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The International Dimension of EMU

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Published in:
The EU Law of Economic and Monetary Union

DOI:
[10.1093/oso/9780198793748.003.0007](https://doi.org/10.1093/oso/9780198793748.003.0007)

IMPORTANT NOTE: You are advised to consult the publisher's version (publisher's PDF) if you wish to cite from it. Please check the document version below.

Document Version
Publisher's PDF, also known as Version of record

Publication date:
2020

[Link to publication in University of Groningen/UMCG research database](#)

Citation for published version (APA):

Donnelly, S., & Wessel, R. A. (2020). The International Dimension of EMU: The Interplay between the Global Financial Stability Architecture and the European Union. In F. Amtenbrink, & C. Herrmann (Eds.), *The EU Law of Economic and Monetary Union* (pp. 99-133). Oxford University Press.
<https://doi.org/10.1093/oso/9780198793748.003.0007>

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THE INTERNATIONAL DIMENSION OF EMU

The Interplay Between the Global Financial Stability Architecture and the European Union

Shawn Donnelly and Ramses A Wessel

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I. Introduction

It is a truism that the European Union's self-proclaimed autonomy may be a helpful concept in legal terms—primary to preserve the monopoly of the European Court of Justice to interpret European Union (EU) law¹—but it is equally clear that the EU is to a large extent influenced by the decisions and policies of other international institutions.² The present chapter

¹ Marise Cremona, Anne Thies, and Ramses A Wessel, *The European Union and International Dispute Settlement* (Hart Publishing 2017).

² Ramses A Wessel and Steven Blockmans, *Between Autonomy and Dependence: The EU Legal Order Under the Influence of International Organisations* (TMC Asser Press 2013); as well as Ramses A Wessel and Steven Blockmans, 'The Legal Status and Influence of Decisions of International Organizations and other Bodies in the European Union' in Piet Eeckhout and Manuel Lopez-Escudero (eds), *The European Union's External Action in Times of Crisis* (Hart Publishing 2016) 223–48; and earlier Andreas Føllesdal, Ramses A Wessel, and Jan Wouters,

aims to assess this external influence in relation to a specific, but core dimension of the EU, the Economic and Monetary Union (EMU).³ More specifically, we will assess the influence of what these days is known as the Global Financial Stability Architecture (GFSA), on the EMU. As will be further explained below, the GFSA is a network of the key global financial institutions that collect data, conduct research, provide insight and propose rules of conduct for the financial sector. Its *mission* is to rethink (global) macroeconomic policy to make economies more resilient—how to steer the economy clear of risks that could lead it to collapse; how to deal with real-time crises; and how to initiate recovery. Its primary *method* is to find out how differing components of financial markets act and react to one another, and to propose prudential regulation that shapes the behaviour of private financial service providers, of governments and of central banks.⁴

- 5.2** The main aim of the present chapter is to explain whether, and how, international institutions shape EU law, policies and procedures in the EMU context. Indeed, as the financial crisis revealed, the EU has been far from autonomous or isolated and its decisions were taken in the context of decisions taken in the GFSA, consisting of both formal international organizations (such as the IMF, World Bank, or OECD) and more informal international organizations (including a number of international standard-setting bodies).⁵ The latter in particular are characterized by different instruments (in which soft law dominates⁶), and

Multilevel Regulation and the EU: The Interplay between Global, European and National Normative Processes (Martinus Nijhoff Publishers 2008).

³ See for a more detailed analysis of the EMU, Chapters 2, 3, and 4.

⁴ Shawn Donnelly, 'Institutional change at the top: from the financial stability forum to the financial stability board' in Renate Mayntz (ed), *Crisis and Control: Institutional Change in Financial Market Regulation* (Campus Verlag 2012) 261–75 (hereafter Donnelly, 'Institutional change at the top'); Eric Helleiner, 'The Financial Stability Board and International Standards' (2010) CIGI G20 Papers No 1; Anthony Elson, *Governing global finance: The evolution and reform of the international financial architecture* (Springer 2011); Geoffrey R D Underhill, Jasper Blom, and Daniel Mügge, *Global financial integration thirty years on: from reform to crisis* (CUP 2010); Geoffrey R D Underhill, 'The Emerging Post-Crisis Financial Architecture: how far has reform gone?' (2014) GR: EEN Working Paper No 46.

⁵ See on informal international lawmaking: Joost Pauwelyn, Ramses A Wessel, and Jan Wouters, *Informal international lawmaking* (OUP 2012) (hereafter Pauwelyn, Wessels, and Wolters, *Informal international lawmaking*); Joost Pauwelyn, Ramses A Wessel, and Jan Wouters, 'When structures become shackles: stagnation and dynamics in international lawmaking' (2014) 25 *European Journal of International Law* 733–63; Jan Wouters and Jed Odermatt, 'Comparing the "Four Pillars" of Global Economic Governance: A Critical Analysis of the Institutional Design of the FSB, IMF, World Bank, and WTO' (2014) 17 *Journal of International Economic Law* 49–76; Steven Bernstein and Hamish van der Ven 'Best practices in global governance' (2017) 43 *Review of International Studies* 534–56.

⁶ See, for instance, Jean Galbraith and David Zaring, 'Soft law as foreign relations law' (2014) 99 *Cornell Law Review* 735 (hereafter Galbraith and Zaring, 'Soft law as foreign relations law'); Chris Brummer, *Soft Law and the Global Financial System: Rule Making in the 21st Century* (2nd edn, CUP 2015); Chris Brummer, 'Why soft law dominates international finance—and not trade' (2010) 13 *Journal of International Economic Law* 623–43 (hereafter Brummer, 'Why soft law dominates international finance'); Chris Brummer, 'How international financial law works (and how it doesn't)' (2011) 99 *Georgetown Law Journal* 257; Chris Brummer, *Minilateralism: How trade alliances, soft law and financial engineering are redefining economic statecraft* (CUP 2014); Douglas W Arner and Michael W Taylor, 'The global financial crisis and the financial stability board: Hardening the soft law of international financial regulation?' (2009) 32 *UNSW Law Journal* 488 (hereafter Arner and Taylor, 'The global financial crisis and the financial stability board'); Kenneth W Abbott and Duncan Snidal, 'Hard and soft law in international governance' (2000) 54 *International Organization* 421–56 (hereafter Abbott and Snidal, 'Hard and soft law in international governance'); Kenneth W Abbott and others, 'The concept of legalization' (2000) 54 *International Organization* 401–19; Gregory C Shaffer and Mark A Pollack, 'Hard vs. soft law: alternatives, complements and antagonists in international governance' (2010) 94 *Minnesota Law Review* 706–99; Andrew T Guzman and Timothy L Meyer, 'International soft law' (2010) 2 *Journal of Legal Analysis* 171–225.

policy narratives form a vital part of the substantive obligations⁷ to which EMU and its Member States are expected to conform, or explain their non-adoption.⁸ Those policy narratives are also part of what binds the single institutions into a cohesive whole with a greater overarching purpose, known as an *architecture*.⁹ It answers not only the question of what the overall mission of the architecture is (financial stability), but also on what basis, and with what means: in other words, with what strategy.¹⁰ Using the GFSa as our focal point is helpful not only to analyse the most relevant international institutions in relation to the EMU, but also to understand the legal and policy links between them.

This chapter thus examines the nature of the GFSa and its relationship to EMU law, policy and practice. It does so by taking an outside-in perspective, focusing on global developments and institutions and their influence on the EMU. Other chapters in the present Volume approach the interplay between the EU and the outside world from the perspective of the EU's external relations or by dealing with international agreements concluded between the EU and third States in relation to the EMU.¹¹ The present chapter makes the case that the GFSa influences financial stability rules within the EU, and within EMU more specifically, by setting out standards and benchmarks for Europeans to adopt, with the goal of maximizing financial stability. As we will see, in part, the EU pushes this development;¹² in part, however, it filters GFSa (soft) law to comply with European political priorities.¹³ **5.3**

This chapter is structured as follows. Section II sets the stage by analysing the relevant international bodies that are now seen as forming the Global Financial Stability Architecture. Section III aims to reveal the institutional links between the emergence of the GFSa and the **5.4**

⁷ See Cornel Ban and Kevin Gallagher, 'Recalibrating Policy Orthodoxy: The IMF Since the Great Recession' (2015) 28 *Governance* 131–46 (hereafter Ban and Gallagher, 'Recalibrating Policy Orthodoxy'); Stephen C Nelson, 'Playing favorites: how shared beliefs shape the IMF's lending decisions' (2014) 68 *International Organization* 297–328; Jaqueline Best, 'From the top-down: the new financial architecture and the re-embedding of global finance' (2003) 8 *New Political Economy* 363–84; Jeffrey M Chwieroth, 'Controlling capital: the International Monetary Fund and Transformative Incremental Change from within International Organisations' (2014) 19 *New Political Economy* 445–69.

⁸ Abraham Newman and David Bach, 'The European Union as hardening agent: soft law and the diffusion of global financial regulation' (2014) 21 *Journal of European Public Policy* 430–52 (hereafter Newman and Bach, 'The European Union as hardening agent'); Assuming also that supranational institutions lack enforcement powers; see Jonas Tallberg and James McCall Smith, 'Dispute settlement in world politics: States, supranational prosecutors, and compliance' (2014) 20 *European Journal of International Relations* 118–44.

⁹ Susana Borrás and Claudio M Radaelli, 'The politics of governance architectures: creation, change and effects of the EU Lisbon Strategy' (2011) 18 *Journal of European Public Policy* 463–84; Kenneth Armstrong, 'EU social policy and the governance architecture of Europe 2020' (2012) 18 *Transfer: European Review of Labour and Research* 285–300; Paul Copeland, *EU enlargement, the clash of capitalisms and the European social dimension* (OUP 2014); Jonathan Zeitlin, 'Towards a stronger OMC in a more social Europe 2020: A new governance architecture for EU policy co-ordination?' in Eric Marlier (ed), *Europe 2020* (P.I.E. Peter Lang 2010) 253–73.

¹⁰ Hervé Hannoun, 'Towards a global financial stability framework' (45th SEACEN Governors' Conference, Siem Reap Province, Cambodia February 2010) 26 (hereafter Hannoun, 'Towards a global financial stability framework').

¹¹ See in particular Chapters 6 and 7.

¹² Daniel Mügge, 'Europe's regulatory role in post-crisis global finance' (2014) 21 *Journal of European Public Policy* 316–26 (hereafter Mügge, 'Europe's regulatory role in post-crisis global finance'); Lucia Quaglia, 'The sources of European Union influence in international financial regulatory fora' (2014) 21 *Journal of European Public Policy* 327–45 (hereafter Quaglia, 'The sources of European Union influence'); Elliot Posner, 'Making rules for global finance: transatlantic regulatory co-operation at the turn of the millennium' (2009) 63 *International Organization* 665–99.

¹³ Lucia Quaglia and Aneta Spendzharova, 'Post-crisis reforms in banking: Regulators at the interface between domestic and international governance' (2017) 11 *Regulation & Governance* 422–37 (hereafter Quaglia and Spendzharova, 'Post-crisis reforms in banking'); Shawn Donnelly, 'Advocacy coalitions and the lack of deposit insurance in Banking Union' (2018) 21 *Journal of Economic Policy Reform* 1–14.

EU. This is followed in Section IV by an assessment of the influence of international law and policies on the EMU in relation to a number of specific areas of financial regulation. Finally, Section V will be used to draw some conclusions.

II. The Emergence of the Global Financial Stability Architecture

5.5 The GFSA can really be considered an architecture since 2009, when the G20 made a concerted attempt to expand the activity and output of international standard-setting bodies (ISSBs) in the financial sector, connect them with one another, and to make their impact more than the sum of their parts. In general, only few international bodies have the competence to enact legally binding rules¹⁴ and the formal and informal bodies making up the GFSA are no exception. The GFSA largely provides ‘soft law’ at the international level to steer national governments and the EU in a certain direction, which then may transpose it into ‘hard law’. This does not imply that the norms produced in the framework of the GFSA are merely general, broad guidelines. On the contrary, they cover so-called ‘microprudential regulation’ (applicable only to one of banking, insurance or capital market sectors) and macro prudential supervision (which takes a holistic approach to how the three microprudential areas affect each other) and require additional measures, from regulation to capital controls to State aid and quantitative easing for financial markets. It also includes discussions within the G20 and its financial stability conferences on both the overall steering of the architecture, and the broad discussions of macroeconomic policy and strategy within the Group. To understand the composition of the GFSA and its impact, it is worthwhile looking at its development.

A. Precedents to the post-2008 GFSA

5.6 The post-2009 GFSA stands in contrast with previous periods. During the Bretton Woods era of 1945–71, public policy limited financial markets greatly, both globally and nationally. Financial stability consisted of a system of fixed exchange rates guaranteed by the United States government (Treasury and Federal Reserve) and the International Monetary Fund (IMF), which provided low-cost loans to governments in financial distress (unable to borrow to pay for government spending, to pay for trade deficits and ultimately unable to support the exchange rate).¹⁵

5.7 Financial stability during this era was primarily a national affair of macroeconomic policy (judicious use of monetary and fiscal policy to smooth out highs and lows of demand in the economic cycle), and largely inseparable from a strategy of supporting mass production, consumption and employment. The IMF provided the key means of dealing with countries in which this financial stability had broken down, and minimising the likelihood that the

¹⁴ See for instance Ramses A Wessel, ‘Informal International Law-Making as a New Form of World Legislation?’ (2011) 8 *International Organizations Law Review* 253–65.

¹⁵ Eric Helleiner, ‘A Bretton Woods moment? The 2007–2008 crisis and the future of global finance’ (2010) 86 *International Affairs* 619–36.

country's breakdown could spread to other members of the system—either through broken business contacts or through a general collapse of confidence in the system's ability to sustain economic interdependence. This era distinguished itself from those preceding and following not only by these institutions, but by the overarching narrative of embedded liberalism that pursued global trade in a context of national social welfare systems, which the IMF and US government supported.¹⁶

During the first decade of the post-Bretton Woods era (1971–2007), exchange rates floated freely without guarantees from the USA, the IMF shifted from lending to support exchange rates to lending to sovereign default governments, and after a panic caused by the collapse of Herstatt Bank in Germany in 1974, the Basel Committee was established at the Bank for International Settlements (BIS) to agree on common regulatory standards for banks. It was the first microprudential ISSB, and heralded a period in which informal organizations started to supplement the functions of formal international organizations, such as the IMF. The International Accounting Standards Board (IASB) was also established as a private body promoting mutually-agreed financial reporting standards outside the United States.¹⁷

5.8

This first decade cannot be seen as a proper architecture of interlocking institutions with a common shared mission, but the first building blocks of what would follow. Rather than a shared narrative of proper public policy and its broader goals as found in Bretton Woods, this period was one in which shared expectations of what global financial stability entailed was absent. Similarly, the willingness of States to cooperate by a process of mutual accommodation and coordination was weaker than the tendency to descend into protectionism and attempts at providing local financial and economic stability at the expense of international trade. Protectionism rose, global and European governance devolved from rules and institutions to communication between national heads of government, and two efforts in Europe to peg exchange rates to one another in a precursor of EMU (the Snake and the Snake in the Tunnel) fell apart as national governments favoured the immediate demands of national constituents over the possible benefits of not undercutting each other through high debt and borrowing levels, high inflation rates, and competitive exchange rate devaluations.¹⁸ It was a time of turbulence and near anarchy in which a GFSA could not be said to exist.

5.9

The second decade of the post Bretton Woods saw the United States and the United Kingdom promote the establishment of two other ISSBs alongside the Basel Committee that brought together regulators from advanced economies: the International Association of Insurance Supervisors (IAIS) in London; and the International Organization of Securities Commissions (IOSCO) in Madrid. Alongside the Basel Committee, they were intended to promote common regulatory standards for the insurance and securities markets (stock and bond markets, hedge and other investment funds, credit rating agencies), respectively. After the Financial Crisis of 1997, which began in East Asia then went global, these bodies were

5.10

¹⁶ John Gerard Ruggie, 'International regimes, transactions, and change: embedded liberalism in the postwar economic order' (1982) 36 *International Organization* 379–415.

¹⁷ Louis W Pauly, 'The old and the new politics of international financial stability' (2009) 47 *Journal of Common Market Studies* 955–75.

¹⁸ Jonathan Story and Ingo Walter, *Political economy of financial integration in Europe: The battle of the systems* (MIT Press 1997). See also Chapter 2.

joined by the Financial Stability Forum,¹⁹ which the G7 called into being to acquire insight into how the Basel Committee, IAIS, IOSCO and IASB were learning from the past and responding to new challenges, and to act as a sort of steering committee for the bodies to act together toward a common goal. As the global economy recovered, however, the promise of a coordinated mission typical of an architecture faded. Nevertheless, the IMF and World Bank adopted these ISSB standards as benchmarks for their reviews of national government policies on financial stability, in an exercise known at the World Bank as the Report on Observance of Standards and Codes (ROSCO) and at the IMF as part of Article IV consultations.²⁰

5.11 These standards worked from a new shared master narrative, known alternatively as the Washington Consensus and neoliberalism, that countries would do best by maximizing the role of capitalist markets within their countries, and allowing them to function between them as well. This meant the liberalization of (international) trade and finance, the reduction of public ownership and State regulation in the economy, and the introduction of macroeconomic policies geared to attracting (international) investment capital. The latter implied that governments should practice austerity in public finance—balancing budgets rather than borrowing and spending during downturns—and that central banks should act conservatively to control inflation through interest rates and the money supply, which in turn would keep inflation low and exchange rates strong, all things being equal. This became known as the Washington Consensus because the IMF and World Bank, both seated in Washington DC, had adopted the framework during this period, meaning that its terms and conditions on countries in financial distress, and its definition of what it meant to be a member in good standing of the international community with regard to financial stability, had been solidified. However, this understanding of financial stability had few provisions for financial stability per se. Markets were thought to be efficient and self-correcting, without inherent deficiencies that needed to be prevented through further regulation.

5.12 Within Europe, a similar shift from embedded liberalism to neoliberalism took place between 1978 and 1984. 1979 marked the second European attempt to coordinate national currencies and macroeconomic policies—with the launch of the European Monetary System (EMS).²¹ Instead of governments managing their currencies and economies politically with the expectation of mutual adjustment, coordination took place by Europe adjusting to the German economy, which served as an anchor until the establishment of EMU. This meant that governments committed themselves to adjusting to the expectations of financial markets rather than steering against them.²²

¹⁹ See <<https://www.fsb.org/>> accessed 3 February 2020.

²⁰ See <<https://www.worldbank.org/en/programs/rosc>> and <<http://www.imf.org/external/NP/rosc/rosc.aspx>> accessed 3 February 2020.

²¹ The first attempt was the Snake in the Tunnel arrangement of 1972, in which European currencies were pegged to each other, and collectively to the United States dollar. It ended under pressure in fall 1973. See Angelos Delivorias, 'A History of European Monetary Integration' (2015) European Parliamentary Research Service. See further Chapter 2.

²² Shawn Donnelly, *Reshaping Economic and Monetary Union: membership rules and budget policies in Germany, France and Spain* (Manchester UP 2004); Timothy J Sinclair, *The New Masters of Capital: American bond rating agencies and the politics of creditworthiness* (Cornell UP 2014).

German ordoliberalism then became the central narrative for the EMS, and for EMU and Banking Union later on.²³ A brief French period of resistance between 1981 and 1984 was followed with effective policy consensus within the future Eurozone.²⁴ It shared with the neoliberal Washington Consensus a devotion to fiscal austerity for governments and a hard currency macroeconomic policy by central banks. It did not share the carefree view of financial market liberalization on the other side of the Atlantic, however. Although Germany introduced a series of Financial Market Promotion Acts to create new room for financial service providers to operate and financial markets to establish themselves, financial stability required strict precautionary measures to limit the size of financial markets, their business practices, and their behaviour toward the real economy.

5.13

During the last years before the GFC, these institutions worked to define how global financial stability could be furthered together with growth by pushing the financialization²⁵ of the global economy even further. By financialization reference is made to the opening up of the economy, its markets and institutions to financing and risk management through stock, bond and derivative markets as an alternative to bank finance and strong regulation of risk. Securitization in particular could benefit flagging global economic growth by massively increasing the supply of money²⁶ while increasing, through financial engineering and advances in probability analysis, the safety of financial instruments used as money,²⁷ to the point that they were considered by central banks and regulators as foolproof.²⁸

5.14

B. The current GFSA

The post-GFC architecture was set up to relaunch securitization on a sound basis,²⁹ and more broadly to rethink macroeconomic policy. The first of the goals remains, while the second has stalled due to a combination of uncertainty over actions and reactions in financial markets, and political divisions between Germany and the rest of the G7 over whether to pursue an accommodating or restrictive monetary policy. Over time, the ambition to redirect macroeconomic policy has given way to data collection on the interaction of many different kinds of prices in the global economy (including those of the real economy and those of financial markets), with a view to determining their ultimate effect on inflation, growth and sometimes employment rates.

5.15

²³ David Schäfer, 'A banking union of ideas? The impact of ordoliberalism and the vicious circle on the EU banking union' (2016) 54 *Journal of Common Market Studies* 961–80.

²⁴ Amy Verdun, *European Responses to Globalization and Financial Market Integration: Perceptions of Economic and Monetary Union in Britain, France and Germany* (Springer 2000).

²⁵ Greta R Krippner, 'The financialization of the American economy' (2005) 3 *Socio-Economic Review* 173–208; Jacob Assa, 'Financialization and its consequences: The OECD experience' (2012) 1 *Finance Research* 35–39.

²⁶ Paul Langley, 'Financialization and the consumer credit boom' (2008) 12 *Competition & Change* 133–47.

²⁷ Greta R Krippner, *Capitalizing on Crisis* (Harvard UP 2011); Robert W Parenteau, 'The late 1990s US bubble: Financialization in the extreme' in Gerald A Epstein (ed), *Financialization and the world economy* (Edward Elgar Publishing 2005) 111–48; John Bellamy Foster, 'The Financialization of Capital and the Crisis' (2008) 59(11) *Monthly Review* 1.

²⁸ Carmen M Reinhart and Kenneth S Rogoff, *This Time is Different: Eight centuries of financial folly* (Princeton UP 2009).

²⁹ G20 Leaders, 'Statement at the 2009 London Summit' (2 April 2009).

- 5.16** Each of the ISSBs had the mission to monitor, analyse and provide standards for their areas of specialty,³⁰ and the Financial Stability Board (FSB) to link those standards together and promote Member State adoption.³¹ Rather than accept critiques that the system of financialization was broken beyond repair, and required a strong regulatory response to provide financial stability, the G20 chose instead to focus on incremental changes based on data collected and evidence-based conclusions that could make securitization safer. It lacks, however, agreement on a new meta-narrative of what constitutes proper macroeconomic policy and how financial market regulation fits into that mission.³² Critiques of the previous system remained,³³ but did not lead to a new dominant direction.³⁴ This took place in an environment of intense political competition over macroeconomic policy ideas.³⁵
- 5.17** The implications of this silence on securitization, financial regulation and macroeconomic policy were a continuation of financial activities leading to the crisis, and a macroeconomic policy intent on preventing financial sector collapse through quantitative easing. Meanwhile, the GFSA started creating the building blocks of a knowledge central to a new, as yet undefined macroeconomic policy in an environment where consensus was lower and uncertainty higher over how to rethink theory and practice. The collection and analysis of microeconomic data through microprudential supervisors created the building blocks, however, for shifting macroeconomic policy from broad principles to include how the laws of economics look in different parts of the economy.³⁶
- 5.18** The decade leading up to the GFC was characterized by excessive risk taking and acceptance in bank lending and investments, securitization (through two kinds of financial engineering products: asset-backed securities (ABSs) and collateralized debt obligations (CDOs)),³⁷ credit ratings, and shadow banking (hedge funds and other special purpose vehicles for unregulated market transactions). Until the crash, risk of default, and its impact on financial stability, was thought by financial stability experts to be manageable through a combination of pricing risk (at the point of providing retail and business loans), bundling risk (in synthetic securities), assessing risk (credit ratings),³⁸ using synthetic securities as risk-free forms of capital, and insuring them against loss (financial derivatives known as

³⁰ John Glenn, 'In the aftermath of the financial crisis: risk governance and the emergence of pre-emptive surveillance' (2014) 40 *Review of International Studies* 227–46.

³¹ Donnelly, 'Institutional change at the top' (n 4) 261–75.

³² Howard Davies, 'Global financial regulation after the credit crisis' (2010) 1 *Global Policy* 185–90.

³³ Paul De Grauwe, *The Limits of the Market: The Pendulum Between Government and Market* (OUP 2016).

³⁴ Kathleen R McNamara, *The currency of ideas: monetary politics in the European Union* (Cornell UP 1999); Cornel Ban, *Ruling Ideas: How Global Neoliberalism Goes Local* (OUP 2016); Kenneth Dyson and Ivo Maes, *Architects of the Euro: Intellectuals in the Making of European Monetary Union* (OUP 2016).

³⁵ Henry Farrell and John Quiggin, 'Consensus, Dissensus, and Economic Ideas: Economic Crisis and the Rise and Fall of Keynesianism' (2017) 61 *International Studies Quarterly* 269–83; Sebastian Dellepiane-Avellaneda, 'The political power of economic ideas: The case of "expansionary fiscal contractions"' (2015) 17 *The British Journal of Politics & International Relations* 391–418; Matthias Matthijs and Kathleen R McNamara, 'The euro crisis' theory effect: northern saints, southern sinners, and the demise of the eurobond' (2015) 37 *Journal of European Integration* 229–45; Vivien Schmidt, 'The Resilience of "Bad Ideas" in Eurozone Crisis Discourse, Even as Rival Ideas Inform Changing Practices' (23rd Conference of Europeanists, Philadelphia, April 2016).

³⁶ Joseph E Stiglitz, 'Rethinking macroeconomics: What went wrong and how to fix it' (2011) 2 *Global Policy* 165–75.

³⁷ Andreas Jobst, 'The regulatory treatment of asset securitisation: The Basel Securitisation Framework explained' (2005) 13 *Journal of Financial Regulation and Compliance* 15–42.

³⁸ Felix Salmon, 'The formula that killed Wall Street' (2012) 9(1) *Significance* 16–20; Paul Wilmott and David Orrell, *The Money Formula: Dodgy Finance, Pseudo Science, and How Mathematicians Took Over the Markets* (Wiley 2017) 207–25.

credit default swaps). Banks could lend more, earn more, and retain less capital for emergencies because they maintained, and regulators accepted, that the algorithmic features of risk management, distribution, market support and insurance were foolproof.

Even if this system proved not to be foolproof, credit rating agencies would monitor the composition of securitizations and report on the results; while banks would take out insurance against loss in the form of yet another security: credit default swaps (CDSs). Regulators accepted that this three-fold, complex means of ensuring financial stability would make bankruptcy a thing of the past, actually lowering capital requirements in Basel II. In other words, financial engineering was thought to make financial markets safer with greater efficiency and lower costs, as long as everyone played by the rules and did not abuse the securitizations model by putting too many problem assets into the products. The problem leading up to the GFC was that banks did precisely this: making loans at high interest rates to depositors who had little chance of repaying. This hollowed out the quality of the ABSs that contained these loans and the CDOs made up of ABSs. **5.19**

The reasons for the blind faith in securitizations and reliance on it was not just a technical advancement in the nature of money and risk management through quantitative analysis, but a desire by banks to lower the cost of risk management, coupled with a political desire in the United States to expand the money supply domestically, and then globally after the 9/11 attacks of 2001. Securitizations radically expanded the money supply in two ways: by allowing banks to sell the loans they had made, re-lending the cash, and so on until they ran out of customers willing to borrow (rather than retaining the asset for interest income as banks traditionally do); and by allowing banks to use ABSs and CDOs with investment grade ratings as if it were cash for the purpose of their requirement to hold certain minimum levels of capital as a buffer against shocks; (rather than holding capital retained or from investors which could otherwise be lent out). Because these instruments paid interest, other banks, particularly large banks with an appetite for more sophisticated financial instruments readily bought them and used them instead of cash, which is how the US practice went global. **5.20**

In the end, this means of diffusing ABSs and CDOs throughout the global economy, primarily over large banks with diversified portfolios, opened up channels of contagion that transformed the American financial collapse into a global one, and the Great Financial Crisis into a Eurozone Crisis (EZC). Europe struggled to find its feet, with Southern European governments and Ireland in particular experiencing financial fragility (inability to rejuvenate economic growth borrow on financial markets). This is the context in which calls for a recalibration of global financial stability policy were raised, in which the impetus for a new GFSA made itself felt, and in which the links between the global and European financial stability architectures were established. However, while the financial regulation community recognized that securitizations practice had undermined financial stability, it held to the notion that securitizations was safe in principle and could be made sustainable by recalibrating the level at which riskier assets could be incorporated.³⁹ But residual **5.21**

³⁹ This is by no means a purely historical concern. The high level of non-performing loans in some European banking sectors has incited a number of proposals to bundle and sell off the assets into new securities that could replicate the pre-GFC problem in Europe. This is the central strategy behind the EU's Capital Markets Union (CMU).

uncertainty remained regarding the source of instability for these assets that might not be traced back to poor lending practices.

- 5.22** The core of the global response in the short to medium term was therefore to look for a path to fix the system rather than radically change it. While the G20 opted to end the Washington Consensus as a running assumption in April 2009, it did not agree on a replacement and simultaneously agreed to pursue a cornerstone of the late Washington Consensus order: the goal to restore securitizations on a safe basis. It was in this environment that BIS Deputy SG Hannoun makes the case for a Global Financial Stability Architecture in 2009.⁴⁰

III. International Bodies and the EMU

- 5.23** EMU policy fields have quite significant international dimensions. The present section aims to reveal the institutional links between the emergence of the GFSA and the EU. The first European legal/institutional response parallel to the global developments was to upgrade coordinating committees for microprudential regulation in the banking, insurance, and securities sectors into European Supervisory Authorities. It took effect at the beginning of 2011, establishing a European System of Financial Supervision (ESFS) to coordinate their activities, and a European Systemic Risk Board to advise European decision-makers on further legal, regulatory and monetary policy initiatives. Those bodies developed close contacts to their international counterparts, sometimes with overlaps of personnel, thereby facilitating the congruence of policy expertise and methods of pursuing goals. The subsections below outline the international bodies to which European institutions are linked. They start with the Financial Stability Board, which is tasked with steering the technical work of the GFSA's various bodies on behalf of the G20. It is further tasked with compiling and discussing synergies between the various components for which individual ISSBs are responsible, in the context of macroprudential supervision, or supervision of the financial system as a whole, rather than individual sectors like banking, insurance and the others (financial market actors). That macroprudential supervision then provides the context in which the individual ISSBs that collectively make up the GFSA are relevant and discussed. It is striking that there is more than one body for banking issues. This reflects the urgency of dealing with failed banks after 2008, as well as building up the different components of a financial stability support structure for banks that are failing.

A. Financial Stability Board

- 5.24** The international body that was explicitly created with the goal of financial stability in mind, is the Financial Stability Board (FSB). The FSB deals with overarching issues of financial stability, but primarily on the regulatory side, while broader macroeconomic policy

⁴⁰ Hannoun, 'Towards a global financial stability framework' (n 10) 26.

questions (quantitative easing, etc.) are left to the G7/G20 and central banks. It was established in 2009 as a successor to the Financial Stability Forum and tasked with coordinating and linking up knowledge and standards across the three microprudential ISSBs outlined below.⁴¹

The Board itself is comprised of twenty-four members (all national with the exception of Hong Kong) and a number of non-governmental entities. While the EU is thus not a member as such, France, Germany, Italy, the Netherlands, Spain and the UK have seats at the table. Non-national institutional members consist of IFIs (WB and IMF), central banks (BIS and ECB), ISSBs (BCBS, IOSCO, IAIS, and IASB), ECB as head of the SSM, the OECD, and two further BIS Committees: the Committee on the Global Financial System and the Committee on Payments and Markets Infrastructures (CPMI). **5.25**

While the FSB has a fairly limited membership, it practices outreach to other jurisdictions through so-called Regional Consultative Groups. This is a practice shared with other ISSBs, particularly the OECD. The purpose is to combine two competing impulses. On the one hand, membership is supposed to be limited to ease decision-making, compatible with club governance.⁴² This allows for transnational deals between like-minded experts and elites,⁴³ though there is no guarantee that those deals will be ratified.⁴⁴ On the other hand, the group aspires to see its standards adopted globally, by a large number of jurisdictions that have no formal membership. The Regional Consultative Groups allow the FSB to square this circle, or at least to attempt to do so. In practice, FSB-sanctioned standards are used more broadly as well. The IMF in particular took on the role of reviewing the degree of FSB standard adoption in all countries as a part of its Financial Services Assessment Program, and Article IV consultations. **5.26**

The FSB consolidates these standards into commitments for FSB Member States. These commitments are soft in two senses: the FSB has no legal personality nor capacity to issue binding standards; and its standards provide room for national legislators and competent authorities to flesh out the details of what it requires. Much like the OECD's and EU's open method of coordination,⁴⁵ a combination of benchmarks, reporting and peer review is designed to assess performance and apply pressure for adaptation. FSB Member States are expected to adopt and implement standard recommendations to retain their status as members in good standing, while other States may, but otherwise face no consequence for non-observance and implementation. **5.27**

⁴¹ Arner and Taylor, 'The global financial crisis and the financial stability board' (n 6) 488. Randall Germain, 'The Financial Stability Board' in Thomas Hale and David Held (eds), *Handbook of transnational governance* (Polity 2011) 50–4.

⁴² Eleni Tsingou, 'Club governance and the making of global financial rules' (2015) 22 *Review of International Political Economy* 225–56.

⁴³ Abraham Newman and Elliot Posner, 'Transnational feedback, soft law, and preferences in global financial regulation' (2016) 23 *Review of International Political Economy* 123–52.

⁴⁴ Quaglia and Spendzharova, 'Post-crisis reforms in banking' (n 13) 422–37; Aneta Spendzharova, 'Regulatory cascading: Limitations of policy design in European banking structural reforms' (2016) 35 *Policy and Society* 227–37.

⁴⁵ The so-called 'open method of co-ordination' is characterized by a 'horizontal', intergovernmental, approach and rests on soft law mechanisms such as guidelines and indicators, benchmarking and sharing of best practice. See for instance Egidijus Barcevičius, Timo Weishaupt, and Jonathan Zeitlin, *Assessing the Open Method of Co-ordination* (Palgrave Macmillan 2014).

- 5.28** The Board's intended impact is reflected in the existence of three standing committees: Assessment of Vulnerabilities (SCAV); Standards Implementation (SCSI);⁴⁶ and Supervisory and Regulatory Cooperation (SCSRC).
- 5.29** The *Standing Committee for Assessment of Vulnerabilities* is where the FSB looks for sources of financial instability that might be significant enough to require countermeasures, as well as links between those sources and the rest of the global financial system. It can be thought of as the place that most directly reflects the state of FSB thinking on what financial (in)stability means in practical terms and what should be done about it. It is therefore here that one can best see evidence of how much the GFSA remains committed to a key part of its original mission—to relaunch securitization on a sound basis.
- 5.30** Of the topics dealt with by the Committee, three stand out as prominent topics. The first, and the only one to which SCAV devotes an annual report, is *shadow banking*.⁴⁷ These are the hedge funds and special-purpose vehicles attached to banks that are largely unregulated, and responsible for both investing and trading in derivatives (securitizations), and for borrowing the funds to carry out those transactions.⁴⁸ The second is *derivatives trading*, largely between these entities. The third and most recent is *leverage*, or borrowing, by shadow banks and corporate entities, with a strong focus on foreign exposures (borrowing in a foreign currency).⁴⁹ All are key components to the problems underlying securitization that generated the Financial Crisis of 2007–09.
- 5.31** FSB work on all of these areas are typified by data collection and presentation about the magnitude of shadow banking, trading and leverage respectively as risks in and of themselves. The emphasis in all of them is on the magnitude of financial assets and liabilities being created and traded, particularly in relation to the overall size of the economy. Underlying this focus appears to be a belief that securitization is safe, even when it incorporates risky assets, provided the involvement of risky assets is contained to modest, but as yet vaguely defined levels. The same can be said for foreign exposures and to a lesser degree (of consensus) for leverage. Foreign exposures have long been recognized as important financial stability risks in emerging markets.
- 5.32** Derivatives trading is different than the other two, however, since it has been the subject of a regulatory initiative on the part of advanced economies to mandate the transfer of over-the-counter (OTC) derivatives through central counter parties (CCPs). CCPs are platforms functioning as financial institutions that underwrite trades between two other financial institutions. Should one of the parties to the transaction fail to pay, the CCP steps in to make the payment instead. The purpose is to prevent financial collapse

⁴⁶ Financial Stability Board, 'FSB assesses implementation progress and effects of reforms' (Press Release Ref No 5/2017, Basel, 28 February 2017).

⁴⁷ Financial Stability Board, 'Global Shadow Banking Monitoring Report 2016' (Basel, 10 May 2017).

⁴⁸ Paul Langley, 'Sub-prime mortgage lending: a cultural economy' (2008) 37 *Economy and Society* 469–94; Thomas Wainwright, 'Laying the Foundations for a Crisis: Mapping the Historico-Geographical Construction of Residential Mortgage Backed Securitization in the UK' (2009) 33 *International Journal of Urban and Regional Research* 372–88; Stephen C Nelson and Peter J Katzenstein, 'Uncertainty, risk, and the financial crisis of 2008' (2014) 68 *International Organization* 361–92.

⁴⁹ Financial Stability Board, 'Letter from IMF-FSB-BIS Work on Data Gaps Involving FX Exposures' (Basel, 11 September 2014); Financial Stability Board, 'Joint CGFS-FSB-SCAV Workshop on Risks from Currency Mismatches and Leverage on Corporate Balance Sheets' (Basel, 11 September 2014). Financial Stability Board, 'Corporate Funding Structures and Incentives' (Basel, 25 September 2014).

of one financial institution from unleashing a domino effect resulting in systemic contagion.

The *Standing Committee on Implementation and Compliance* is responsible for the exercises that compel members to file reports and submit to peer review on a regular basis.⁵⁰ In a soft law context, it is the primary means by which FSB-sanctioned standards are translated into meaningful obligations by national governments, though the latter retain some discretion on how to transpose them. Some of the peer reviews are applied to all members at once on a specific issue of critical importance. To date these thematic issues have covered the same topics dealt with above: shadow banking; OTC derivatives trading; and bank regulation. A prerequisite for the FSB to become involved is that the topic is cross-sectoral or cross-functional, so that it does not replicate a review by one of the microprudential ISSBs, the IMF or the World Bank. Other peer reviews cover the entire spectrum of financial market practices and regulations that apply within a specific country. Overall, the country reviews keep in mind three points: the overall provisions for financial stability; ensuring a commitment to openness and transparency of the financial sector, as well as implementing international standards.⁵¹ **5.33**

Data on implementation and compliance is derived from two sources: from country reviews, in which Member States are visited by counterparts from other FSB members; and from IMF reports under the Financial Sector Assessment Program (FSAP), that conclude with a Financial System Stability Assessment (FSSA) for the world's twenty-five largest systemic jurisdictions. A great deal of the data collection is therefore already on hand when the FSB shows up. In addition to these reviews, SCSI has been given the task of conducting ex post impact assessments on the adoption of financial stability standards. In other words, it is responsible for asking whether adoption of standards in the past has made a meaningful contribution to financial stability that is worth the cost. **5.34**

The *Standing Committee on Supervisory and Regulatory Cooperation* sets out the protocols and memoranda of understanding that regulate the collection, processing and sharing of data between national competent authorities, and interaction in the case of supervising and resolving cross-border financial institutions. **5.35**

In addition to the standing Committees, the FSB has Regional Consultative Groups that allow the Board to discuss standards with non-members as well as members. The Regional Consultative Group for Europe has both Eurozone members (Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, and Spain) and non-members (Czech Republic, Denmark, Hungary, Iceland, Israel, Norway, Poland, Sweden, Switzerland, UK, and GIFCS (Group of International Financial Centre Supervisors: small jurisdictions)). Each country is represented by finance or treasury ministers, central bank representatives and securities regulators. **5.36**

In addition to linking up standards generated elsewhere, the FSB also acts as a clearing house of ongoing and innovative research into elements of the economy that are changing, developing, and impacting financial stability, as well as recommended standards in those **5.37**

⁵⁰ Financial Stability Board, 'FSB Framework for Strengthening Adherence to International Standards' (Basel, 9 January 2010).

⁵¹ Financial Stability Board, 'Handbook for FSB peer reviews' (Basel, 31 March 2017).

areas, particularly ones that help supervisors to collect further data for analysis. Examples of initiatives to generate better international oversight of financial market activity are the Data Gaps Initiative, the Legal Entity Identifier project, and the Unique Product Identifier project. Research and initiatives on new areas can be seen in reports on cybersecurity in financial services and artificial intelligence.

- 5.38** All in all, the FSB's direction of global macroeconomic policy is negligible. Moschella⁵² notes that FSB goes beyond coordinating national affairs, to deal with assessing vulnerabilities and monitoring Member State implementation of Board-recommended initiatives. At the same time, Helleiner and Pagliari also note that the FSB's capacity to work independently of its members is quite limited, so that the initiative lies with member applications rather than the other way around.⁵³ It embodies the post-2008 focus on macro prudential supervision, but reflects a combination of intergovernmental compromise, and lowest denominator decision-making typical of organizations that require consensus.⁵⁴
- 5.39** In this context, the FSB has worked on measures that reinforce the work of other standard setters, where technical knowledge matters greatly, and where specific international points of conflict can be sorted out, if anywhere. The most important output of standards that the FSB adopts is that they push financial institutions to hold more capital in reserve to hedge against the risk of a financial shock. This has a modest macroeconomic drag in the short term, in return, it is hoped, for greater resilience to shocks down the road. The wait and see approach to shadow banking and foreign exposures, coupled with the central counter parties initiative, however, is not only modest in terms of restricting securitization, but sets up the CCP infrastructure through which a relaunch of securitization on even grander scales can be prepared. As Underhill⁵⁵ notes, this reflects an accommodating attitude toward monetary policy and financial regulation within the GFSA.
- 5.40** As will be highlighted with regard to EMU in section 4, the GFSA's work to relaunch securitization on a sound basis resonates in EU Commission proposals for a Capital Markets Union, which promotes the use of financial engineering to assist States and corporations, particularly banks, in existing the so-called doom loop of financial fragility between States and sovereigns in Southern Europe and Ireland. It also is behind the European Systemic Risk Board's plans to use securitization, with all the precautions that go along with it, to keep the money supply stable and growing in the Eurozone in the absence of a large EU budget.⁵⁶

⁵² Manuela Moschella, 'Designing the Financial Stability Board: a theoretical investigation of mandate, discretion, and membership' (2013) 16 *Journal of International Relations and Development* 380–405.

⁵³ Eric Helleiner and Stefano Pagliari, 'The end of an era in international financial regulation? A postcrisis research agenda' (2011) 65 *International Organization* 169–200.

⁵⁴ Fritz W Scharpf, 'The joint-decision trap revisited' (2006) 44 *Journal of Common Market Studies* 845–64.

⁵⁵ Geoffrey R D Underhill, 'The emerging post-crisis financial architecture: The path-dependency of ideational adverse selection' (2015) 17 *The British Journal of Politics and International Relations* 461–93.

⁵⁶ Expertise on financial stability at international financial institutions (IMF, OECD) and key European think tanks broadly accepted the need for automatic fiscal stabilizers for the Eurozone to mitigate both economic shocks to the Eurozone's weakest economies and long-lasting trends of low or negative economic growth that could prevent economies and banks from rebounding after an initial crash. See Shawn Donnelly, 'Expert advice and political choice in constructing European banking union' (2016) 17 *Journal of Banking Regulation* 104–18.

B. Bank for International Settlements

The BIS⁵⁷ is responsible for overarching financial stability policy in the sense of combining macroeconomic policy expertise with financial stability and banking regulation.⁵⁸ It also supports and coordinates a number of the committees and organizations outlined below. In a sense one might ask whether the contribution to the GFSA by the BIS is as meaningful as the one by the FSB described above. In practice, it is probably greater. **5.41**

Part of the answer lies in the constitution of the BIS, the profile of its officers, and the Committees it forms to study topics of interest. Unlike the FSB, the BIS has a much larger staff, resources and high-profile representatives to give the Bank's views and research greater standing. A great number of working and research papers are issued, and the position of Chief Economist provides profile to the views of the Bank. Whereas the FSB examines a wide but still limited range of phenomena, the Bank may focus on broader economic developments and their implications for macroeconomic practice, which may then have implications for standard setters, but often central banks and national governments as well. It is the true counterpart to the more politically-oriented G7 and G20 fora, in the sense that it is free to propose agenda items, promote discussion of policy and standards, and create the room for the ISSBs it supports (including the FSB) to set standards and guidelines themselves. **5.42**

From time to time this means that the BIS may be critical of G7/G20 political compromises, or current trends by elected governments on either overall macroeconomic policy or specific parts of it, without explicitly referring to the global steering body. A recent development at the Bank that illustrates this willingness to wade into contentious issues (that affect the Eurozone in particular) is the warning by the Bank's Head of Monetary and Economics Department that the extended period of low interest rates that has persisted since 2008 has permitted macroeconomic imbalances to develop in the form of asset bubbles that could endanger financial stability when they burst.⁵⁹ This speaks in particular, though not exclusively, to the current fight between the Eurogroup and the ECB over whether national governments ought to cut back on borrowing to comply with EMU membership rules, or whether those rules should be relaxed in some way to allow for more robust economic growth.⁶⁰ Low interest rates, a key component of quantitative easing,⁶¹ persist in part because economic growth remains anaemic in much of the Eurozone, which in turn is caused by the bloc's strong and globally unique political focus on national budgetary retrenchment.⁶² These low interest **5.43**

⁵⁷ Kern Alexander, 'Bank for international settlements' in Christian Tietje and Alan Brouder (eds), *Handbook of Transnational Economic Governance Regimes* (Brill 2009) 305–18.

⁵⁸ Beth A Simmons, 'Why innovate? Founding the bank for international settlements' (1993) 45 *World Politics* 361–405; Leonard Seabrooke, 'The bank for international settlements' (2006) 11 *New Political Economy* 141–49.

⁵⁹ Claudio Borio, 'Secular stagnation or financial cycle drag?' (National Association for Business Economics, 33rd Economic Policy Conference, Washington DC, March 2017) 9 (hereafter Borio, 'Secular stagnation or financial cycle drag?').

⁶⁰ Shawn Donnelly, 'ECB-Eurogroup Conflicts and Financial Stability in the Eurozone' (2018) 51 *Credit and Capital Markets* 113–26 (hereafter Donnelly, 'ECB-Eurogroup conflicts and financial stability in the Eurozone').

⁶¹ See Chapter 22 regarding Monetary Policy. Low and negative interest rates help to ensure that incentives are low to save money, and relatively high to spend it. They are a prerequisite for ensuring that increased liquidity into the financial system is not frozen again.

⁶² Shawn Donnelly, 'The public interest and the economy in Europe in the wake of the financial crisis' (2011) 10 *European Political Science* 384–92; Simona Piattoni, 'The European Union between Intergovernmentalism

rates then follow to keep economies from crashing, but incite financial manias and crashes instead.⁶³

- 5.44** In this context of chronic fragility, central bankers have found it difficult, if not impossible to taper quantitative easing (QE).⁶⁴ QE was originally intended to compensate for temporary fragility during a downturn. Regardless of how gradual the raising of interest rates, the retraction of issued liquidity and the sale of financial instruments on central bank balance sheets is portrayed. While the Federal Reserve has had more room to taper due to more robust growth,⁶⁵ the ECB has had to face a more fragile economy, leading it to take a 'slower for longer' approach to winding down QE.⁶⁶ Meanwhile, QE has had further impacts on emerging markets worldwide.⁶⁷
- 5.45** Another development illustrating the BIS's leadership role in thinking about how to best approach financial stability is its development of policy rules for capital controls in November 2017 which help generate converging expectations on how to apply such controls.⁶⁸ Given their increased use during local financial stability crises, and the IMF's warming to capital controls during crises,⁶⁹ the standards help steer the behaviour of financial sector actors, and most importantly, set and maintain the terms of international financial interdependence.
- 5.46** In this context, the BIS is best thought of as a body which does the real, overarching thinking behind financial stability in the GFSA, linking and weighing all the parts of the puzzle into a larger picture. It cannot be considered macro economically conservative in principle, but pragmatic. This means that there is greater flexibility in the rules and orientation of the Bank than one would find in EMU rules and regulations.
- 5.47** The BIS hosts a number of committees beyond the FSB that focus on key parts of the GFSA puzzle: the Basel Committee on Banking Supervision (BCBS); the Committee on the Global Financial System (CGFS); the Committee on Payments and Markets Infrastructures (CPMI); the Markets Committee and the Irving Fisher Committee on Central Bank Statistics. The Markets Committee and the CGFS have similar functions to the FSB's SCAV—they monitor developments, risks and vulnerabilities and think through possible

and "Shared and Responsible Sovereignty": The Haptic Potential of EMU's Institutional Architecture' (2017) 52 *Government and Opposition* 385–411.

⁶³ Borio, 'Secular stagnation or financial cycle drag?' (n 59).

⁶⁴ European Central Bank, 'Financial Stability Review 2015' (Frankfurt, November 2015) 48.

⁶⁵ Jana Randow and Carolyn Look, 'ECB's Follow-the-Fed Strategy Set to Change on QE Exit Road' *Bloomberg* (25 October 2017).

⁶⁶ Failed attempts at tapering here. Mehreen Khan, 'ECB dilemma looms over pace of expected QE tapering' *Financial Times* (26 October 2017).

⁶⁷ Barry Eichengreen and Poonam Gupta, 'Tapering talk: The impact of expectations of reduced Federal Reserve security purchases on emerging markets' (2015) 25 *Emerging Markets Review* 1–15; Joshua Aizenman, Mahir Binici, and Michael M Hutchison, 'The transmission of Federal Reserve tapering news to emerging financial markets' (2014) NBER Working Paper No 19980; Robert Lavigne, Subrata Sarker, and Garima Vasishtha, 'Spillover effects of quantitative easing on emerging-market economies' (2014) Bank of Canada Review 23–33.

⁶⁸ Gurnain Kaur Pasricha, 'Policy Rules for Capital Controls' (2017) BIS Working Paper No 670.

⁶⁹ Manuela Moschella, 'The institutional roots of incremental ideational change: The IMF and capital controls after the global financial crisis' (2015) 17 *The British Journal of Politics & International Relations* 442–60 (hereafter Moschella, 'The institutional roots of incremental ideational change'); Barry Eichengreen and Andrew Rose, 'Capital controls in the 21st century' (2014) 48 *Journal of International Money and Finance* 1–16; Ban and Gallagher, 'Recalibrating policy orthodoxy' (n 7) 131–46; Manuela Moschella, 'Governing Cross-border Capital Flows: The Dynamics of Capital Account Policies' in Giliberto Capano, Michael Howlett, and M Ramesh (eds), *Varieties of Governance* (Palgrave Macmillan 2015) 27–50.

solutions to them. CPMI is an important player in promoting ideas regarding payment and clearing systems and has taken on a prominent role together with IOSCO (a non-BIS institution discussed below) in conceiving and designing central counter party infrastructures that make it possible to ensure financial stability in a highly securitized environment. This means that BIS and its committees are doing much of the work that is required to provide financial stability, particularly in banking, in a highly securitized environment.

C. Basel Committee on Banking Supervision

The Basel Committee is a small (twenty-four members), self-appointed group of central bankers and bank supervisors that sets standards by consensus on how much cash banks should have on hand at any given time, what counts as cash, how losses are insured, how banks are governed to avoid risky behaviour, and how financial instruments can be used to minimize the likelihood that an economic shock leads to collapse. Supported by the BIS, it is nevertheless fairly independent.⁷⁰ Unlike most other ISSBs, it does not engage broadly with stakeholders but is more selective.⁷¹ While this promotes consensus, it does not guarantee it. Disagreements between the United States and Europe have led to disappointment in some cases regarding Basel Committee rules,⁷² specifically on leverage on bank balance sheets. **5.48**

The BCBS deals with regulations designed to make banks resilient from economic shock, and well-governed. This amounts to standards covering capital adequacy, bank governance and the relationship between banks and their regulators. It is central to efforts to get the global economy safe again, with implications for EMU banks and Member States. Its links to EMU are made through terms of banking union, to stabilize EMU. **5.49**

A central mission of the Basel Committee after the onset of the GFC was to revisit the existing rules known as Basel II and upgrade them in light of the fact that their observance had led to financial collapse in 2008. These standards had promoted the use of quantitative risk management that is at the core of the securitization process (which in turn was at the core of the financial crisis)⁷³ and its stabilization. **5.50**

Basel III negotiations focused on forcing global systemically-important banks (G-SIBs) to raise more capital than had been the case under Basel II and to hold it in reserve against future calamities (core equity tier 1 capital (CET), total-loss-absorbing capital (TLAC), minimum reserves and eligible liabilities (MREL), and a liquidity coverage ratio (LCR) that **5.51**

⁷⁰ Kevin L Young, 'Transnational regulatory capture? An empirical examination of the transnational lobbying of the Basel Committee on Banking Supervision' (2012) 19 *Review of International Political Economy* 663–88.

⁷¹ Geoffrey R D Underhill and Xiaoke Zhang, 'Setting the rules: private power, political underpinnings, and legitimacy in global monetary and financial governance' (2008) 84 *International Affairs* 535–54; Stefano Pagliari and Kevin L Young, 'Leveraged interests: Financial industry power and the role of private sector coalitions' (2014) 21 *Review of International Political Economy* 575–610.

⁷² Ranjit Lall, 'From failure to failure: The politics of international banking regulation' (2012) 19 *Review of International Political Economy* 609–38; Eric Helleiner, *The status quo crisis: Global financial governance after the 2008 meltdown* (OUP 2014); Andrew Baker, 'The gradual transformation? The incremental dynamics of macroprudential regulation' (2013) 7 *Regulation & Governance* 417–34.

⁷³ Hyun Song Shin, 'Securitisation and financial stability' (2009) 119 *The Economic Journal* 309–32; James Crotty, 'Structural causes of the global financial crisis: a critical assessment of the "new financial architecture"' (2009) 33 *Cambridge Journal of Economics* 563–80; Charles A Goodhart, 'The background to the 2007 financial crisis' (2008) 4 *International Economics and Economic Policy* 331–46.

includes a definition of high-quality liquid assets (HQLA). All of these standards are fairly detailed and serve as a template for European capital requirements for larger banks.

- 5.52** EU-US divisions made common standards impossible in the field of leverage, however. Leverage refers to the amount of debt a bank incurs in order to do business. Because banks in Europe are much more highly leveraged than their American counterparts, and because the US government identified high leverage as a source of vulnerability to economy shock that had to be reduced, agreement was not possible.⁷⁴
- 5.53** The consequences of the Basel Committee's efforts are new regulations intended to force banks to seek and hold higher levels of capital, to hold new kinds of capital (borrowing that converts to capital in a crisis) and to change the kind of borrowing they undertake (safer) to do business.
- 5.54** The effects of these changes are still ongoing, and were fully phased in 2019. But the initial effect is that banks have become more conservative in their capital structure and in their lending. This increase in resilience comes at the price of lowering money creation through business loans, which in turn leads to a reduction of economic and employment growth; and by implication, to lower bank revenues and increasing bank fragility as a *chronic* condition.⁷⁵ This has had two implications. The first is that economic growth (in the Eurozone particularly) is hit by a double whammy of public sector retrenchment and declining credit levels as banks reduce their loans. The second, as the FSB has noted in its reviews on shadow banking, is that shadow bank's lending activity is growing at a stronger rate than that of traditional banks.⁷⁶
- 5.55** Bank supervisors have also been confronted with the challenge of banks becoming increasingly fragile due to long-term weakness of the economy, at the same time that they are trying to improve their resilience through increased capital buffers. Assets turn more frequently into non-performing loans (NPLs), financially fragile sovereigns put the investment grade status of treasury bills in question in some countries, and banks and sovereigns in some countries find themselves periodically cut off from financial markets, which increases their fragility. For this reason, bank resolution and the treatment of NPLs has come onto the radar for bank regulators. However, this research has been located in the BIS (specifically the Financial Stability Institute),⁷⁷ and most importantly the International Association of Deposit Insurers (IADI, below).
- 5.56** In banking, the macroeconomic effect of macro prudential regulation is a trade-off: better bank resilience against future, indeterminate credit events paid for with a reduction of credit in the general economy, at least in the short to medium term. This trade-off was seen in 2017 in a European dispute referred to the Basel committee on whether European

⁷⁴ Shawn Donnelly, *Power Politics, Banking Union and EMU: Adjusting Europe to Germany* (Routledge 2018) (hereafter Donnelly, *Power Politics, Banking Union and EMU*).

⁷⁵ Bill Allen, Ka Kei Chan, Alistair Milne, and Steve Thomas, 'Basel III: Is the cure worse than the disease?' (2012) 25 *International Review of Financial Analysis* 159–66; Sami Ben Naceur, Katherin Marton, and Caroline Roulet, 'Basel III and Bank-Lending: Evidence from the United States and Europe' (2018) 39 *Journal of Financial Stability* 1–27.

⁷⁶ Financial Stability Board, 'Global Shadow Banking Monitoring Report 2017' (Basel, 5 March 2018).

⁷⁷ Patrizia Baudino and Hyuncheol Yun, 'Resolution of non-performing loans—policy options' (2017) FSI Insights on Policy Implementation No 3.

banks would have to treat government bond assets from certain countries like Greece or Italy as safe or risky. Germany had brought up the issue as a quid pro quo for discussing the establishment of a European Deposit Insurance Scheme for the Eurozone. While the Eurozone crisis demonstrated that the bonds were in fact risky, Basel rules still allowed banks to determine themselves that the bonds were safe, even after review in Basel III. Doing so would absolve banks of any legal responsibility to raise capital against the likelihood of default. In addition to bank lobbying, the hostility of the US Trump administration to sharpened rules⁷⁸ was followed by stalemate. In late 2017, the BCBS ruled that it could not rule on the question,⁷⁹ demonstrating the limits of consensus-based decision-making on sensitive topics.⁸⁰

Otherwise, Basel standards form the core for European capital adequacy standards, embodied in the Capital Adequacy Directive IV and the Capital Requirements Directive (2013). These standards adopted Basel initially for nearly all banks, but then later in 2017 carved out exceptions for smaller banks to relieve pressure on their finances. CAD IV and the CRR then formed a core measuring stick by which the ECB could determine whether a bank was sufficiently capitalized or whether it had to be resolved (shut down)(discussed below).

5.57

D. IADI: International Association of Deposit Insurers

In the aftermath of the GFC, various national authorities worldwide reacted to protect deposits in differing ways, and with differing effects. A result of the process led to the following conclusions about how Deposit Insurance (DI) contributes to financial stability. Reimbursement should be set so that it covers the maximum number of depositors (reducing the likelihood of a panic), at a reasonable amount (many systems found they had too little coverage to contain panic) but not an unlimited volume of deposits (to contain taxpayer costs and encourage large institutional depositors to monitor bank behaviour). Furthermore, DI should be paid for by banks before crises to act (ex ante funding) as countercyclical shock absorbers in time of crisis, and paid out as quickly and simply as possible. All of these core principles are reflected in European deposit insurance regulations. DI also can and should be deployed as part of resolution. Resolution involves winding down a bank without causing collateral damage to other institutions. Asset separation, sale, and transfer are standard tools that can be used swiftly to ensure that bank customers are moved to another institution without the delays or uncertainties of regular insolvency law. This means that the rights of shareholders, creditors, and other counterparties can be set aside. In the wake of the GFC, many countries found themselves

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⁷⁸ Caroline Binham, 'Basel puts new banking policy initiatives on hold until 2019 pending review' *Financial Times* (25 April 2017).

⁷⁹ Fiona Maxwell and Bjarke Smith-Meyer, 'Basel banking reform talks to prevent future financial crises fail again' *Politico* (16 June 2017).

⁸⁰ BCBS, 'The regulatory treatment of sovereign exposures—discussion paper' (Basel, 7 December 2017); Shawn Donnelly, 'Financial Stability Board (FSB), Bank for International Settlements (BIS) and Financial Market Regulation Bodies: ECB and Commission Participation Alongside the Member States' in Jed Odermatt and Ramses A Wessel (eds), *Research Handbook on the EU's Engagement with International Organizations* (Edward Elgar Publishing 2019).

learning by doing, and agreeing that banks should pay ex ante into resolution funds to be used to prevent contagion effects from bank failure, much like deposit insurance, to minimize the pressure on central banks and national treasuries to bail out banks, particularly ones considered too big to fail (TBTF).

- 5.59** The International Association of Deposit Insurers (IADI) was formed in May 2002 to enhance the effectiveness of deposit insurance systems by promoting guidance and international cooperation. Members of IADI conduct research and produce guidance for the benefit of those jurisdictions seeking to establish or improve a deposit insurance system. Members also share their knowledge and expertise through participation in international conferences and other forums. IADI currently has eighty-three members who represent deposit insurance organizations. IADI is a non-profit organization constituted under Swiss Law and is located at the Bank for International Settlements in Basel, Switzerland. The supreme authority in all matters of the Association is the General Meeting of its members. IADI is governed by the Executive Council, composed of individuals elected by the Members. Members of the Executive Council must comply with IADI's Code of Conduct. The Executive Council is structured as a working body with broad participation encouraged by means of a committee structure that is largely self-reliant. All members of the Executive Council serve on at least one of the Association's four Council Committees, and perhaps also Technical Committees, which other Members and Associates may join. In addition, Regional Committees have been created for Africa, Asia-Pacific, the Caribbean, Eurasia, Europe, Latin America, the Middle East and North Africa, and North America, to reflect regional interests and common issues through the sharing and exchange of information and ideas.
- 5.60** IADI consulted with the European Commission regarding Core Principles, along with the European Forum of Deposit Insurers, the FSB, IMF and World Bank. Those principles were formed parallel to the EU's own legislation, the Deposit Guarantee Systems Directive 2014/49/EU.
- 5.61** IADI is also supported by the Bank for International Settlements, and promotes policy learning, exchange of views and best practice, and generates principles of good deposit insurance.⁸¹ In addition, it deals with bank resolution, and questions of public backstops (government financial assistance to the financial sector to prevent systemic collapse). Its purpose is to design principles of deposit insurance and resolution mechanisms based on mutual exchange and policy learning so that when a bank collapses, it does not lead to a chain reaction of bank failures (financial contagion) or bank runs (in which depositor fears of bank failure lead them to withdraw deposits, causing the bank to fail).
- 5.62** Finally, IADI also concluded that deposit insurance should also be buttressed by a public backstop to be called on in time of systemic crisis. A properly-designed DIS should minimize the need for public backstops, and minimize the likelihood of contagion, thereby also reducing the likelihood of expansionary monetary and policy to compensate for losses, but cannot handle all eventualities.

⁸¹ IADI, 'Core Principles for Effective Deposit Insurance Systems' (Basel, November 2014).

E. IOSCO and CPMI

The International Organization of Securities Exchange Commissions (IOSCO), deals with financial markets (traditionally stock and bond markets), including shadow banks (hedge funds, special purpose vehicles), credit rating agencies, securitization, and (jointly) central counterparties. IOSCO dates back to 1983 as a US-backed initiative to spread the acceptance of open, transparent financial markets and prudential regulation. It is the most open of the ISSBs, with most countries represented. Before the GFC, its ethos was one of promoting open and frank discussions about financial market developments, regulation, and promoting policy learning and experimentation. Principles of securities regulation were considered to be the extent of their soft law ambitions, as it was feared that anything further would stifle debate and learning. After 2008, however, IOSCO came under pressure from the G20 and the FSB to upgrade its legal output to cover most of what did not fall under banks or insurance. This has led to research on (dealing with) hedge funds,⁸² as well as principles for dealing with credit rating agencies⁸³ and fintech⁸⁴ alongside its traditional areas of business, in addition to the new work in central counter parties (see further section 4). **5.63**

IOSCO is the broadest organization in terms of membership in the global financial stability architecture. Nearly all countries have representatives in it, and decisions are still taken by consensus. It sees the open nature of the organization and the general nature of its principles and guidelines as a strength that encourages open debate and mutual learning about financial market trends, strengths, weaknesses, opportunities and threats that would prove more difficult if negotiations were to ensue about binding and extensive standards. In this sense, IOSCO has remained more aloof than the other ISSBs in relative terms about developing clear regulatory standards. **5.64**

IOSCO is headed by a General Secretary, and organized since 2012 into a Board that steers the organization's activity. It consists of eighteen permanent and sixteen rotating members. France, Germany, Italy, the Netherlands, Spain, and the UK (still a member at the time of writing) are permanent Board members from the EU. Formal decisions are taken by the President's Committee, which is in fact the General Assembly. The work of IOSCO is handled by a series of Committees, each with the task of seeking out consensus on how standards and guidelines might look, and how they might be different in different settings. The most important overall is the Technical Committee, which meets at different places worldwide to gather differing views in a broad-based consultation process. The Emerging Markets Committee deals both with the sometimes more lively and volatile nature of financial markets in those countries, and the more challenging nature of complying with standards appropriate elsewhere. The Assessment Committee brings together experts in the area of supervision. Regional Committees (which includes the European Regional Committee with twenty-two non-EU members and twenty-eight EU members) debate and consult on generally accepted interpretations of general standards in their regions. Finally, there are a number of Consultative Committees (Issuer Accounting & Disclosure; Secondary Markets; Market Intermediaries; Enforcement & Exchange of Information; Investment Management; **5.65**

⁸² IOSCO, 'Hedge Funds Oversight: Final Report' (Madrid, June 2009).

⁸³ IOSCO, 'Code of Conduct Fundamentals for Credit Rating Agencies' (FR05/2015, Madrid, March 2015).

⁸⁴ IOSCO, 'IOSCO Research Report on Financial Technologies (Fintech)' (FR02/2017, Madrid, February 2017).

Credit Ratings Agencies; Commodities Derivative Markets; and Retail Investors) that provide a sounding board for IOSCO on the substantive standards that the organization is considering adopting, whether at an initial or more advanced stage of debate.

- 5.66** Both the European Commission (represented by DG FISMA) and the European Securities and Markets Authority (ESMA) are associate members of IOSCO since 2012, which provides them with the opportunity to participate and speak, but not to vote. This puts them in the same category as the Financial Services Authority of Monaco and Kazakhstan, who are the other two associates. The Commission's request to sit on the Board was denied. In contrast, all EU MS are ordinary members. Six are permanent board members.
- 5.67** IOSCO works together with CPMI (Committee on Payments and Market Infrastructures) at the Bank for International Settlements (BIS) to develop standards on central counterparties (CCPs). With this in mind, they jointly developed Principles for Financial Market Infrastructures (PFMI) in 2012. CCPs are required to assess what level of finances are required to manage liquidity and credit risk. CPMI and IOSCO introduced stress testing in 2012 and reviews in 2015 and 2017. This work was further enhanced by an April 2015 work plan on CCP resilience, recovery and resolvability.
- 5.68** CPMI and IOSCO are central to improving the stability-oriented features of the GFSM that make securitization a major component of the global economy. It therefore has implications for the global supply of liquidity. IOSCO standards on securitization are therefore central to new EU plans to stabilize and rejuvenate the EMU economy through Capital Markets Union (a securitization plan to spin off toxic assets from zombie banks, and issue new loans to the economy) rather than a Fiscal Union.

F. The OECD

- 5.69** The Organization for Economic Cooperation and Development (OECD) is an intergovernmental organization that is devoted to a wide range of economic, social and technological policy issues related to competitiveness and quality of life, and related issues of public governance that impact the adoption of improvements in a positive or negative way. Its relevance to financial stability is centred on the issues of public finance, macroeconomic (im)balances on the various forms of structural adjustment that can make national economies sustainable. It provides economic policy analysis and performance surveillance, plus cutting-edge analysis of future trends and best practice. On principle its guidelines and principles stick to formulae that focus on common ground between members. However, it also issues country reports (general and macroeconomic imbalances) and economic performance data (national accounts).
- 5.70** OECD has thirty-six members. European Commission representatives participate alongside Members in discussions on the OECD's work programme, and are involved in the work of the entire Organization and its different bodies. While the European Commission's participation goes well beyond that of an observer, it does not have the right to vote and does not officially take part in the adoption of legal instruments submitted to the Council for adoption. The Council is the main decision-making body, representing all members of the organization. It may adopt legally binding decisions and enter into agreements with

members, non-Members and other international organizations. In addition, the Council may issue recommendations. Decisions are taken on the basis of consensus. 250 specialized bodies, called Committees or specialized bodies are in charge of the substantive work of the organization.

OECD research into the impact of Growth Policies on Macroeconomic Stability⁸⁵ underline that growth policies follow a combination of an accommodative monetary policy indicated by low interest rates (given contemporary low inflation levels), close attention to avoiding fiscal and macroeconomic imbalances, plus structural adjustments and strategic investments in new sunrise sectors. While these growth policies are generally beneficial, they can backfire if combined with rigidities in labour and product markets. OECD research is therefore necessarily granular and pragmatic, stressing a combination of growth-inducing and structural adjustment features. Concerned with macroeconomic imbalances, it is also the place where illusionary growth is called out as a risky path to recovery. This takes place in light of recent attention to asset price bubbles in the housing and raw materials sectors. Overall, OECD recommendations are not specifically contractionary, but focused on sustainable growth, without front-loading macroeconomic contraction measures.

5.71

G. IMF

The International Monetary Fund (IMF) and its staff provide for financial stability in two separate ways: by providing lines of credit to national governments in financial distress (or at risk of becoming so); and by assessing the health of national economies and financial sectors (surveillance). The former task has been the IMF's core contribution to global financial stability since its inception in 1945. The latter dates back to 1952, when the IMF first introduced a policy of imposing conditions in return for financial assistance.

5.72

The IMF is a large international organization with 189 State members, including all EU Member States. At the top of its organizational structure is the Board of Governors, consisting of one governor and one alternate governor from each member country, usually the top officials from the central bank or finance ministry. The Board of Governors meets once a year at the IMF–World Bank Annual Meetings. Twenty-four of the governors serve on the International Monetary and Financial Committee (IMFC), which advises the IMF's Executive Board on the supervision and management of the international monetary and financial system. The day-to-day work of the IMF is overseen by its twenty-four-member Executive Board, which represents the entire membership and supported by IMF staff. The Managing Director is the head of the IMF staff and Chair of the Executive Board and is assisted by four Deputy Managing Directors.

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The IMF⁸⁶ has a key role in approving capital controls, debt forgiveness, and promoting bazookas (countercyclical public backstops) that EMU does not provide. Its policy focus

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⁸⁵ Douglas Sutherland and Peter Hoeller, 'Growth Policies and Macroeconomic Stability' (2014) OECD Economic Policy Papers No 8; OECD, 'How do growth-promoting policies affect macroeconomic stability?' (2014) OECD Economics Department Policy Notes No 22.

⁸⁶ Adam Feibelman, 'Law in the Global Order: The IMF and Financial Regulation' (2017) 49 *NYU Journal of International Law and Politics* 687.

has adopted lessons from the 1997 crisis that have led it to stress budget retrenchment and structural adjustment policies less vigorously and to allow for more growth-oriented parts of the macroeconomic policy mix.⁸⁷ In light of the Eurozone crisis, it has found itself in two different roles. It is a critical part of the Troika that provides advice on financial assistance under the ESM (Article 13(1), (2), and (7) ESM Treaty) and provides loans to programme countries cut off from financial markets. It also provides policy advice on public backstops, fiscal and monetary policy, and debt sustainability for program countries (receiving ESM assistance).⁸⁸ These policy advices are in line with the rest of the GFSA and leading in the macroeconomic policy field in that they support a common public backstop to the Eurozone (not just provided by the ECB), and have been pragmatic about the introduction of capital controls and the use of debt forgiveness in the absence of such a backstop.⁸⁹

5.75 In light of the Eurozone Crisis' practical developments in 2015, the IMF' found itself in the difficult position of being at odds with the Eurogroup, which is not as such part of the Troika, but is an effective veto player in talks over financial assistance and conditionality. IMF advice to reduce demands on Greece went unheeded to the point that the IMF nearly withdrew from the arrangement.⁹⁰

5.76 The EU is not a member of the IMF. IMF influence on the EU, however, has been clearly visible over the past years. As shown in a study by Bergthaler, this is visible in three different ways: First, certain obligations under the IMF's Articles may have a direct binding effect on the EU, to the extent that the EU assumed the Member States' competences under the TFEU related to obligations under the IMF's Articles. Second, in the Member States' exercise of their rights and obligations under the IMF's Articles, IMF law interacts with and impacts EU law indirectly by way of EU Member States; and with respect to the specific field of financing and financial operations, EU law absorbed and was receptive to 'borrow' concepts and terminology from IMF law. Third, IMF law and EU law use similar concepts.⁹¹

H. Interim conclusions: the GFSA and macroeconomic policy

5.77 The GFSA has been remarkably active since 2008, and by some measures, extremely effective in preventing a sharp, global shock from developing into a global depression. What the sections above leave unrecorded is the role of the United States, and the Federal Reserve in particular, in getting the ball rolling in the early stages of the crisis to ensure that key central banks, the ECB included, were providing enough extra cash to their distressed economies and governments.⁹² They also leave untouched the fact that these GFSA bodies are

⁸⁷ Kevin Farnsworth and Zoë Irving, 'Deciphering the International Monetary Fund's (IMFs) position on austerity: Incapacity, incoherence and instrumentality' (2017) 18 *Global Social Policy* 119–42.

⁸⁸ See also Chapters 12, 30, and 33.

⁸⁹ Moschella, 'The institutional roots of incremental ideational change' (n 69) 442–60; Ban and Gallagher, 'Recalibrating Policy Orthodoxy' (n 7) 131–46;

⁹⁰ Daniel W Drezner, 'The IMF clears its throat very, very loudly on Greece' *Washington Post* (15 July 2015).

⁹¹ Wolfgang Bergthaler, 'The Relationship Between International Monetary Fund Law and European Union Law: Influence, Impact, Effect, and Interaction' in Ramses A Wessel and Steven Blockmans (eds), *Between Autonomy and Dependence: The EU Legal Order Under the Influence of International Organisations* (TMC Asser Press 2013) 159, 195.

⁹² Daniel W Drezner, 'The system worked: Global economic governance during the great recession' (2014) 66 *World Politics* 123–64.

relegated to the sidelines in the event of a major dispute between Europe and the United States.⁹³

After that moment, however, it was up to the G20, who made it up to the institutions of the GFSA to sort out the mechanisms of recovery, resilience, and future crisis prevention. The GFSA's effort to upgrade financial stability and resilience is taken to take two separate moves: by upgrading regulatory standards and through those standards the safety of the banking, securities and insurance markets (in that order); and by linking them together in the pursuit of macro prudential insights, regulation and financial sector compliance. The first of these implies upgrading common standards of regulation and practice, while the second reflects a shift to macro prudential regulation beyond the simple use of monetary and fiscal policy to even out economic cycles and absorb systemic shocks to the global economy. **5.78**

The use of macroeconomic policy in contrast, remained officially the remit of the G7 and the G20, where a dispute between Germany and the other members could be managed. This did not prevent key GFSA institutions, however, particularly the IMF and the OECD from advocating the use of expansionary monetary and fiscal policy resources, and their creation in the case of the Eurozone, to provide the ultimate backstops for financial stability. This included advice on the microprudential innovations for the European banking sector and EMU as a whole, discussed further below. **5.79**

All in all, there is a significant body of, primarily soft, law coming from international standard-setting bodies, the FSB included, that have implications for EMU and how it is further stabilized. There are also peer review mechanisms intended to ensure that Member States transpose those expectations into national hard law. It is also expected that they are reflected in EU law as it retrofits EMU to be more stable. As will be seen hereafter, however, the EU has been highly selective in how it does this based on its own internal disputes. National politics (or in the case of the EU, international politics) filters international soft law. **5.80**

IV. An Influence of International Law and Policies on the EMU?

A. Soft law and its implications

In the context of the present chapter, it is important to note that the extent that international law and standards in financial stability impacts EMU, it does so by a combination of technical standard setting and a broad application of data collection, rather than norm setting and diffusion over choices in macroeconomic policy, regulation and surveillance. Indeed, the focus on 'soft law' is a clear element of financial regulation and has extensively been analysed over the past years.⁹⁴ On the basis of existing research, the reasons to opt for soft **5.81**

⁹³ John C Coffee Jr, 'Extraterritorial Financial Regulation: Why ET Can't Come Home' (2014) 99 Cornell Law Review 1259.

⁹⁴ David T Zaring, 'Finding Legal Principle in Global Financial Regulation' (2012) 52 Virginia Journal of International Law 683; Brummer, 'Why soft law dominates international finance' (n 6) 623-43; Lawrence L C Lee, 'The Basle accords as soft law: Strengthening international banking supervision' (1998) 39 Virginia Journal

law are also quite clear and they range from financial topics mostly being in the hands of the executive branch,⁹⁵ a preference for more flexibility, to the involvement of various State and non-State actors.⁹⁶ More in general, the highly technical nature of a policy area may define the 'governance arrangement' that is being chosen to make international cooperation possible.⁹⁷

5.82 This is not the place to revisit the classic, extensive, and ongoing debate on soft law in international legal scholarship. In general, soft law has been defined as 'rules of conduct that are laid down in instruments which have not been attributed legally binding force as such, but nevertheless may have certain (indirect) legal effects, and that are aimed at and may produce practical effects'.⁹⁸ The absence of 'legally binding force' is indeed a common way of distinguishing soft law from hard law. As argued by one of the present authors elsewhere, however, this characteristic is confusing and does not seem to do justice to the fact that these norms (as *law*) form part of the legal order and that they commit the actors involved.⁹⁹ The following description by Saurugger and Terpan is therefore more helpful:

Soft law refers to those norms situated in-between hard law and non-legal norms . . . Hard law corresponds to the situation where hard obligation (a binding norm) and hard enforcement (judicial control or at least some kind of control including the possibility of legal sanctions) are connected. Non-legal norms follow from those cases where no legal obligation and no enforcement mechanism can be identified . . . In-between these two opposite types of norms lie different forms of soft law: either a legal obligation is not associated with a hard enforcement mechanism or a non-binding norm is combined with some kind of enforcement mechanism.¹⁰⁰

of International Law 1; Glenn Morgan, 'Market formation and governance in international financial markets: The case of OTC derivatives' (2008) 61 *Human Relations* 637–60; Abbott and Snidal, 'Hard and soft law in international governance' (n 6) 421–56; Arner and Taylor, 'The global financial crisis and the financial stability board' (n 6) 488; Pierre-Hugues Verdier, 'The political economy of international financial regulation' (2013) 88 *Indiana Law Journal* 1405.

⁹⁵ Galbraith and Zaring, 'Soft law as foreign relations law' (n 6) 735.

⁹⁶ Anna Di Robilant, 'Genealogies of soft law' (2006) 54 *The American Journal of Comparative Law* 499–554; Pauwelyn, Wessels, and Wolters, *Informal international lawmaking* (n 5); Kal Raustiala and Anne-Marie Slaughter, 'International law, international relations and compliance' (2002) Princeton Law & Public Affairs Paper No 02-2; Ryan Goodman and Derek Jinks, 'How to influence states: Socialization and international human rights law' (2004) 54 *Duke Law Journal* 621–703; Emilie M Hafner-Burton, David G Victor, and Yonatan Lupu, 'Political science research on international law: the state of the field' (2012) 106 *The American Journal of International Law* 47–97; Friedrich V Kratochwil, *Rules, norms, and decisions: on the conditions of practical and legal reasoning in international relations and domestic affairs* (CUP 1991); Richard H Steinberg and Jonathan M Zasloff, 'Power and international law' (2006) 100 *American Journal of International Law* 64–87; Claudio M Radaelli, 'Harmful tax competition in the EU: policy narratives and advocacy coalitions' (1999) 37 *Journal of Common Market Studies* 661–82.

⁹⁷ Ramses A Wessel and Evisa Kica, 'Political Economy and the Decisions of International Organizations: Choosing Governance Arrangements through Informality' in Alberta Fabbriotti (ed), *The Political Economy of International Law: A European Perspective* (Edward Elgar Publishing 2016) 127–58.

⁹⁸ Linda Senden, *Soft Law in European Community Law* (Hart Publishing 2004) 112.

⁹⁹ See in particular on the use of institutional legal theory to define what belongs to a legal order also Ramses A Wessel, 'Resisting Legal Facts: Are CFSP Norms as Soft as They Seem?' (2015) 20 *European Foreign Affairs Review* 123–46. See for a description of other international arrangements also Dinah Shelton, 'International Law and "Relative Normativity"' in Malcom D Evans (ed), *International Law* (4th edn, OUP 2014) 137, 159: 'any international instrument other than a treaty containing principles, norms, standards, or other statements of expected behaviour'.

¹⁰⁰ Sabine Saurugger and Fabien Terpan, 'Studying Resistance to EU Norms in Foreign and Security Policy' (2015) 20 *European Foreign Affairs Review* 1, 5. See also Fabien Terpan, 'Soft Law in the European Union—The Changing Nature of EU Law' (2015) 21 *European Law Journal* 68–96.

The absence of judicial control as well as, more generally, the absence of procedural rules, allegedly provides freedom to the actors to be more flexible as to what they agree on and how they arrange that. And, indeed, in principle international actors are free to choose their own means of committing themselves and in establishing the legal nature of an instrument.¹⁰¹ In international law, the potential problems caused by a move from hard to soft law have been highlighted,¹⁰² At the same time, it has however been pointed out that a 'turn to informality' should not *per se* have negative consequences for, for instance, the legitimacy of norms when 'thin State consent' (the traditional basis for international agreements) is being replaced by 'thick stakeholder consensus' (resulting from the participation of not just governmental actors).¹⁰³

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In the case of EMU, the 'soft law' standards seem to have allowed the EU to pick and choose what seemed to work best in a highly politicized policy area. Economic and Monetary Union turned twenty years old in 2019. As the contributions to the present Volume testify, it has been a great achievement for the European Union, but an incomplete construction that has been fought over, modified and expanded over time.¹⁰⁴ As the EU has stumbled from one crisis to another since its establishment, the Eurozone in particular has adopted some of these standards and involved institutions according to a logic of political utility.¹⁰⁵ Rather than technocratic expertise, which is what the international institutions and standards promote, the adoption procedure periodically selects or rejects these standards on the basis of political criteria.¹⁰⁶ These sometimes reflect the priorities of the EU's most powerful Member States—when adopting international standards or not is controversial—and sometimes a broad consensus that deviations are desirable. Notable is that some of these standards are now enshrined in treaties and funds (EFSE, ESM, and SRF) designed to buttress EMU financial stability, but from outside the EU legal framework, by virtue of international treaty and intergovernmental agreement (IGA), where they remain non-justiciable by the CJEU. This has been the result of a political demand from Germany, which sought to impose more stringent legal obligations on EU Member States and their EMU and related policy issues than those Member States would allow under EU voting rules. The result is that each national government is responsible for promoting financial stability, that private investors are forced to pay as well for financial collapses alongside sovereigns, and that the EU's fiscal capacity remains severely constrained. The legal instruments to ensure responsible sovereignty of the Member States is anchored in these non-EU instruments.

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The EU has selectively adopted international rules on financial stability. While in some cases EU rules are basically a copy of an international norm (a good example being Regulation 1060/2009, which clearly reflects the IOSCO Code of Conduct on CRA regulation¹⁰⁷),

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¹⁰¹ Also the Court of Justice of the European Union is of the opinion that the intention of the parties 'must in principle be the decisive criterion'. See Case C-233/02 *France v Commission* [2004] ECR I-2759, para 42.

¹⁰² See for instance Anne Peters, 'Soft Law as a New Mode of Governance' in Udo Diedrichs, Wulf Reinert, and Wolfgang Wessels (eds), *The Dynamics of Change in EU Governance* (Edgar Elgar Publishing 2011).

¹⁰³ Pauwelyn, Wessels, and Wolters, *Informal international lawmaking* (n 5).

¹⁰⁴ See additionally Michele Chang, *Economic and monetary union* (Palgrave Macmillan 2016).

¹⁰⁵ Shawn Donnelly, 'Explaining EMU reform' (2005) 43 *Journal of Common Market Studies* 947–68; Martin Heipertz and Amy Verdun, *Ruling Europe: The politics of the stability and growth pact* (CUP 2010); Dermot Hodson, 'Eurozone governance: From the Greek drama of 2015 to the five presidents' report' (2016) 54 *Journal of Common Market Studies* 150–66.

¹⁰⁶ Donnelly, 'ECB-Eurogroup conflicts and financial stability in the Eurozone' (n 60); Shawn Donnelly, 'Banking Union in Europe and Implications for Financial Stability' (2014) 67(2) *Studia Diplomatica* 21–34.

¹⁰⁷ See Fabian Amtenbrink and Jakob de Haan, 'Credit Rating Agencies' (2011) DNB Working Paper No 278.

counter examples may be found in the rejection of IMF and OECD advice on the provision a public backstop to EMU, the selective emulation of macroeconomic policy advice by the IMF in EMU Member State budget surveillance (European Semester and the Macroeconomic Imbalances Procedure) and in the selective use of Basel Committee banking standards and recommendations on capital adequacy (in the context of establishing banking union to stabilize EMU). In the case of Capital Markets Union, which is designed to stabilize EMU in ways that Banking Union did not, it remains to be seen how the EU will adopt (parts of) standards, recommendations and insight from IOSCO. The same selective adoption applies to standards brought forward by the FSB, which brings these microprudential standards together.

- 5.86** Some, but not all the standards and approaches have been used as blueprints for stabilizing EMU after the onset of the Eurozone crisis in 2010. In some cases, the EU has promoted the development of these standards, in others used them to resolve disputes over how to proceed. And in others, EU politics rejected the advice of these bodies to stabilize EMU with new innovations. In general, however, substantive influence of international (soft) law on EMU rules remains very limited.¹⁰⁸ The following sub-sections will, nevertheless, briefly highlight some examples of institutional links in relation to some key policy areas.

B. EMU-GFSA links in macro- and microprudential surveillance

- 5.87** Certain European institutional initiatives in the area of surveillance are clearly influenced by global institutional developments. The European Systemic Risks Board (ESRB) and the European Financial Stability Facility (EFSF) were established in 2011 and mirror the Financial Stability Board, plus the main ISSBs: the BCBS, IOSCO and IAIS. The EFSF consists of three European Supervisory Authorities: the European Banking Authority (EBA: responsible for collectively recommending improvements to how the EU adopts and applies Basel Committee capital adequacy standards; conducting stress testing of banks; and working together with the ECB to develop and apply a Single Rulebook on banking supervision); the European Securities and Markets Authority (ESMA: responsible for collectively recommending improvements to how the EU adopts and applies law and regulation regarding securities markets); and the European Insurance and Occupational Pensions Authority (EIOPA: which does the same for insurance markets). The European Supervisory Authorities (ESAs) do not have formal lawmaking powers, but recommend to the Commission, which does.¹⁰⁹ They have more formal powers in coordinating and supervising implementation by national authorities within the context of EU law.¹¹⁰
- 5.88** The influence of developments at the global level is clearly visible on the ESAs having a mildly contractionary effect in the banking sector in the medium term as efforts continue to increase resilience. In the securities sector, the effect is currently accommodating, and

¹⁰⁸ Mügge, 'Europe's regulatory role in post-crisis global finance' (n 12); Elliot Posner and Nicolas Véron, 'The EU and financial regulation: power without purpose?' (2010) 17 *Journal of European Public Policy* 400–15; Newman and Bach, 'The European Union as hardening agent' (n 8).

¹⁰⁹ Marta Simoncini, 'Legal boundaries of European Supervisory Authorities in the financial markets: Tensions in the development of true regulatory agencies' (2015) 34 *Yearbook of European Law* 319–50.

¹¹⁰ See also Chapter 34 (Part VIII) Volume on the EFSF and the ESAs.

intended to lay the groundwork for future expansion, but is also working on measures to increase safety and resilience. This can be seen in both the EU's Capital Markets Union (CMU) project,¹¹¹ and the 2012 regulation of Central Counterparties,¹¹² as the infrastructural backbone of financial stability in the derivatives trading sector. In this area, the EU is fully in line with the GFSA's proposals, but not in a way that provides cohesiveness to the Eurozone itself.

The ESRB both mirrors the FSB and works somewhat differently from it. Like the FSB's relationship to the BIS, the ESRB is hosted by the ECB. Decisions are adopted by the General Board, consisting of the ECB's President and Vice President, the heads of the EU's national central banks, representatives of the Commission and ESAs, and representatives from two ESRB committees: the Advisory Technical Committee and the Advisory Scientific Committee. Unlike the FSB, it provides a wider range of overarching advice to EU institutions regarding state of the art in financial stability research and policy learning, future challenges, and best practice in macroeconomic and microeconomic developments, supervision and regulation.¹¹³ As an overview body, it shares with the ECB a mission to work on the linkages between macroeconomic and microeconomic parts of the regulatory and policy puzzle, and to map possible strategies forward.

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In this context, the ESRB works together with the EFSF to bridge supervision, resolution, and deposit insurance, with the ultimate goal of enhancing financial stability and systemic resilience. The latter involves in particular ending a negative feedback loop between financially fragile sovereigns (national governments) and banks located within their jurisdictions. Unlike macro prudential bodies elsewhere at the national level, however, the ESRB is purely advisory. This applies as well to its academic advisory board. The European Supervisory Authorities (pensions, banks, financial markets) replicate the behavioural approach of their global counterparts even more strongly. This is visible in the compilation of financial stability risk dashboards in each of the authorities.¹¹⁴ This reflects a neutral approach to the issue of risk analysis that sidesteps disagreements within the Eurozone and across Europe over the relative importance of various factors in laying the groundwork for crises and engineering resilience.

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C. EMU-GFSA links in macroeconomic and monetary policy

The ECB is responsible for price stability in the Eurozone, and for financial stability, particularly through the use of monetary policy. It also represents the EU at the FSB as the

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¹¹¹ Nicolas Véron, 'Defining Europe's capital markets union' (2014) Bruegel Policy Contribution No 2014/12; David Howarth, Lucia Quaglia, and Moritz Liebe, 'The political economy of European capital markets union' (2016) 54 *Journal of Common Market Studies* 185–203; Lucia Quaglia and David Howarth, 'The policy narratives of European capital markets union' (2018) 25 *Journal of European Public Policy* 990–1009;

¹¹² European Parliament and Council Regulation (EU) 648/2012 of 4 July 2012 on OTC derivatives, central counterparties and trade repositories Text with EEA relevance [2012] OJ L201/1.

¹¹³ European Parliament and Council Regulation (EU) 1092/2010 of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board [2010] OJ L331/1; Council Regulation (EU) 1096/2010 of 17 November 2010 conferring specific tasks upon the European Central Bank concerning the functioning of the European Systemic Risk Board [2010] OJ L331/162.

¹¹⁴ Anat Keller, 'Collecting Data: How Will the ESRB Overcome the First Hurdle towards Effective Macro-Prudential Supervision' (2013) 24 *European Business Law Review* 487.

competent authority for monetary policy in the Eurozone. Overall, the ECB's thinking and behaviour has been close to that of its counterparts in the GFSM, and has pushed that view on the Eurozone where the Eurogroup has not been able to steer its countries out of the EZC. The Eurogroup contests this, and continues a strong narrative of how their efforts to impose austerity (fiscal contraction) are bearing fruit through economic growth and will continue to do so (expansionary contraction),¹¹⁵ Europe's flat economic growth and anemic price developments suggest otherwise.

- 5.92** The ECB's willingness to engage in Outright Monetary Transactions (OMT) in 2012 (whatever it takes to save the euro) and its later foray into quantitative easing therefore meant a rift between itself and the Eurogroup over monetary policy. Whereas the Maastricht Treaty explicitly forbids the ECB from purchasing treasury bills directly from Member States, the (OMT) announcement of June 2012 threatened to do just that, to which plaintiffs at the German Federal Constitutional Court objected.¹¹⁶
- 5.93** ECB attempts to convince the Eurogroup to sequence a package of growth-inducing measures, followed by structural adjustments, and then finally some austerity,¹¹⁷ have fallen on deaf ears. The ECB has the independence to determine its own policy course and has expanded that room since the EZC, but also has no means to force the Council to do what it prefers. The result is that the Council and the ECB are at odds in an extended stalemate. While the ECB seeks to keep the Eurozone afloat and inject liquidity into the economy, the Council is determined to ratchet that liquidity down, both through more limited government borrowing and spending, and through pressure to reduce domestic credit creation (through the MIP). A linking of monetary, fiscal, structural adjustment and strategic investment policies as recommended by the ECB therefore seems to be a more promising, if politically unlikely course of action for the Council to follow.

D. EMU-GFSM links in relation to Banking Union

- 5.94** EMU's greatest problem extended beyond the solvency of national governments to include national banking systems by 2012.¹¹⁸ This demonstrated the failure of the EBA to properly ensure supervision in the EU, so that a further step was taken to give some of those tasks to the ECB. The ECB accordingly has a second seat at the FSB in its role as supervisor for the Eurozone's largest systemically important banks. In 2012, Spain received financial assistance from its fellow Eurozone members through the European Stability Mechanism (ESM) to help recapitalize some of its banks, particularly local savings and cooperative banks that had lent aggressively before the crisis and suffered badly due to extended recession.¹¹⁹

¹¹⁵ Klaus Regling, 'The ESM after 5 years: successes, challenges and perspectives' (The Bridge Forum Dialogue, Luxembourg, 30 November 2017); Guy Chazan, Jim Brunsden, and Mehreen Khan, 'Wolfgang Schäuble feels vindicated by tough bailout policies' *Financial Times* (8 October 2017).

¹¹⁶ See on the *Gauweiler* case, Chapter 41.

¹¹⁷ Mario Draghi, 'Introductory remarks by Mario Draghi' (Portuguese Council of State, Lisbon, 7 April 2016).

¹¹⁸ David Howarth and Lucia Quaglia, 'Banking union as holy grail: Rebuilding the single market in financial services, stabilizing Europe's banks and "completing" economic and monetary union' (2013) 51 *Journal of Common Market Studies* 103–23; Rachel A Epstein, *Banking on Markets: The Transformation of Bank-State Ties in Europe and Beyond* (OUP 2017).

¹¹⁹ Richard Deeg and Shawn Donnelly, 'Banking union and the future of alternative banks: revival, stagnation or decline?' (2016) 39 *West European Politics* 585–604; Rachel A Epstein and Martin Rhodes, 'The political dynamics behind Europe's new banking union' (2016) 39 *West European Politics* 415–37; David Howarth and Lucia Quaglia,

A *quid pro quo* from Germany was the improvement of supervision. The need to provide some kind of means for stopping financial contagion throughout the Eurozone without instituting an EMU-wide budget with cross-border transfers meant imposing controls on banks (supervision) to reduce local risks, limiting national bailouts to reduce the risk of banking problems spreading to the public sector (where they became relevant to EMU) through resolution and bail-ins of private creditors, and by providing emergency finance as a means of preventing contagion across national borders.

Banking supervision has since that time been the Eurozone's biggest institutional and policy success,¹²⁰ and it has been moving Europe closer to global expectations as for instance laid down by the Basel Committee and IADI. It has a significant contractionary effect on the economy as banks raise capital and devote attention to dealing with existing stocks of non-performing loans rather than issuing new credit. The SSM (Single Supervisory Mechanism) was added to the European Banking Authority (EBA) in November 2014—at which point the ECB became direct supervisor to 128 Systemically-Important Banks (SIBs) (now 117), and took over the tasks of carrying out a regular Asset Quality Review, directing banks on how much capital to raise in accordance with the EU's Capital Requirement Directives, and in some cases indicating insolvency to the Single Resolution Board (below).

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The EU also instituted a resolution system in 2016—the Single Resolution Mechanism (SRM).¹²¹ Within the SRM, the Single Resolution Board coordinates resolution plans for E-SIBs and recommends resolution to the Commission if the ECB announces the bank is insolvent. The SRM also incorporates a bail-in mechanism that reduces what banks owe to creditors in the event of insolvency and is supposed to reduce the input of public funds into failed banks (bail-out). Although the powers of the SRM to move banks toward resolution have proved disappointing, and an agreement on any sort of deposit insurance for EMU remains elusive for political reasons, the rule structure itself regarding resolution reflects standards set out by IADI. What it lacks is truly independent powers by the SRB to act swiftly and without legal recourse to dispute as IADI suggests. It also lacks any meaningfully large resolution fund, or any deposit insurance fund.

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The SRM has attached to it a small (55 billion euro), *ex ante*, bank-funded fund known as the Single Resolution Fund (SRF). As with the ESM, a key legal feature of the SRF is that it is based on an intergovernmental agreement under international law, outside of EU law. This means that decisions are made according to the decision-making procedures of the SRF. While the SRB may make a recommendation or what amount of money should be deployed during a resolution, the Fund retains the right to decide for itself if this is appropriate. As an extra-EU entity, the Fund is not justiciable under EU law and cannot be forced to act in ways other than its shareholders wish.

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'Internationalised banking, alternative banks and the Single Supervisory Mechanism' (2016) 39 *West European Politics* 438–61.

¹²⁰ Stefaan De Rynck, 'Banking on a union: the politics of changing eurozone banking supervision' (2016) 23 *Journal of European Public Policy* 119–35.

¹²¹ David Howarth and Lucia Quaglia, 'The steep road to European banking union: Constructing the single resolution mechanism' (2014) 52 *Journal of Common Market Studies* 125–40.

E. EMU-GFSA links in securing the financial market

- 5.98** The European Securities and Markets Authority (ESMA) reflects its global counterpart IOSCO, and is responsible for payments systems and futures markets where asset bubbles are an issue. It is also responsible for credit rating agencies, hedge funds and other shadow banking institutions where liquidity is strong, but unconnected to the real economy. Its General Board consists of national securities regulators of EU Member States, plus an Executive Board, like the other ESAs. Unlike the others, however, it is a de facto independent supervisory authority. As with the others, the rules it applies are legislated through the ordinary legislative procedure. Rules are generally in line with, and often based on, international standards emanating from IOSCO.
- 5.99** In the context of financial stability, and the potential for macroeconomic effects, ESMA is key in the development of regulations regarding central counterparties (CCPs), which are seen as a missing link.¹²² In the medium term, EU law prevents the Eurozone from ensuring that CCP clearing services take place within its territory, however. The ECB lost a key case on mandating that CCPs be located in the eurozone.¹²³ The Court ruled that while ECB has jurisdiction over payments systems, it does not have automatic control over all clearing systems (such as derivatives). CCPs have to have access to both: payments and security transfer systems. This was controversial since the ECB provides liquidity backstop to CCP systems. At stake was not only whether UK financial institutions could operate for the eurozone, but whether financial stability would be further ensured.

F. EMU-GFSA links in macroeconomic surveillance

- 5.100** The EU's mirror to the OECD, G20 and IMF on proper macroeconomic policy is found in its on budget and debt rules (Maastricht Treaty criteria on debt, deficits and inflation), but also in the Macroeconomic Imbalances Procedure introduced in 2011. Member States provide Stability Reports to the European Commission, which reviews them and proposes Country-Specific Recommendations (CSRs) to the Council. The CSRs are only final once adopted by the Council and as the title implies, not legally binding.
- 5.101** The monitoring of the Stability and Growth Pact was transformed by name into the European Semester in 2011. It was then extended into private economic behaviour in 2011 through the macroeconomic imbalances procedure (MIP).¹²⁴ Like the European Semester, the MIP is designed to observe, analyse and provide country specific recommendations (CSRs), but on private sector price developments. These range from inflation rates, labour costs, asset prices (to capture unstable phenomena such as housing bubbles, which played a significant role in the 2008/2009 crashes of Ireland and Spain), but also capital account balances and private debt levels. The intent of the ES and the MIP is to restrict credit growth in such a way as to prevent future asset bubbles. CSRs are not legally binding, and in practice,

¹²² Heikki Marjosola, 'Missing pieces in the patchwork of EU financial stability regime? The case of central counterparties' (2015) 52 Common Market Law Review 1491–527.

¹²³ Case T-496/11 *United Kingdom v European Central Bank* [2015] ECLI:EU:T:2015:133.

¹²⁴ See further Chapter 29.

less than 10 per cent are actually followed up on. However, the trend toward fiscal retrenchment sets the Eurozone apart from other jurisdictions worldwide. Furthermore, in this area, the Eurozone has not taken on much of the GFSA recommendations. This can be seen in the IMF-Eurozone fight in 2015 over austerity and debt sustainability: IMF wanted more of Greece's debt forgiven, so that the bills would be payable. Eurogroup disagreed and refused to talk further reductions in debt. It can also be seen in IMF support for a common public backstop for the Eurozone to ensure automatic stabilizers are in place.

The biggest rift between the GFSA and the Eurozone is therefore between two macro-economic visions: the GFSA has accommodated a more dovish view of macroeconomic policy—an accommodating monetary and fiscal policy—that the Eurogroup (with the exception of the ECB with regard to monetary policy) has rejected. This has nothing to do with milder economic circumstances in the Eurozone as a whole compared to elsewhere, given the severity of the Eurozone Crisis. Rather it has had to do with a division between national governments in the Eurozone. This division is partly on the issue of who should pay for financial stability, and how much. But more importantly, the debate between European countries has been characterized by a war of ideas over proper macroeconomic policy that Germany, the Netherlands, and Finland within the Eurogroup have decisively won over France and much of Southern Europe.¹²⁵ The model institutionalized in the European Semester outlines a combination of budget retrenchment, debt reduction structural adjustment policies and further measures contributing to internal devaluation that help individual countries pull themselves back from the prospect of fiscal cliffs as happened in 2010–12. The features are strongest when countries hit that fiscal cliff and seek financial assistance from the European Stability Mechanism. At that point, the Troika, supplemented by the Eurogroup, sets out these forms of internal devaluation in contract form with programme countries, rather than relying on voluntary adoption in the normal ES procedure.

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That this constitutes a breach with the GFSA's interpretation of proper macroeconomic policy is signified by the IMF's repeated conflicts with the Eurozone regarding demands made on programme countries. Debt sustainability reviews regarding Greece, in the absence of a common public backstop, particularly regarding the Eurozone demand that the Greek government run a 3.5 per cent budget surplus, are the most telling way to see that conflict. Another is the repeated call for a backstop itself.

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V. Conclusion: An Interplay Between the GFSA and the EMU?

The present chapter purported to assess the influence of the Global Financial Stability Architecture on the European Economic and Monetary Union. The GFSA is complex of ISSBs, with the FSB as an umbrella, with a highly behaviouralist (evidence-based) approach. It accommodates a dovish monetary and fiscal policy stance typical of neokeynesian monetary policy. In this sense, the Washington Consensus really does appear to be dead at the global level.¹²⁶ It is alive and well in Europe

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¹²⁵ Geoffrey R Underhill, 'Paved with good intentions: global financial integration and the eurozone's response' (2011) 10 *European Political Science* 366–74.

¹²⁶ Susanne Lütz, 'From Washington Consensus to Flexible Keynesianism? The International Monetary Fund after the Financial Crisis' (2015) 6 *Journal of International Organization Studies* 85; Ban and Gallagher,

however,¹²⁷ for political reasons that have intensified rather than moved toward compromise within the EU. German/Dutch demands to do this have resulted in a wide range of legal rules on budgetary policy, banking supervision and resolution, that have a contractionary impact on national economies rather than accommodative ones.

- 5.105** The global rules are characterized by an informal, 'soft', nature, and allowed the European Union to be quite selective in adopting them. The overall tendency seems to be to turn some of the softer international rules into hard EU law,¹²⁸ which has made it harder for the EU bodies and the Member States to reach compromises. As—in most cases—the EU as such is not a formal member of the GFSB bodies, it has to rely on its Member States, that are often not in agreement on the course to follow. Where this is the case, the EU's divisions lead it to have weaker influence on the global standards they promote.¹²⁹
- 5.106** In a substantive sense, it hard to find clear examples of an influence of the GFSB on EMU rules. At the same time, it is clear that, institutionally, many of the global frameworks and their tasks, have been copied as EU bodies and play a similar role in relation to the Eurozone.
- 5.107** To what extent is the 'disconnection' between the GFSB and the EMU to be seen as problematic? Obviously, the aim of the GFSB is to enhance global financial stability and 'cherry picking' by the EU (mostly for political reasons related to varying views on further European integration) can not only harm the EU itself, but can also have an effect on global financial stability. The situation between the EU and the rest of the world resembles the failed macroeconomic coordination attempts of the late 1980s, when German insistence on macroeconomic prudence eventually forced its neighbours to follow, and entrenched a transatlantic rift.¹³⁰ In the wake of the Eurozone Crisis (EZC), a split developed between the GFSB and EMU over proper macroeconomic policy, so that the GFSB's impact must be considered contingent on EU and EMU approval. While the GFSB is driven by an accommodative monetary and financial stability policy in nearly all areas,¹³¹ EMU reforms have rendered it more restrictive—above all in the areas of fiscal policy, macroeconomic imbalances and banking regulation. This rupture, in turn, reflects power politics between groups of States within EMU that have more to do with who pays for providing financial stability and following a narrative of proper public policy at the national level¹³² than whether it provides optimal resilience. The most important of the EMU deviations has been the EMU focus on alleviating the sovereign default ('bankruptcy') of EMU Member States with prudential

'Recalibrating Policy Orthodoxy' (n 7) 131–46; Ben Clift, *The IMF and the Politics of Austerity in the Wake of the Global Financial Crisis* (OUP 2018); Ilene Grabel, *When Things Don't Fall Apart: Global Financial Governance and Developmental Finance in an Age of Productive Incoherence* (MIT Press 2018).

¹²⁷ Susanne Lütz and Matthias Kranke, 'The European rescue of the Washington Consensus? EU and IMF lending to Central and Eastern European countries' (2014) 21 *Review of International Political Economy* 310–38.

¹²⁸ Lucia Quaglia, *The European Union and global financial regulation* (OUP 2014).

¹²⁹ Quaglia, 'The sources of European Union influence' (n 12).

¹³⁰ Michael C Webb, 'International economic structures, government interests, and international co-ordination of macroeconomic adjustment policies' (1991) 45 *International Organization* 309–42.

¹³¹ Claudio Brio, 'The International Monetary and Financial System: Its Achilles Heel and What to do about it' (2014) *Globalization and Monetary Policy Institute Working Paper No 203*; Donnelly, *Power Politics, Banking Union and EMU* (n 74).

¹³² Dermot Hodson and Lucia Quaglia, 'European perspectives on the global financial crisis: introduction' (2009) 47 *Journal of Common Market Studies* 939–53.

austerity measures at the national level, rather than approaching EMU instability with common financial backstops.

The outcome of this break is a mixed picture. On the one hand, the Eurozone has introduced innovations in bank supervision and resolution that reduce the likelihood of a new financial crisis that threatens to take on systemic proportions coming from inside the banking system. On the other, robust public backstops constitute a critical component of the financial stability architecture that are clearly missing in the European case. This split between a European insistence on frugality and individual Member State responsibility for financial stability and growth is reflected in the Eurozone's macroeconomic policy framework as well, which favours, though its tendency to reduce government consumption during economic downturns, a further weakening of its weakest members over time.

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