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The new Economic component of EMU: A Lawful and Effective Design?

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Abstract

This analysis aims to set out clearly and succinctly the legal arrangements for macro-economic governance in EMU, legal challenges to that regime and different ways of assessing that new regime. It focuses on changes introduced from 2010, the year when the euro area crisis, and the response to it, began, and on changes to the law other than those concerning provision of sovereign debt loan assistance. The analysis first presents the (many) key EMU acronyms before outlining in four diagrams what is new in EMU by looking at what changes have been made since 2010. It outlines what further proposals in this area are included in the Five Presidents' Report of June 2015. It then briefly examines three central legal challenges with the current regime: competence, compatibility and complexity. Finally it raises issues of the effectiveness of the EU macro-economic governance regime by considering three assessments: too early to say, abject failure or triumph of pragmatic intelligence. These raise questions of optimal policy design. The four diagrams accordingly provide the foundation for understanding the current regime, further proposed changes, legal challenges and issues of effectiveness.

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1. What's new in EMU

A. Already in place

Changes to the Economic component of EMU have been introduced in three main waves since 2010, in the Six-Pack (of 5 Regulations and 1 Directive) of 2011, in the Fiscal Compact Treaty of March 2 2012 and in the Two-Pack (of 2 Regulations) of May 2013.

Reconstructing the sources in this area, with a view to highlighting the crisis innovations, is a formidable task. It is approached here by starting from the EU Treaty sources underpinning the two key pillars of EU macro-economic governance, economic policy co-ordination in Article 121 TFEU and fiscal discipline in Article 126 TFEU. As the EU has no inherent competence to act, it must be able to point to a provision in the EU treaties allowing it to act. That Treaty basis will also give details of how it is allowed to act. To respect the EU's limited competences the action taken should fall fully within the legal basis. Up until the crisis, preventive fiscal discipline and economic policy co-ordination have been dealt with under Article 121 TFEU while corrective fiscal discipline – the Excessive Deficit Procedure – was dealt with in Article 126 TFEU and Protocol 12 to the EU Treaties. A new legal basis was added by the Lisbon Treaties, Article 136 TFEU, for euro area states only. Articles 121, 126 and 136 constitute the Treaty bases upon which the Economic component in EMU is further constructed after the onset of crisis in 2010. In four diagrams below I show how the Economic component of EMU has been dramatically expanded and deepened during the crisis, and how that has entailed different combinations of Treaty bases. Pre-crisis provisions are in black, new EMU is in blue. A few additional 'explainer' tables are in green. These diagrams also lay the ground for understanding why the new provisions raise competence, compatibility and complexity challenges, discussed in the second part of this brief. The diagrams can also be used to pin-point and explore issues of policy (in)effectiveness of the Economic component of EMU, the concluding part of this analysis.

The Economic in EMU acronyms

SGP = Stability and Growth Pact (a cluster of instruments introduced in 1997 and subsequently revised in 2005 and 2011. The most important are Regulation 1466/97 on Preventive Fiscal Discipline and Regulation 1467/97 on the Excessive Deficit Procedure.)

MTO = Medium-Term Budgetary Objective. This is the key concept underpinning the preventive arm of fiscal discipline.

BEPGs = Broad Economic Policy Guidelines = the original focus of economic co-ordination, still part of the European Semester.

MIP = Macro-Economic Imbalance Procedure

IDR = In-Depth Report (stage in the MIP)

CAP = Corrective Action Plan (stage in the MIP)

EIP = Excessive Imbalance Procedure (stage in the MIP)

EDP = Excessive Deficit Procedure

ED = Excessive Deficit

EPP = Economic Partnership Programme (new regime for excessive deficit states)

MAP = Macro-Economic Adjustment Programme (regime for euro-states receiving sovereign debt loan assistance)

PPS = Post-Programme Surveillance (regime for states which have exited sovereign debt loan assistance but have not yet repaid 75% of the loan)

DEC = decision by Council

REC = Recommendation (by Commission or Council)

QM or QMV = Qualified Majority Voting by Council on a measure. The measure will be adopted only if a qualified majority of states are in favour.

R-QMV = Reverse Qualified Majority Voting by Council. The measure will be adopted unless a qualified majority of states are not in favour.

Diagram 1 THE EXCESSIVE DEFICIT PROCEDURE (EDP) UNDER ARTICLE 126 TFEU

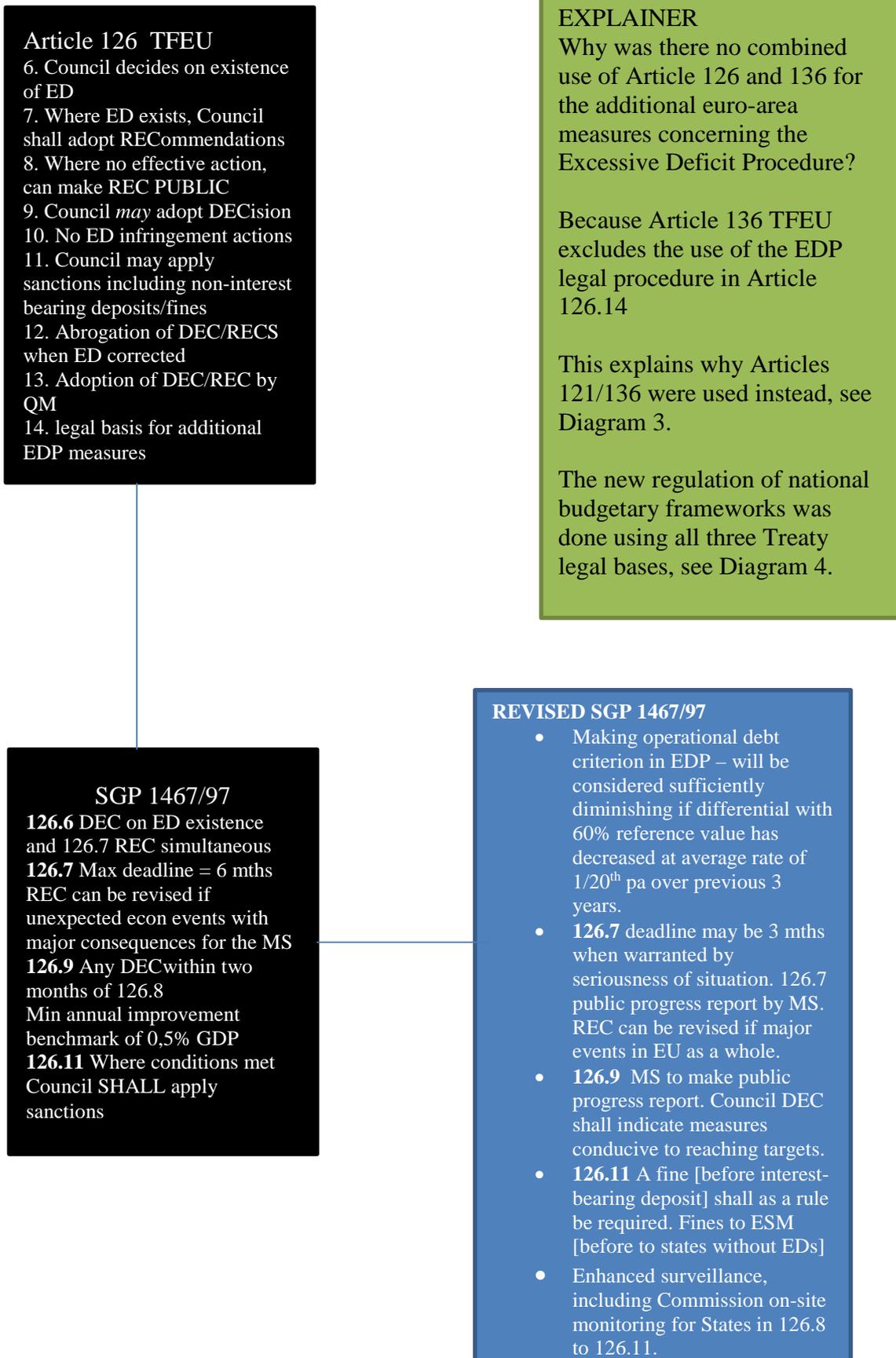


Diagram 2 ECONOMIC CO-ORDINATION AND SURVEILLANCE UNDER ARTICLE 121 TFEU

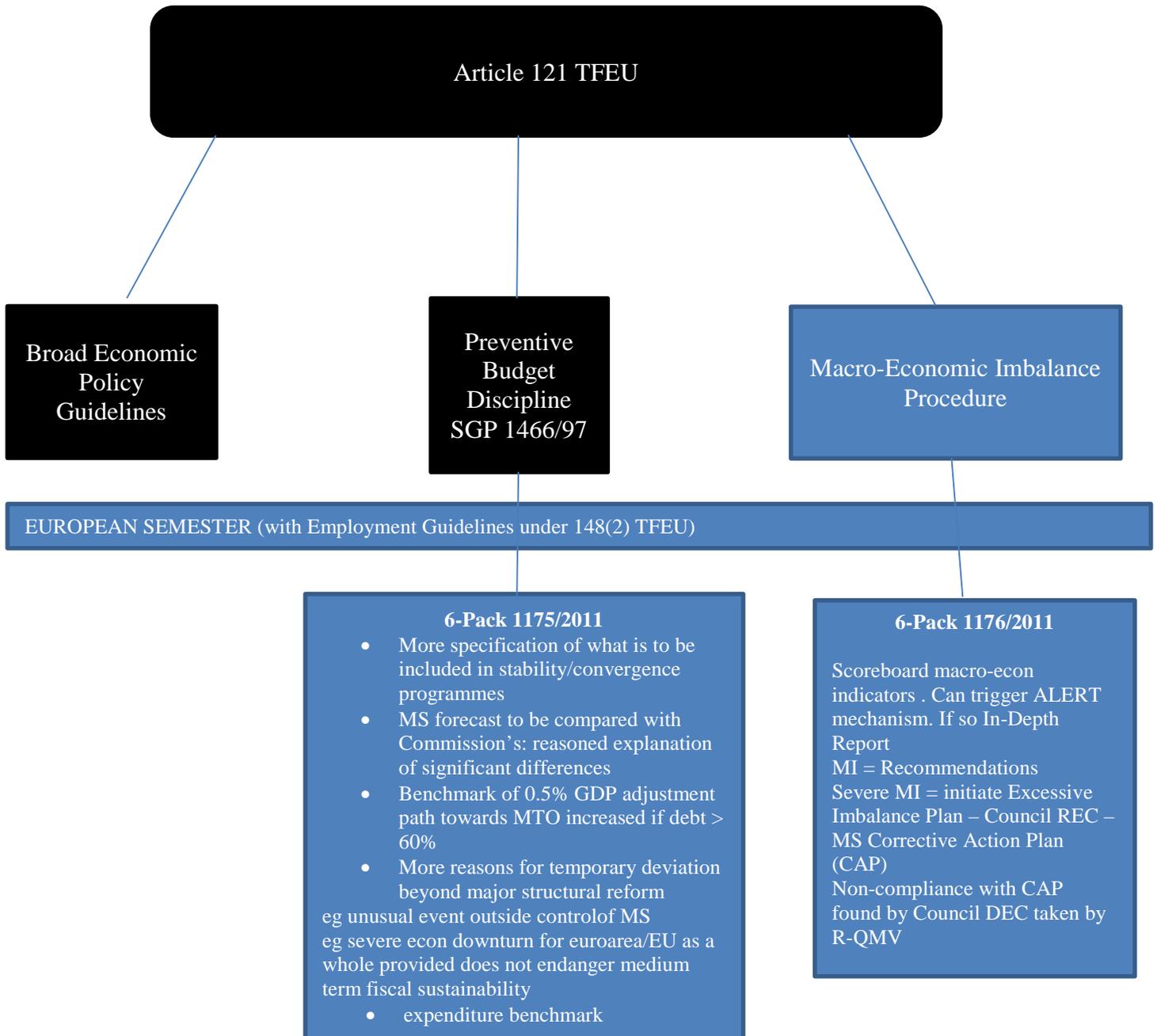


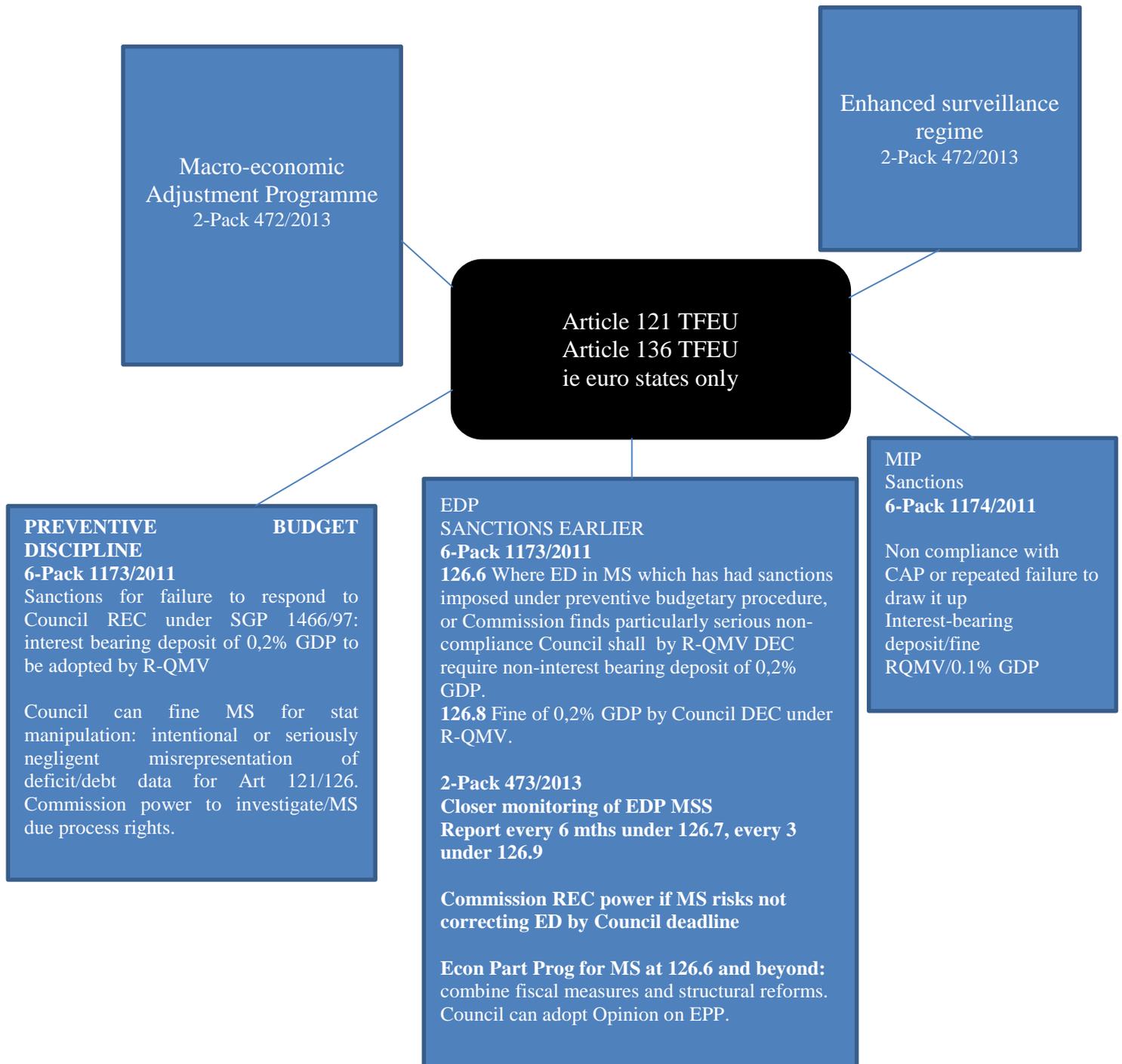
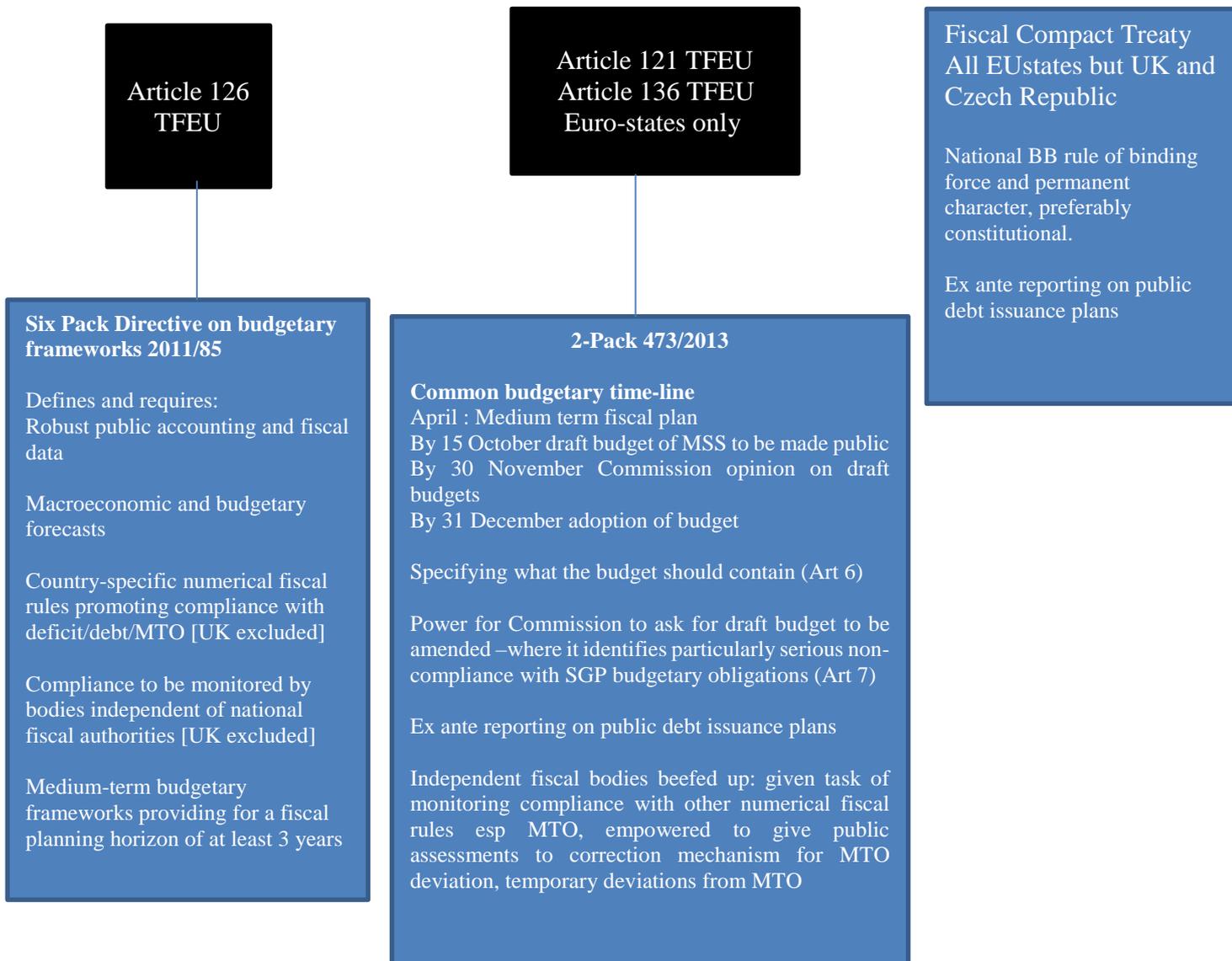
Diagram 3 NEW OBLIGATIONS AND REGIMES FOR EURO AREA STATES ONLY

Diagram 4 NATIONAL BUDGETARY FRAMEWORKS - A KEY NEW FOCUS OF EU MACRO-ECONOMIC GOVERNANCE



As a result of the crisis changes to the Economic in EMU, a range of different macro-economic statuses are now possible for Member States. Pre-2010, the only clear status was to be a State with an Excessive Deficit. The crisis legislation adds the following four new possibilities, most of which apply only to euro area states:

- Macro-Economic Adjustment Programme States: euro area only
- Enhanced Surveillance States: euro area only
 - All those with precautionary basis financial assistance
 - Others Commission decides have or at are risk of having serious difficulties with financial stability
- Economic Partnership Programme States (a new regime for excessive deficit states): euro area only
- Post-Programme Surveillance States

B. Five Presidents' Report of June 22 2015 and its follow-up

The Five Presidents' Report sets out a road-map by the heads of the EU institutions for EMU. What does it propose to add to the Economic regime of EMU as set out in the four diagrams above? In the short-term (2015-2017), and using the existing Treaty framework, the following changes are proposed.

European Semester

- Adding a euro area system of national independent competitiveness authorities to oversee the European Semester. Their mandate could include assessing 'whether wages are evolving in line with productivity' and to assess progress made with economic reforms to enhance competitiveness more generally. A Commission Recommendation of October 2015 (COM (2016) 127 final) for the Council to adopt a Recommendation to this end was not given a warm reception at the Competitiveness Council of 30 November 2015 at which 'A large number of delegations expressed concerns that these would create additional burdens and delays in decision-making.'
- Simplification and strengthening. Clear, concrete and ambitious recommendations (in content and timeframe) should be set. However the Report states that they should remain 'political' (rather than, it is to be supposed, 'legal') obligations leaving Member States a degree of freedom regarding the exact measures to be implemented. A multi-annual timeframe should be accepted for some reforms. Accountability should be stepped up via reporting, peer-review, comply or explain methods and best practice identification. There should be clear delineation of a Euro-area stage followed by a national stage.

MIP

- The MIP should be used not just for detecting imbalances but to encourage structural reform. It should also capture imbalances in the euro-area as a whole rather than in individual Member States. Its corrective arm should be used forcefully (though note that there is no legal obstacle to this in the existing framework).

Budgetary governance

- The forthcoming review of the 6- and 2-Packs is said by the Report to provide an opportunity to improve clarity and transparency of ‘admittedly complex’ rules as well as compliance and legitimacy, while preserving their stability-oriented nature.
- Its decision to create an advisory European Fiscal Board to co-ordinate and complement the national fiscal councils has already been put into effect by a Commission Decision in October 2015 ([2015] OJ L 282/37). Its five members shall provide a public and independent assessment, at European level, of how budget execution performs against the requirements of the EU budgetary governance framework.

Other priorities are mentioned but the accompanying proposals for their policy realisation are projected for the medium term, and to be preceded by a White Paper in Spring 2017:

- Formalising convergence by making it more binding. The most worked through example concerns reforming labour markets and social protection systems. This includes the policy objectives of getting the unemployed back to work, reducing the insider/outsider divide by focusing on those with high protection and wages, finding the right balance between flexible and secure labour contracts, ensuring a social protection floor for the most vulnerable and making pension and health systems sustainable through major reforms. Common high-level ‘flexicurity’ standards would be defined in EU legislation.
- Making access to a planned euro-area stabilisation function/fund subject to compliance with the Economic regime of EMU.

2. Legal challenges of the new Economic regime of EMU regime: Competence, Compatibility, Complexity

A. Competence: Mind the Gaps!

As noted at the beginning, the EU operates under the principle of conferral; it can only act in the way the EU Treaties give it the power to act. When it acts outside its competences, those legal acts are vulnerable to being challenged and can be found to be invalid for that reason by the Court of Justice. This will depend on how the Court of Justice interprets the competence granted in the event of a legal challenge.

These competence issues are very present in EMU. It is clear from the diagrams above that the Treaties provide for three central legal bases for the Economic regime of EMU: Articles 121, 126 and 136. Yet these do not clearly permit many of the new measures adopted. There are two main problems. One concerns whether the EU law-maker is permitted to adopt the *substance* of the measure. Are, for example, macro-economic imbalances covered by the legal basis in Article 121 TFEU? The other, even more central in considering the new regime, is the *procedure* and *measures* permitted. If the Treaty only permits Recommendations (a non-legally binding EU measure) against Member States agreed by QMV, but the legislation provides for legally-binding Decisions against Member States agreed by R-QMV, that raises competence problems. An interesting feature of EMU is that competence problems or doubts have in fact been present from the 1997 SGP onwards. However, these doubts increase

dramatically in light of the changes introduced after 2010. I illustrate this further by briefly looking at each of the diagrams from a competence perspective.

Article 126

Diagram 1 illustrates nicely how the detailed steps laid down by the Treaty had already been 'built upon' or 'departed from' by the SGP before the crisis, but more so afterwards. One example suffices. The Treaty provides (126.11) that sanctions *may* be applied by the Council. The SGP pre-crisis provided that the Council *shall* apply sanctions but left the choice of sanction to the Council. The SGP post-crisis provides that *finances shall as a rule be required*. So there is a significant move from the Council's freedom under the Treaty to apply sanctions as and when it sees fit to requiring it to apply a pre-defined sanction.

Article 121

What does Article 121 TFEU authorise the EU to do? It provides that the Council shall formulate broad economic policy guidelines (BEPGs) for the Member States and monitor and assess economic developments on that basis. Where Member States are out of line with these or risk jeopardising the proper functioning of EMU, a series of EU actions can be taken. These are a Commission warning and a Recommendation from the Council which it can decide to make public.

Let us apply this to the Macro-Economic Imbalance Procedure introduced in 2011. In terms of substance, the MIP with its Preventive and Corrective arms mirrors more closely the EDP than the BEPGs. Nonetheless, this might still be seen as economic policy *co-ordination* to prevent jeopardising the proper functioning of EMU. In terms of procedure, however, the match with its legal basis is much less secure. Specifically, as shown in Diagram 2, the MIP empowers the Council to take a Decision by R-QMV on non-compliance with the corrective arm of the procedure. Yet Article 121 includes only the possibility for the Council to adopt Recommendations by QMV.

Article 121 and 136

Excessive Deficit

We have seen that the Treaty basis for extra euro-area measures (Article 136) does not allow euro area only measures to be adopted under the EDP legal basis in Article 126. One could conclude from this that no euro area only measures on the EDP can lawfully be adopted. Instead, as Diagram 3 shows, the EU law-makers decided to go ahead and adopt extensive further Excessive Deficit measures for euro-area states only by using Article 121 TFEU as the accompanying legal basis.

New sanctions for preventive fiscal discipline, excessive deficit and macro-economic imbalances

Diagram 3 clearly shows that new sanctions are the most central feature of the new measures adopted for euro-area states only. Sanctions are introduced for the first time into the preventive arm of fiscal discipline, moved earlier in the EDP, and sanctions – interest-bearing deposits or fines – are also introduced for non-compliance with the corrective arm of the MIP. All sanctions are subject to R-QMV. We have already seen that Article 121 does not provide the basis for such sanctions or the procedure for their adoption. Does Article 136 fill the gap? Unpromisingly for those who wish to argue that it does, it says that the Council shall adopt

measures, 'following the relevant procedure from among those referred in Articles 121 and 126'. However, it goes on to say they can adopt 'measures' 'to strengthen the coordination and surveillance of their fiscal discipline' which could be seen as authorisation to adopt a wider range of measures, including sanctions. It refers to QM voting by Council on any such measures. At the very least, a broad purpose-oriented interpretation of Article 136 would be required to bridge the competence gaps.

Article 121, 126 and 136: the national budgetary frameworks

The links between the Treaty bases and the extensive framework of national budgetary governance introduced since 2010 are not self-evident. Perhaps the creation of independent fiscal bodies in each Member to monitor compliance with a range of EU-determined country specific numerical fiscal rules is the strongest evidence of how far these Treaty bases have been extensively interpreted.

Solving Competence Problems

It might be argued, albeit not very convincingly, that Articles 121, 126 and 136 form an integrated package and therefore one treaty basis is as good as another. Or, as the MIP Regulation states, that Decisions are an 'integral follow-up' to the Recommendations permitted under Article 121. Or, again not very convincingly, that R-QMV is simply a variant of QMV, rather than a significant shift in the EU institutional balance towards the Commission and away from the Council.

The most sure-fire way to solve competence problems is evidently to amend the Treaty. However, this presents problems of its own. It is typically very difficult to successfully amend the Treaties. The need for unanimous agreement also means that opening up negotiations on EMU can lead to bargaining for concessions on other non-EMU issues. Hence the efforts to amend the EU Treaties in 2011 to include a balanced budget rule led to the UK demanding concessions in unrelated areas. To avoid making these concessions, ultimately a non-EU Treaty, the Fiscal Compact treaty, was agreed and ratified by 25 EU States. Furthermore, it may be felt that amending the Treaties leads to an overly rigid structure for the Economic component of EMU. Legislation is easier to amend and is thus a better vehicle for adapting macro-economic governance to changing circumstances.

Finally, and perhaps most importantly, no competence challenge to the Economic component of EMU package has to date emerged; this is the practical resolution of this issue so far. In this respect, there is a sharp contrast between the competence issues raised by the extensive reforms to the Economic component of EMU and the high-profile challenges to loan assistance mechanisms (the ESM challenged in *Pringle* (C-370/12, ECLI:EU:C:2012:756) and exceptional ECB measures during the crisis (the OMT challenged in *Gauweiler* (C-62/14, ECLI:EU:C:2015:400)).

B. Compatibility with binding EU Social Europe commitments

One striking feature of the new EMU is the incredibly detailed instructions given to Member States about how they should manage their national social, employment and industrial relations systems. Yet such instructions can create sharp tensions with other EU Treaty commitments, including commitments to respect fundamental rights in the EU Charter. Let us

take the Recommendation issued to France in July 2015 under the European Semester (for which see Diagram 2). It recommends, for instance, that:

- Sizeable short-term savings cannot be achieved without curbing significantly the increase in social security spending, which represented 26% of GDP in 2014...Healthcare expenditure savings of EUR 11 billion are planned for 2015-2017, but further efforts are needed to limit expenditure increases in this area. In particular, there is scope to implement further cost-containment policies in the area of pharmaceutical prices and hospital spending.
- The minimum wage should evolve in a manner that is more conducive for competitiveness and job creation. In addition, in a context of low inflation, its automatic indexation may lead to wage increases beyond what is necessary to preserve purchasing power.
- France should take decisive action to remove the regulatory thresholds in labour law ...that limit the growth of French firms, in particular SMEs.
- Reform labour law to provide more incentives for employers to hire on open-ended contracts. Facilitate take up of derogations at company and branch level from general legal provisions, in particular as regards working time arrangements. Reform the law creating the *accords de maintien de l'emploi* by the end of 2015 in order to increase their take-up by companies. Take action in consultation with the social partners and in accordance with national practices to reform the unemployment benefit system in order to bring the system back to budget sustainability and provide more incentives to return to work.

Contrast those Recommendations with the very substantial set of binding EU commitments to Social Europe. A good start is the EU Treaty commitment to 'a social market economy, aiming at full employment and social progress....[it] shall promote social justice and protection' (Article 3(3) TEU). Article 9 TFEU provides that, 'In defining and implementing its policies and activities, the Union shall take into account requirements linked to the promotion of a high level of employment, the guarantee of adequate social protection, the fight against social exclusion, and a high level of education, training and protection of human health'. Article 152 TFEU provides that 'The Union recognises and promotes the role of the social partners at its level, taking into account the diversity of national systems. It shall facilitate dialogue between the social partners, respecting their autonomy'.

The EU Charter of Fundamental Rights, which has the same legal value as the Treaties, contains numerous relevant rights and principles. The 'Solidarity' part of the Charter is the most relevant. Article 28 guarantees workers and employers 'the right to negotiate and conclude collective agreements at the appropriate levels'. Article 30 gives protection in the event of unjustified dismissal while Article 31 provides that 'every worker has the right to working conditions which respect his or her health, safety and dignity'. Young people at work are protected (Article 32). The right to social security and social, including housing, assistance is recognised and respected 'so as to ensure a decent existence for all those who lack sufficient resources' (Article 34). Health and education are also protected so that 'A high level of health protection shall be ensured in the definition and implementation of all the Union's policies and activities' (Article 35) and there is the right to receive free compulsory education and to have access to vocational and continuing training (Article 14).

Solving Compatibility Problems

Many of the new EMU provisions contain what might be called *social rights prophylactics* to try to resolve these economic-social compatibility issues. The MIP Regulation (see Diagram 2) accordingly provides that:

The application of this Regulation shall fully observe Article 152 TFEU, and the Recommendations issued under this Regulation shall respect national practices and institutions for wage formation. This Regulation takes into account Article 28 of the Charter of Fundamental Rights, and accordingly does not affect the right to negotiate, conclude or enforce collective agreements or to take collective action in accordance with national law and practice (Article 1(3)).

Yet provisions such as these may not be legally convincing particularly if non-EU human rights bodies or national constitutional courts find that the measures in which they are embedded breach fundamental rights.

Moreover, beyond legal compatibility, there is the broader legitimacy issue of EMU shifting the substance of EU policies away from safeguarding certain social entitlements and institutions as well as the economic security of those in the EU. The need to respond to such concerns is reflected in commitments to achieving a ‘Social Triple-A’ in the 5 Presidents’ Report and the announcement of Commission President Juncker in his State of the Union speech to the European Parliament on 9 September 2015 that:

“... I will want to develop a European Pillar of Social Rights, which takes account of the changing realities of Europe's societies and the world of work. And which can serve as a compass for the renewed convergence within the euro area. The European Pillar of Social Rights should complement what we have already jointly achieved when it comes to the protection of workers in the EU. I will expect social partners to play a central role in this process. I believe we do well to start with this initiative within the euro area, while allowing other EU Member States to join in if they want to do so.”

Consultation on the European Pillar of Social Rights began on 8 March 2016 (Commission Communication COM (2016) 127 final). The consultation documents envisage production of ‘principles’ drawing on existing EU Charter and Treaty social commitments in three umbrella areas of equal opportunities and access to labour markets; fair working conditions; and adequate and sustainable social protection. These principles would, the consultation suggests, serve as a reference point to drive convergence of euro area states, and other voluntary participants, employment and social policies. At the same time the social *acquis* will be reviewed in light of this pillar.

Initiatives such as these will ring hollow if the evidence of EU actions and their impacts point, as they have done during the crisis to date, away from protecting and enhancing social rights and economic security for individuals living and working in the EU. It is worth stressing, however, that these issues are much more sharply legally defined for countries required to comply with social loan conditions to obtain sovereign debt loan assistance. Unlike those loan conditions, much of the output of the Economic regime of EMU is non-binding. This makes it more difficult to envisage a successful legal challenge. Hence the Court of Justice recently rejected a challenge to a 2012 change to Spanish employment law on the basis that it breached Article 30 EUCFR. The Spanish Court’s suggestion that the Spanish employment law was covered by the Charter because it ‘implemented’ the European Semester was rejected because the latter ‘does not impose any specific *obligation* with respect to probationary periods in employment contracts’ (C-117/14, *Nisttahuz Poclava*, judgment of 5 February 2015).

C. Complexity

My efforts to simplify into four diagrams the genesis and legal organisation of the Economic component of EMU cannot disguise one of the main features of this body of law: its complexity. Indeed, this is the primary concern with this area identified by the European Commission in its November 2014 review of the 6 and 2-Packs (COM/2014/0905 final). It states:

The relationships between the various instruments of economic surveillance are complex and limit the transparency of policy-making, which in turn poses challenges for its implementation, for communication with stake-holders and the general public and consequently for ownership, democratic legitimacy and accountability.

As noted above, this complexity is also noted in the 5 Presidents' Report as an issue to be addressed by a further review of the 6 and 2-Packs which is envisaged in the Commission Work Programme for 2016 (COM(2015)610 final). It seems likely that any proposals emerging will not entail legislative change but rather more communication with Parliaments (EP and national) and more efforts to explain and present clearly the Economic component of EMU.

3. Issues of Effectiveness: too early to say, abject failure or triumph of pragmatic intelligence?

No sanctions under the entire Economic regime of EMU outlined in this policy brief have ever been applied. Despite the many excessive deficits, and the instruction in the SGP from 1997 that the Council shall impose sanctions, it has never happened. Although the Commission in 2013 and 2014 identified excessive imbalances under the new MIP on five occasions, it did not submit a proposal for their formal establishment by the Council so the procedure was not triggered. The multiplication and intensification of sanctions from 2010 onwards has to date made absolutely no difference. How can this be interpreted?

It may be, as the Commission asserts in its November 2014 Review, that it is simply too early to say. Indeed, it is important to carefully track the ongoing use of the new extensive array of powers and procedures introduced since 2010 to see which are used and in what circumstances.

An alternative reading is that EMU's economic component has never worked properly and that the changes wrought since 2010 are not going to make any difference: the gap between the law on the books and its real-life application could hardly be wider than in this area. Germany and France, when faced with entering into the sanctions phase of the EDP early in the millennium, famously placed the procedure in abeyance, leading to litigation before the Court of Justice (*C-27/04, Commission v Council* [2004] ECR I-6649), and a revamping, for some a dilution, of the SGP in 2005. On this reading, the interests of states in their budgetary and macro-economic policies are simply too strong, or too complex, to make compliance with the Economic regime in EMU prevail over them. Compliance is therefore largely coincidental. There may also be objections to the soundness of the rules themselves: is it really an overriding priority for States to reduce public debt below 60% GDP? When compliance would entail what the state regards as undesired fiscal or economic effects, and is not seen as a sufficiently compelling good in its own right, non-compliance will be chosen. On a straightforward reading of the Economic component in EMU, this would make the new legal framework an abject failure. When states breach clear rules with apparent impunity, the solution is not to create more rules and more intense, yet still unapplied, sanctions. Yet this is

what has happened since 2010. The shift to R-QMV in the Council has not had the effect of pushing enforcement forwards but rather the effect that the Commission does not propose enforcement measures to the Council.

Yet there is a further possible reading of the new EMU. Despite sanctions not being applied, on this argument, it is reductive to say that the Economic component of EMU is an abject failure. The Economic regime of EMU is not best understood as a crime-punishment system although the sanctions, and the supposed automaticity leading to their imposition implied via timelines, imposing obligations to act on the Council and the shift to R-QMV might lead one to assume otherwise. Instead the rules and sanctions operate as strong signalling mechanisms of what EU, especially euro, state macro-economic behaviour should be. Importantly, this is now backed up, as a result of changes from 2010, by much more intense knowledge production, multi-level monitoring and accountability mechanisms concerning states budgetary and economic policies. Hence, rather than the introduction of a wide spread sanctions regime across the Economic regime of EU for Euro area states (Diagram 3) being the core of the transformation of EMU's economic regime since the crisis, it is more centrally the changes which produce additional knowledge, such as the MIP (Diagram 2) and especially the oversight of national budgetary frameworks (Diagram 4) which have the potential to bring about deep changes in how national budgetary and economic policy-making is conducted. The sanctions largely serve the complementary function of underlining the seriousness of the policy commitments being agreed. Evidence for this reading could be found in the visible role already played by national independent fiscal bodies and the use by the Commission of its power to ask for national draft budgets to be amended. These show the real strength the new regime can have. It is also worth underlining the expansion of the new regime to accept new good reasons for departures from achieving numerical fiscal rules. Accepting such reasons has the benefit of making the number, absent any such reason, a much stronger normative statement. On this reading the comments by a range of European leaders that the application of the rules is appropriately underpinned by pragmatic or flexible intelligence is not so far off the mark.

These three possible interpretations of the effectiveness of the Economic regime of EMU raise important agendas for assessing the current policy design and planning future policy in this field.