks had to be saved by the member states after 2008) and sovereign risk.

All of the reforms proposed in recent years, starting from the creation of the SSM, were aimed at disconnecting public risk from banking/financial sector risk. Unfortunately the reforms were never credibly implemented, which was basically the consequence of uncertainty about the long-term political prospects for the European Union.

The “Trojka” approach does not fit with a political perspective, as it implies that creditors would only commit to just enough solidarity to keep countries afloat, and only in exchange for serious commitments to significant debt/deficit reduction measures and spending controls. In some sense, there are still no long-term political prospects, which means that creditors remain suspicious and investments do not materialize. This may be part of the explanation for current liquidity excesses not resulting in inflation.

I would rather push for a new political deal, aimed at designing a new Europe by means of a clear step-by-step path. A message to the markets that such a deal was in the works would certainly have a positive effect on the national economies, attracting investments and promoting growth, which, ultimately, would make the politicians’ jobs easier.

**Niamh Moloney:** It is strange that we now have this hugely centralized supervision of the banking system – which of course puts Europe in a pretty strong position to manage the next year with respect to nonperforming loans, credit difficulties, and so on – that there is now this rather sophisticated system for handling that process at the European level (and at the same time, we’re continually hearing from the European Council, from the EC, that alongside the public interventions, and of course Prof. Binder spoke about the role of the state, we have to have market-based interventions given the scale of the investment needed for the European economy), but we have nothing like this supervisory and regulatory superstructure around the capital markets.

I was reflecting on this – I suppose there are so many reasons: firstly, there’s the fact that in banking it was driven by a risk mutualization problem under acute conditions of crisis, which pushed us into the banking union model, and I think, secondly, even if one is philosophically supportive of centralized or greater European supervision in the capital markets, you come up against really big operational problems. If you think about the capital markets in the EU, you’re looking at infrastructure, central counterparties, securities

depositories, asset managers, private equity, investment firms, etc. It's a huge profile of actors that you have to somehow manage into a system, whereas in banking union, we have 130 or so major systemic banks that are within the Single Supervisory Mechanism. So, there is a rather boring and technical operational challenge that lies behind this. And then thirdly, there is a supervisory challenge. We know that a lot of banking supervision is heavily data-intensive; it's about stress-testing, it is about capital, it is about liquidity, it is about constantly crunching data pertinent to the resilience of banks, but the capital markets piece, and here I go back to my first set of comments, is messy. It is conduct, it is fraud, it is insider dealing, it is consumer protection, it is tied up with enforcement, it is tied up with national legal systems, it is tied to cultural approaches to the financial markets, and it is very hard to manage all of that at a centralized level. And then I suppose a final issue is, as Prof. Binder mentioned earlier, the reality of current fragmentation. We still have very deep fragmentation across capital markets in the EU, even though we have pockets of specialization.

And going to Brexit, as an Irish academic working at an English university, this topic is unavoidable, and it becomes more and more challenging as we get close to January 1. But it is profoundly important; it has to be. I think the impact of Brexit goes in two directions: first of all the market impact, and secondly, the political impact. I think we're now beginning to see the supertanker moving, the business slowly, slowly, but inexorably, in my view, beginning to drift away from the UK. We have seen companies moving to the EU, but there is not the creation of an immediate market superstructure in competition with the City – business is fragmenting across the EU. If then there are these centers of specialization, this becomes somewhat challenging for centralized supervision, except that we always have the specter of competition, of regulatory arbitrage, of races to the bottom, of fragmentation, so in some respects there is a very powerful counterargument for centralized supervision. The other point to be made with respect to the market impact is that Brexit is, without doubt, a moment for enhancing the EU's capital market capacity. As the UK retreats, we need a deep look inward to see if we have the capacity to support the funding and risk management for the EU market that the City has provided. And then there is the political economy impact – it's an absolute reality that the UK was a long-standing hostile voice to any form of supervisory centralization of any kind. So Brexit clearly changes the political dynamic; it allows the discussion to happen, where it was almost impossible before. My sense is that with the political space changing, it at least allows a freer discussion of different models, the pathway, the journey, in a way that was extremely difficult when



Britain was holding a notional veto. As against that, it doesn't need to follow that all the member states are on board for a move toward a more centralized structure.

I was interested to see that, at the end of September, the Commission produced its new capital markets action plan, and if I can quote, it said, "gradual progression toward more integrated capital markets supervision will be indispensable," so there's one word and one phrase that are important: "indispensable" – there's a recognition this is an endpoint – and "gradual progression." So I think there's a sense of an incremental movement in that direction. But in light of these huge, powerful challenges – structural, fiscal, monetary – to get the EU through the next two to five years, I wonder if serious thought about supervisory infrastructure will be a casualty of that, even though, as Prof. Binder points out, it all goes hand in hand – you need strong capital markets and strong supervision allied to the role of the state.

**Jens-Hinrich Binder:** I think I very much agree with both of Prof. Moloney's assessments. First, the current situation with regard to capital markets integration is a mess, and second, we urgently need to change that because we need to activate the European capital markets as a platform for the reconstruction of the European economies post-crisis, so I'm fully in line with that.

I think that, especially because this is so important, it is worth looking at the reasons why differences in the European legal framework for the regulation of banks proper, on the one hand, and the development of financial markets regulation on the other, have emerged over time. I think that one of the most important aspects in this regard is the different real-world background to the regulatory initiatives in both fields: European banking regulation, including at the European level, traditionally had the role that any regulation or any state or supranational environment had to play – European banking regulation can be perceived as a reaction to problems in the markets, including the market in traditional bank services such as deposit-taking and the provision of bank credit and payment services, which existed across all European countries, both on the continent and in the UK, even prior to the first European legal instruments. By contrast, the situation with regard to securities markets was entirely different from the start, at least in my perception, but of course Prof. Moloney is the expert on this. Securities regulation in Europe always had to play a twofold role: first, to create the very market in many places that it would then regulate in the second place. European securities market regulation was not just about regulating *existing* market practices and existing market developments, but first creating the very market for securities services that it was then to regulate, and that is of course attributable to the fact that in conti-



mental Europe, bank financing played a much more important role for many firms than market-based funding. So, we have an entirely different situation here, and I think it's important to bear that in mind.

There are a number of residual problems that have not yet been mentioned and have not yet been addressed at the European level, and I think the current situation really draws our attention to that fact. Let me just mention some of them: further integration requires not just harmonization of securities laws, but other kinds of harmonization, including in private law, and that again includes the applicable contract law that governs the relationship between intermediaries and their customers. Further harmonization in the following areas is also needed: in company law, as far as providing capital to firms is concerned; in accounting rules and auditing practices, something we in Germany are coming to love as a result of the Wirecard scandal; and finally, harmonization in liability rules in all of these different fields. As long as there is no harmonization in these fields, further integration of securities markets is very difficult to accomplish. Then there is the institutional side, in terms of the capacity of supervisory authorities and also the capacity of national courts to act as enforcers, as well as institutions that can help with the private enforcement of securities laws. So, there are plenty of problems on the table, and I think that this is what really requires immediate action at the European level.

And then with respect to Brexit, I don't think that Brexit as such will remove any of these residual problems. It will certainly play no role at all in promoting further harmonization of private laws across Europe. What it could change, though, is to help trigger a shift of business from the City of London to places like Dublin, Amsterdam, Luxembourg, Paris, or Frankfurt, and that in turn may help create genuinely European markets, which then in turn will require regulatory approaches like we saw in the field of banking decades ago. We might eventually be able to catch up thanks to this shift in business, but this remains to be seen.

**Enrico Letta:** I think there is a great opportunity first of all to complete the Banking Union, which has not yet been completed, and there is also a great opportunity to complete the Capital Markets Union. I strongly believe that without these two achievements, it would be impossible to have a successful economic and monetary union because it is clear that there is an asymmetry between the "M" and the "E" – the "M" is very big and the "E" is still very small. I think that with respect to the two issues you raise, and I can't agree more with Prof. Moloney and Prof. Binder, it is necessary to keep in mind that the "gradual progression" referred to in the statement Prof. Moloney appropriately quoted from the EC, is not the correct way to apply what is needed for

many reasons, including the urgency of the situation and also the competition that Brexit will create in the field of markets. I think a fully integrated EU capital market would result in a lot of important advantages – it would help improve the EU’s leadership in global financial markets and it is crucial for a Commission that has decided to take a geopolitical approach, the approach of a world leader. It is crucial to make it easier to set up companies and to make companies more visible, and I think that a fully integrated EU capital market also needs to be able to embrace new technologies for the purpose of improving the efficiency of transactions. This is another crucial point that is maybe related to this period of digitalization that we are all experiencing. And there are many other issues related to the completion of the Capital Markets Union.

I strongly think that this must be considered to be one of the main missions of the European legislature. This was not the case for the previous legislature, maybe because of all of the mess around Brexit, but now Brexit is here, and I think that Brexit has to be thought of as another push for the capital markets in the Euro area and to the EU leaders. I will complete my thoughts on Brexit by stating that at the end of the day, Brexit is a reality and we should consider it to be an opportunity. I was among those crying because of Brexit, but now it’s a reality. The EU has more cohesion at the European Council level, the level that I experienced, and there are many points on which Brexit can be a big boost. I will mention another one that for me is another crucial mission for this legislature, and that is tax harmonization. You know very well that because of UK vetoes, we never achieved any tax harmonization, and we know very well that during this period of the crisis, it’s incomprehensible for the people to see that we are in the same Euro area but that there are so many fiscal havens. I think it is inconceivable to continue like that. It is very important to give entrepreneurs the opportunity to say that being in the same Euro area gives me the benefits of harmonization, a simplification of procedures, of tax procedures. That is not the case today – it is a mess today if you work in multiple countries in the Euro area. So I think this third point about harmonization, combined with the banking union and the capital markets union, is for me the other key mission. So you correctly included this finance topic as part of our conversation – it is just as crucial as the other topics that we have discussed. I think this is an issue about how to be competitive at the global level and how to take advantage of being united in the Euro area at the EU level.

If I may ask a question to Prof. Binder, I would be very pleased to receive a further explanation, not about the legal terms of the Constitutional Court’s statement, but on the mood in Germany on these topics. It seemed to me that it was a sort of an atomic bomb at the very beginning, in the first days, but then

it was marginalized in a corner. For me and for us it might be very interesting to understand what the role of this statement is in the political debate in Germany. Don't you think that the position Merkel adopted, without saying so a clear way, is that we don't want to apply the statements of the Court, and that, at the end of the day, Merkel took a completely different path from the Court, saying clearly to the rest of Europe, "Germany's position is my position. It is not the position of the Court." I want to know, I repeat, not in legal terms, but just in terms of the feeling of both the political and legal debate in Germany – what is the situation right now?

**Jens-Hinrich Binder:** That is a huge question and I guess there are, if not hundreds of answers to that, at least a couple of dozen. Let me perhaps start with your last remark, Chancellor Merkel's explanation to the rest of Europe that Germany's position is her position, not the Court's position. I think that is a very fair assessment, and it aptly captures also the real, the de facto, outcome of all of this. Right now what we've seen is the ECB handing over a couple of documents no one has yet seen to the Deutscher Bundestag, mediated by the Bundesbank, which by the way happened to be much closer to the Constitutional Court's position than the ECB's position. Within Bundesbank, which is a fairly conservative institution, you have lots of supporters of a more restrictive approach to defining monetary policy in the 21st century than you have in the ECB. But still, the end result is basically that we see this bomb explode with no collateral damage done whatsoever, other than perhaps damage to the reputation of the Constitutional Court, which in conservative circles, including large parts of the German constitutional law community, is considerable. For some reason, the expectation among those conservative circles that were also behind the constitutional complaints on which the decision was based, was that at the end of the day the Constitutional Court, given all of its previous rhetoric in the OMT case and in other judgments, would be the final custodian not just of German constitutional values, but also of what some perceive to be core values, or what should be the core values, of European integration in terms of monetary and fiscal policy. So, the perception was that the Constitutional Court would protect us all; this was the hope of many, and it was at the same time feared by others who are more progressive, more pro-European, more internationalist when it comes to defining how a modern central bank in the 21st century should react to crises. That was the general background – there was not one single view; there were a couple of views, and there was a clear-cut division, but at the same time, everybody knew that the Constitutional Court had, prior to the judgment, in other judgments, drawn red

lines that should never be crossed, or else it would be engaging in a substantive review of European policies.

I think that many observers, including some in conservative constitutional law circles, were of the opinion that the constitutional complaints made in the case were futile, because at the end of the day, the Constitutional Court would act as it had always done in the past – redefining, recalibrating the red lines, but at the same time holding that the red lines in this particular case actually had not been crossed. That of course didn't happen, so the outcome was a huge surprise, both to the supporters of a more conservative stance with respect to monetary policy, and actually, in my view, to the complainants themselves, because they could not have reasonably expected the Constitutional Court to go as far as it now has. That's the general picture. I've seen the end result in Germany, and it's like a bit of a hangover after a party characterized by an escalation after lots of alcohol. Everybody realizes now that nothing really much has happened. The Bundesbank has *not* stepped forward to support the ECB, the government was *not* forced to do anything at all, there has been no meaningful change to the Public Sector Purchase Program or to other programs, and I think people want to forget it. The landscape is in ruins, and everybody is trying to get over it, something we Germans are particularly used to especially after 1945. Thanks to the pandemic, this has dropped out of public attention, but the complainants in the case have now launched a second action to enforce the judgment, so there is an action pending asking the Constitutional Court to actually enforce the judgment. It's anybody's guess how that might look, but I don't really expect much from it, even though Judge Huber, who was the main drafter of the judgment, has already said in newspaper interviews – something which is perhaps somewhat strange for a Constitutional Court judge to do – that he will actually review whether the judgment has been complied with. I don't know – my expectation is that given all this mess, and given the fact that at the end of the day nothing has much changed, the Constitutional Court will be rather reluctant to go any further, but again, I'm not a constitutional lawyer, and it remains to be seen what will happen.

*Q. The basic reason underlying the opposition to making use of ESM is conditionality. Art. 136 TFEU is pretty clear in providing that the granting of any required financial assistance shall be made subject to strict conditionality. How is it thinkable to use ESM without any conditionality?*

**Enrico Letta:** The question hits on the key point, which is related to two issues. The first is related to what Prof. Moloney mentioned when she made a

reference to what happened at the creation of ESM, which, as we all remember, was accomplished apart from the treaties because of the UK and Czech Republic vetoes. We were obliged to negotiate another treaty, a side treaty, for ESM. I make this point because it demonstrates that European leaders know how to deal with emergency situations. They know how to use all the legal shortcuts to find a legal solution. We did it eight years ago, and that was the beginning of the solution. Your reference to art. 136 is very important and my answer is that in reality this article has already been cancelled de facto because when they decided to allow the use of ESM without conditionality for health-related equipment, this was, at the end of the day, a sort of overcoming of article 136 de facto. The key problem is the fact that ESM's "brand," in everything related to the Greek situation, is an obstacle that is too high, is higher than we expected. This is true not only in Italy, but also in many other European countries, and this why I have recently begun saying – and I know it is a sort of blasphemy because I'm making a very strong proposal; today it seems like a crazy proposal – that when the second wave becomes bloody, and when the economy, because of the second wave, is under attack in one month's time, I think it will be necessary to create or invent something, and the only money that is available today is the €415 billion in Luxembourg at the ESM's disposal, and it is crazy not to use it.

In Europe, de facto situations are sometimes more important than legal constraints. I say that not only because of the ESM story, the way in which the ESM was created, but also for another reason. The ESM has had to address two cases – one a situation involving a program for Spain's banking system, and it worked, and nobody today refers to it because it was successful. And then there was the disaster with Greece, a disaster in political terms, in terms of the ESM's reputation, and today we are paying the price of this disaster, not because of legal problems or legal constraints, not because the people in ESM were bad people or "bad cops," but because the shareholders of ESM were divided, and when the main shareholders are divided, it's quite impossible to manage things in a successful way. At that time, there was a division between France, Italy, and Spain on one side, together with other countries, including Belgium, Ireland, and Portugal, and the German orthodoxy at that time under Minister Schäuble. This was a clear division over the destiny of Greece, and Minister Schäuble was very clear in saying that it would have been better to create a sort of second basket for the Euro in Greece. The other countries decided to keep Greece on board. But again, the problem was obviously not created by the "bad cops" of the ESM, but by the fact that the shareholders were divided. Today the shareholders are united; I think the current German leader-

ship is a European leadership, and we are very much trusting Merkel's leadership. I think everything will be easier in Europe than we expect.

*Q. How can we continue with a continental Europe that, for at least a relatively long period of time, will still be applying English law and jurisdictional rules even to their own local – meaning for example Italy/Germany or Italy/France – financial transactions?*

**Jens-Hinrich Binder:** Perhaps since this goes back to what I said, my personal view would not be that pessimistic. Of course it is true that English law and jurisdictional clauses that bring matters over to London have played an important role in European continental practice for a long time. However, I think there are different opinions about whether or not these are perceived to be preferable by market participants; I know of many practitioners from Frankfurt who would dispute that a certain problem is being resolved better under English law than it is under German law or maybe Italian or French law. In this regard, things might be about to change thanks to the fact that I mentioned before – at least some of the transactions business that used to be carried out in London has shifted over to the continent because of regulatory constraints that will kick in as soon as the City of London has left the ship. We are likely to see changes, to see developments toward more continental European practices, at least in some parts of the securities law and also in terms of classic banking transactions. I think this is likely to happen, and over time it might even be that market participants will come to realize that in some respects, using continental European lawyers and private law is beneficial because it's more reliable, it's less costly, and so forth. I think this is likely to happen, and this is what I'm told by lawyers practicing in Frankfurt. But this will take time, and of course a lot will depend on whether or not continental European jurisdictions are able to reinforce the capacity of their court systems to actually deal with matters swiftly and efficiently and in short periods of time. If this is not the case, and there are huge differences of course between Member States, the changes are less likely to happen. We all know there are huge differences in the average duration of commercial law disputes adjudicated before the state courts across Member States, and this is something that needs to be addressed individually by each member state. This is less conducive to European harmonization, but I think it is likely to play an enormously important role in this process. Still, at the end of the day, I wouldn't be as pessimistic as you in this respect.

**Niamh Moloney:** I would very much like to echo Prof. Binder on this. I would certainly say that there is very grave nervousness about the potential loss of business. There's an acute worry that this long-standing choice of English law is not immutable. Part of it is this sense that priorities will shift, clients will focus elsewhere, but there are also some practical legal issues. The *Financial Times* reported just a week ago or so that there are going to be real difficulties in legal services entering the EU and how this has not been a part of the Brexit negotiations and the English legal community is really quite worried about this.

I would also very much like to echo Prof. Binder's point about procedure. There is global recognition of English law, but a lot of this is due to what's called the "financial list," dedicated courts staffed with specialist judges that are very fast, very efficient, but I think as procedure in other jurisdictions comes to compete with that, I can see business moving.

Another point goes to the issue about culture, and here I will switch my hat from England to Ireland. There is nervousness in Ireland too, because we are now the only common law jurisdiction in the EU. There's a sense that the weight of time goes against the common law when there's only one common law jurisdiction – that fact feeds into everything, it shapes drafting, it shapes legal texts, it shapes how the courts operate, so that ultimately there is an inexorable movement toward the civilian way of thinking. I think it will be a very interesting couple of years in this regard.

**Enrico Letta:** I hope that Profs. Binder and Moloney are right. I am afraid that the inertia will last for a bit. It depends on the way we will apply all of what we said with respect to financial markets, capital markets, and the Banking Union. I think all of these missions are also related to the response of the Eurozone and the EU.

