

ADEMU WORKING PAPER SERIES

EMU and national constitutional conditions to long term change

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December 2015

WP 2016/039

www.ademu-project.eu/publications/working-papers

Abstract

Significant long-term developments in EMU are conditioned not only by the current EU legal framework but also by national constitutions. Conditions are posed by constitutional courts interpreting the constitution, by putting limits to transfers of sovereignty and by putting limits on the basis of rights protection. Good examples of this are the German and Portuguese constitution. Conditions are posed also by referenda prescribed or allowed for the ratification of new treaties. Member states are free to determine the national constitutional requirements for the ratification of EU treaties (in line with the national constitution), including the use of referenda. The United Kingdom illustrates that development of the EU can also be conditioned by referenda on membership. Conditions are posed to euro area development by non-euro area member states. The most prominent example of this is again provided by the United Kingdom (Fiscal Compact and in-or-out referendum).

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Acknowledgments

The author would like to acknowledge the support of the ADEMU project, "A Dynamic Economic and Monetary Union. This project is related to the research agenda of the ADEMU project, "A Dynamic Economic and Monetary Union". ADEMU is funded by the European Union's Horizon 2020 Program under grant agreement N° 649396 (ADEMU).

The ADEMU Working Paper Series is being supported by the European Commission Horizon 2020 European Union funding for Research & Innovation, grant agreement No 649396.

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INTRODUCTION

The Eurozone is undergoing a metamorphosis as a consequence of the Eurozone crisis. Central to this development are new crisis management instruments like the (external) ESM, a substantively and institutionally strengthened economic governance (6- and 2-pack), a fundamental change in the role played by the ECB (e.g. OMT), an important single supervisory and resolution mechanism in the new European banking union (SSM and SRM) and a Balanced Budget Rule imposed by an international treaty (Fiscal Compact).

These developments have taken place with relatively few changes to national constitutions (an exception being the balanced budget rule introduced in some national constitutions; these constitutional amendments have taken place not for the ratification of the Fiscal Compact, but for its (anticipated) implementation). This does not mean however that they are not conditioned by the same national constitutions. For example, many constitutional courts *have* dealt with these instruments, in very different ways, sometimes imposing conditions for compatibility of the new instruments with the national constitution (most notably the German Constitutional Court, the *Bundesverfassungsgericht*, with regard to the involvement of the German *Bundestag*, the lower chamber of the Federal Parliament), sometimes referring questions of EU law to the European Court of Justice. Also, national constitutional procedures prescribed for the ratification or implementation of (EU) treaties, including referenda, have conditioned EMU development, e.g. in the choice not to impose the incorporation of a Balanced Budget Rule directly in national constitutions.

Similarly, future development of EMU will be conditioned by national constitutions. This is especially true for significant long-term developments. The political will to take significant steps forward is lacking in most if not all member states at the moment. At the same time, in political reports prepared by European institutions (most recently the 5-Presidents' report of June 2015), as well as in academic research, significant further integration steps are identified in reaction to (lessons learned from) the Eurozone crisis. In the medium- to long-term, these mostly relate to the following: the creation of a fiscal capacity capable of absorbing macroeconomic shocks or with an insurance type function; further risk-sharing through some sort of mutualisation of debt; and the creation of a European Treasury.

This policy brief identifies and illustrates several types of policy challenges posed to further EMU development: 1) competence and democratic limits clearly illustrated by the German Constitution; 2) rights limits prominently illustrated by the Portuguese Constitution; 3) conditions posed by the coexistence of both euro area and non-euro area member states, illustrated by the United Kingdom and 4) the need to secure popular or political support, again illustrated by constitutional events in the UK. All types exist and can be illustrated at both EU level and national constitutional level, in different degrees.

Box 1. Context: current literature

A significant amount of relevant research is being carried out by legal scholarship about the Eurozone crisis,¹ including about the limits to further change posed by EU law at the moment. Less attention is given in academic literature to conditions posed to change at EU level by national constitutions (with the exception probably of the conditions posed by the German constitution due to the rich *Bundesverfassungsgericht* case law). An important exception is a recent study carried out by Besselink e.a.,² which looks in-depth at the constitutional conditions posed by 12 EU member states and gives a bird's eye view of all 28 EU member states. The study however does not look in great detail at possible further developments of EMU, instead taking a much broader view of European integration. An important empirical study providing relevant data in this context are the country reports prepared in the framework of the 'Constitutional Change through Euro Crisis Law' project.³ This policy brief links future integration options in EMU to the conditions posed by (three) national constitutions in the Union.⁴

WHAT LONG-TERM DEVELOPMENTS OF EMU ARE CURRENTLY ON THE TABLE?

Among the many proposals for further reform of EMU, three central elements can be identified among the significant medium- and long-term proposals for EMU reform. All three of them raise questions of EU law and of national constitutional law. A first central element is the creation of a fiscal capacity for the absorption of macroeconomic shocks.⁵ Such a fiscal capacity raises many institutional design questions relating to the way the resources are raised (part of the EU budget or not; based on direct EU taxation or not), what function it will have (insurance type of function, shock absorption), whether its activation should in any way be linked to contractual arrangements with the member states involved, and who should decide on its activation (automaticity on the basis of

¹ For an overview and analysis of this literature see e.g. Beukers, *Legal Writing(s) on the Eurozone Crisis* (EUI Law Working Paper, 2015) and Martinico, *The Constitutional Implications of the European Union Crisis. A Review Article* (forthcoming, 2015).

² Besselink e.a., *National Constitutional Avenues for Further EU Integration* (Study prepared for the European Parliament, 2014), available at http://www.europarl.europa.eu/RegData/etudes/etudes/join/2014/493046/IPOL-JURI_ET%282014%29493046_EN.pdf.

³ See in great details these Country Reports from the 'Constitutional Change through Euro Crisis Law' project of the EUI Law Department at <http://eurocrisislaw.eui.eu/>.

⁴ See for a presentation of the ADEMU research project: <http://apps.eui.eu/Personal/rmarimon/projects/ADEMU/ADEMU%20presentation%20201503.pdf>.

⁵ H. Van Rompuy, *Towards a Genuine Economic and Monetary Union*, 5 December 2012, p. 11, http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ec/134069.pdf.

specified criteria or a European treasury). Depending on the choices made there will be different challenges at EU level relating to the possibility to introduce (direct) taxation, the unity of the Union budget, and the institutional balance of powers.⁶ Equally at national level different choices will lead to more or less constraints at member state constitutional level.

A second central element in the new reform proposals is the introduction of further risk-sharing through some sort of common debt issuance.⁷ The exact modalities of the 'Eurobond' proposals differ between blue bonds,⁸ red bonds, or a jointly and severally guaranteed Eurobond issued by a European debt agency.⁹ At the level of the EU Treaties these options will have to be confronted with the no-bail out clause of article 125 TFEU. At national constitutional level they will have to be confronted with limits posed by the budgetary autonomy enshrined in the constitution.¹⁰

A third element is the introduction of a European treasury, for example with the power of veto over national budgetary plans or with powers regarding the activation of a European fiscal capacity (in fact this third element is related to the first element above).¹¹ At European level these proposals run into limits in the current EU treaties as to the competences of the EU to decide in the area of economic policy. At national level they are again at tension with the budgetary autonomy central to member state sovereignty enshrined in national constitutions.

⁶ See on this e.g. Repasi, Legal options for an additional EMU fiscal capacity (Study for the EP, 2013) available at http://www.europarl.europa.eu/RegData/etudes/note/join/2013/474397/IPOL-AFCO_NT%282013%29474397_EN.pdf.

⁷ See the comparative overview of the various proposals made by Shahin Vallee at http://www.bruegel.org/fileadmin/bruegel_files/Blog_pictures/eurobonds_EP_snv.pdf.

⁸ Delpla and Von Weizsacker, 'Eurobonds: the Blue Bond Concept and its Implications', (Study for the EP, 2010),

<http://www.europarl.europa.eu/document/activities/cont/201103/20110321ATT15948/20110321ATT15948EN.pdf>.

⁹ Jacques Delors institute, Report of the Tommaso Padoa-Schioppa Group, *Completing the Euro: A road map towards fiscal union in Europe*, June 2012,

<http://www.institutdelors.eu/media/completingtheeuroreportpadoa-schioppagroupjune2012.pdf?pdf=ok>. Possibly with a limit of 40% of GDP, see Juncker C and Tremonti G,

"E-bonds would end the crisis", *Financial Times* (5 December 2010).

¹⁰ IMF Working Paper, Paths to Eurobonds,

<https://www.imf.org/external/pubs/ft/wp/2012/wp12172.pdf> p. 19-20: "Some scholars, and the legal services of the Council, now seem to interpret the Article as compatible with joint and several guarantees as long as member states enter voluntarily into such agreements. (...) Each member state is likely to have important and idiosyncratic legal challenges and the possibility that constitutional amendments are necessary in a number of countries is more than distinct. This is particularly, but not only, the case for Germany, key to any decision on common debt issuance."

¹¹ An even further reaching possibility that could involve a European Treasury, but which however is not often advocated by policy makers, is that of a single European economic policy.

The German case offers a paradigmatic example of constitutional limitations posed to the acceptance of new EMU long-term measures under certain conditions. These conditions have been set through constitutional case law whereby, ruling after ruling, the German Constitutional Court has elaborated on the notion of “constitutional identity”: the untouchable core of the German Constitution (Basic Law) grounded in unamendable constitutional clauses as defined and reinterpreted by the Court itself as implicit limits.

Box 2. German Constitutional Court, identity review and Bundestag powers

The constitutional identity review, however, was expressly acknowledged by the German Constitutional Court with the judgment on the Treaty of Lisbon of 30 June 2009 and so far it has never been applied. In the Lisbon ruling the Court grounded the constitutional identity review in art. 23.1 GG in combination with the eternity clause of the German Constitution, Art. 79.3 GG. The two provisions are indeed strongly intertwined in that the former prescribes to subject changes in the EU treaties that are able to “amend or supplement” the German Constitution either to a prior constitutional amendment (Art. 79.2 GG) or to review them in the light of the eternity clause (Art. 79.3 GG) meaning that they are inadmissible as long as the Constitution remains in force. The judicial protection of the *Bundestag* then is built upon a peculiar interpretation of Art. 38.1 GG on the right to vote for the *Bundestag* as a ‘right to democracy’ – a right that would be irremediably impaired if the powers and the autonomy of this chamber, where people are represented, are severely limited. This is to be seen in conjunction with Art. 20.2 GG that identifies the source of the state authority in the people and in the elections and Art. 79.3 GG, which makes the democratic principle unamendable as part of the German constitutional identity. This implies that the constitutional identity review focuses, in this regard, on the ability of the national parliament to exercise its representative function towards the citizens when the EU decision-making is at stake, since, according to the Court, German citizens are not adequately represented in the European Parliament nor are they able to directly take decisions at supranational level.

The protection of the democratic principle and democratic representation in EU affairs through the *Bundestag* represent the bulk of the argument used by the German Constitutional Court in the review of the Euro-crisis law. As a consequence such an

interpretation of the German Basic Law by the Constitutional Court could affect – and even forbid – any further transfer of power to the EU.

In a series of judgments issued from 2011 to 2014 this Court has repeatedly insisted on the overall budgetary responsibility of the *Bundestag*, thus on the constitutional requirement to keep budgetary powers in the hand of the national parliament. The standard for review was constituted, as usual since 2009, by Art. 38.1 GG in conjunction with Art. 20.1. and 2 GG, and Art. 79.3 GG.

The constitutional limitations set by the German Constitutional Court in the field of the budgetary powers of the Parliament are the following:

- Before authorising to issue or to extend guarantees for a rescue fund the Government must obtain the consent of the *Bundestag*, which in fact retains a veto power. This ex ante parliamentary authorisation is also required for the German Government to negotiate a rescue package in favour of a Eurozone country. In case of particular urgency the consent can be given, on behalf of the *Bundestag*, by a new parliamentary body, the so-called *Sondergremium*, elected from among the members of the Budget Committee.
- The Government's obligation to keep the *Bundestag* informed, comprehensively and at the earliest possible time, 'in matters concerning the European Union', also applies to international treaties and political agreements negotiated outside the EU legal framework though linked to the European integration (e.g. the Treaty on the European Stability mechanism and the Fiscal Compact). The Constitutional Court also set specific standards of quality and quantity for the information to be transmitted to the *Bundestag* as to enable the Parliament to contribute effectively to shape the government's position (the Parliament must have a direct influence on it). The more complex a matter is and the more intrusive on Parliament's legislative power a measure is, the more intensive and detailed the information to be provided will have to be. The duty to inform does not regard only governmental acts or documents, but also official materials of the EU institutions, international organizations, and other Member States, and must be supplied in written form as a general rule. Furthermore, the information must be transmitted step by

step and not ‘in an overall package’, once the decision-making process has been completed.

- Particularly relevant for our purposes finally is the following condition: “Art. 38 sec. 1 GG is violated in particular if the German Bundestag relinquishes its budgetary responsibility with the effect that it or a future Bundestag can no longer exercise the right to decide on the budget on its own. Deciding on public revenue and public expenditure is a fundamental part of the ability of a constitutional state to democratically shape itself. The German *Bundestag* must therefore make decisions on revenue and expenditure with responsibility to the people.”¹² This warning has been launched against the “passive attitude” of the German Parliament and Government towards the announcement on the OMT by the President of the ECB.

From this case law it follows that under the German Basic Law two main legal developments in the EMU could trigger a reaction on the part of the German Constitutional Court, according to its rulings on the constitutional identity review. The first is the area of further transfer of budgetary powers from the *Bundestag* to the EU, like in the case of setting up of a European-Eurozone Treasury and the appointment of an EU-Eurozone Finance Minister. The same limits would run in the event of the creation of a ‘fiscal capacity’ for the EMU (common budget, insurance-type tool against output gaps, unemployment insurance scheme, equalisation of interest burden on government bonds), whereby the budgetary powers of the Bundestag could be potentially undermined.

Likewise problematic could be the transformation of the European Stability Mechanism into a European Monetary Fund, followed by debt mutualisation either through Eurobonds or by means of the European Central Bank acting as a lender of last resort. This way the Bundestag would lose control of national tax-payers money, as recalled by the German Constitutional Court in its case law since September 2011.

Despite these constitutional limitations, however, it should be highlighted that so far not only have the warnings of the German Constitutional Court never been put into practice (although we are still awaiting the final decision of the German Constitutional

¹² German Constitutional Court, BVerfG, 2 BvR 1390/12, 18 March 2014, § 161. Emphasis added.

Court in the OMT case), but whenever a potential conflict has arisen between the German Constitution and EU measures, the German participation in the EU has not been threatened. Rather a constitutional amendment was approved (after the Treaty of Maastricht and the *Tanja Kreil* judgment,¹³ for instance) as to adjust the German constitutional system to EU obligations or, following an interpretation in conformity with the Basic Law by the German Constitutional Court, a legislative reform was considered sufficient (after the Treaty of Lisbon and the judgments of 2011 and 2012 on the new Euro-crisis measures).

PORTUGAL: TAKING RIGHTS SERIOUSLY

The arguments used by the German Constitutional Court based on the protection of parliamentary powers that are able to threaten the creation of a debt mutualisation mechanism or the conferral of further budgetary powers to the EU-Eurozone do not apply in the case of Portugal. It is worth mentioning here that it was precisely the former Prime Minister of Portugal, Pedro Passos Coelho, who was one of the first to launch the idea of a European Monetary Fund and to strongly support debt mutualisation.

In Portugal there are nevertheless other potential constitutional limits to further EMU long-term reforms. The Portuguese Constitution is provided with a long list of limitations posed to constitutional amendments (art. 288 Pt. Const.), which has undoubtedly influenced the more or less explicit identification of supreme principles of the constitutional system as part of the national constitutional identity. Particularly relevant for our purpose is the application by the Portuguese Constitutional Court in many decisions on the Euro-crisis law of the (supreme) principle of proportional equality in the case of the right of workers, which appears in art. 288 Pt. Const., lit. e, as one of the fields where constitutional amendments are restricted. The Court has done so often without paying much attention to the effects of this case law, in particular on the need for the Portuguese government to re-negotiate with the Troika the terms of the financial assistance (2011-2014).

¹³ Case C-285/98, *Tanja Kreil v Bundesrepublik Deutschland*, 11 January 2000.

Box 3. Portuguese Constitutional Court and the principle of proportional equality

The principle of proportional equality had been extensively used by the Constitutional Court of Portugal well before the eruption of the financial crisis. According to the Court, the compliance with this principle postulates that, whenever a differential treatment between groups of people occurs, the equality principle requires this treatment to be appropriate, necessary and rational with regard to the objective that is deemed to justify it. However – and this is where the proportionality test comes in – the sacrifices required to a targeted group cannot be excessive, i.e. cannot supersede the benefits granted to another group, from the viewpoint of the objective pursued and of the treatment reserved.

As Portugal received financial assistance from 2011 to 2014 and thus was subject to strict conditionality, the Government and, in turn, the Parliament were forced to adopt a series of structural reforms involving serious welfare cuts. Starting from 2012, when the Portuguese Constitutional Court began to declare provisions of the Budget Acts determining pensions and salary cuts for public workers unconstitutional, this Court resorted to supreme constitutional principles against the legislation passed by the Parliament under the emergency of the rescue operations.

The principles on which the Court relied to strike down provisions of the Budget Acts were those of proportional equality, of equality *tout court*, and legitimate expectations, often combined together. The economic emergency – according to the Court – does not justify per se the overthrowing of the fundamental principles of a democratic State based on the rule of law (art. 2 Pt. Const.), particularly when the same cohort, i.e. civil servants and pensioners, is systematically affected year after year by austerity measures compared to the less adverse conditions of other groups of citizens. Also the public status and working or retirement conditions do not give ground for a persistent, if not permanent, discriminatory treatment. In particular, according to the Constitutional Court, there was no evidence that the conditions imposed by the MoU and the loan agreement, which the Court recognized as international agreements, did not leave discretion to the Parliament in their implementation. At the opposite, the Parliament could have explored alternative avenues to implement the rescue package. This has been the warning of the Court since judgment n. 353/2012, which has grounded most declarations of unconstitutionality of the Budget Acts from judgment n. 187/2013 onwards.

In judgment n. 575/2014, the Court considered the EU Council of Ministers' recommendations within the excessive deficit procedure against Portugal to be non-legally binding insofar as they did not impose the adoption of concrete and ad hoc policies to put public spending and the deficit under control. In this field – the Court added – EU law is binding upon Member States only with regard to the objectives set, not on the national means chosen to reach those objectives. Furthermore, the Court added that the adaptation of national legislation to the standard fixed by EU law did not entail any consequence from the viewpoint of the application of the Constitution. The Portuguese Constitutional Court also moved forward to say that in this field – namely Euro-crisis law – there is a convergence between the EU Law and the Portuguese Constitution, based on the fact that the guiding principles used by constitutional judges to solve the case law on Euro-crisis measures, namely the principle of equality, the principle of proportionality, and the principle of the protection of legitimate expectations, are at the core of the rule of law and an inherent part of the common European legal heritage, which the EU is also bound to respect.

It follows that the new proposals to develop the EMU – namely those contained in the Five Presidents' Report, in the Communication by the European Commission of 21 October 2015 and the new measures just adopted – do not directly encroach upon the Portuguese Constitution and especially its untouchable provisions and principles. Only if the implementation of these EU-Euro area reforms at domestic level undermine workers' and pensioners' rights, in particular under the condition posed by the constitutional case law on proportional equality, the Portuguese Constitutional Court could annul the implementing measures.

The Portuguese case illustrates the limits to EMU from the perspective of the protection of rights, in particular social rights, enshrined in the Constitution and subject to limitations as for constitutional amendments. So far the Constitutional Court has reviewed national measures in light of the national constitution, arguing that the Portuguese measures were not directly imposed by Euro crisis measures as the latter did not impose the adoption of concrete and ad hoc policies. Leaving aside the question whether the Portuguese measures are imposed by EU law or not, a policy challenge exists when EU law directly imposes concrete economic policy measures on a member state. This challenge has a national dimension of fundamental rights review by a critical Constitutional Court in light of the national constitution. At the same time in such case

there is a parallel risk of fundamental rights challenges at the EU level (that is in light of the EU Charter of Fundamental Rights).

Given the long-term proposals to change the EMU governance, none of them appears to have a direct adverse impact on workers' rights and social rights in general that might trigger challenges before the Constitutional Court.¹⁴

Finally, although this has never happened, it has to be pointed out that the Portuguese Constitution allows to hold binding referenda "on the approval of treaties concerning the construction and deepening of the European Union" (art. 295 Const.), hence on EU Treaty amendments, as well as on any "issue concerning the national interest that must be the object of an international convention", except for "questions and acts with a budgetary, tax-related or financial content" (art. 115 Const.) Therefore potentially further EMU reforms could be blocked by the outcomes of referenda.

UNITED KINGDOM: TOWARDS A SUSTAINABLE SETTLEMENT

Although not a member of the Eurozone, the UK is still a relevant case in a study of conditions to reform of the Eurozone, as most clearly evidenced by the combination of events leading to the adoption of the Fiscal Compact in 2012 by 25 member states of the EU outside the framework of the EU Treaties. Since UK Prime Minister Cameron at the December 2011 European Council blocked treaty reform on EMU, most of the other member states decided to resort to development outside the EU Treaties, which significantly impacted on the substance of the commitments finally agreed to.

These events illustrate conditions posed to change at EU level: the need to secure support for an amendment of the treaty rules on the EMU among all member states, notably including those outside the euro area, even permanently. Arguably, an important substantive part of discussions on such amendments to EMU will be their impact on the relationship between euro area and non-euro area member states, or between EMU and the integrity of the single market.

At the same time, the UK provides an illustration of limits to EMU development at national level. In the UK – as in other member states, most notably Ireland – ratification

¹⁴ Although from a political point of view this is unlikely to happen, from a constitutional point of view, the Constitutional Court can also be asked to review *ex ante* (i.e. before its entry into force), upon request by the President of the Republic, any norm of an international treaty, including EU Treaty amendment, submitted to him for ratification (art. 278.1 Pt. Const.).

of EU treaties requires a referendum for certain Treaty amendments on the basis of the 2011 European Union Act. Strictly speaking a referendum would not necessarily be required for treaty changes only affecting the euro area, if they do not involve the transfer of powers or competences from the UK to the EU. Potential national constitutional hurdles could thus – with regard to the UK, not Ireland – in theory relatively easily be overcome by not rendering treaty reform on the euro area applicable to the UK. However, in practice it may not be so easy, either because a comprehensive treaty amendment will include changes affecting also non-euro area member states, or because there might be a political decision to hold a referendum even in the absence of a legal obligation to do so. The planned UK in-or-out referendum illustrates this.

The UK referendum on EU membership will condition any further reform of the EU in the coming years, including that of the euro area. This constitutional event, the consequence of a political choice by the Conservative Party, will condition development of the euro area, as the UK has linked it to its own political demands concerning its relation to the EU and to the euro area. This link was made in December 2011 in the run up to the Fiscal Compact, and it is made again now in the negotiations on a new settlement for the UK in a reformed EU. In the words of Prime Minister Cameron:

So we do not want to stand in the way of measures Eurozone countries decide to take to secure the long-term future of their currency. But we want to make sure that these changes will respect the integrity of the Single Market, and the legitimate interests of non-Euro members. I am confident we can achieve an agreement here that works for everyone.¹⁵

As much as the planned UK referendum represents a condition to change, it may also present the EU with an occasion for Treaty amendment, something many member states are eager to avoid, especially since the failed Constitutional Treaty of 2005. Prime Minister Cameron has made it explicit that he strives for an amendment of the EU treaties to accommodate the British concerns. Treaty amendment would also be necessary for an ambitious reform of EMU, such as the creation of a fiscal capacity for the absorption of macroeconomic shocks, further risk-sharing through some sort of common debt issuance, and the introduction of a European treasury with a veto power

¹⁵ Letter from Cameron to President of the European Council Tusk, 10 November 2015.

over national budgets. From the above it follows that any treaty amendment that is to provide a sustainable new settlement for both the UK and the member states of the euro area, will have to secure political support in all member states, but also popular support in a referendum in several among them.

CONCLUSIONS: POLICY CHALLENGES

- Accommodating competence and democratic concerns; challenges exist not only at EU level, but there are also constraints following from national constitutions. In particular, based on the case law of the German Constitutional Court, long-term EMU reforms on further conferral of budgetary powers at supranational level and debt mutualisation can be found by the Court as impairing the budgetary responsibility of the *Bundestag* towards the people.
- Taking rights seriously: in some member States, in Portugal for example, there are constitutional limitations in terms of rights protection to what can be pursued through long-term EMU reforms. In the case of Portugal their ratification and implementation does not appear to directly affect the principle of equality and workers' rights as to trigger a reaction on the part of the Constitutional Court. In general, economic policy choices imposed for the objective of fiscal discipline have to be confronted with rights protection at both national and EU level. A more direct intervention from the EU level in national economic policy making increases the need to take rights seriously in EMU.
- Towards a sustainable EU/euro area settlement; a further EMU policy challenge is to secure political support for further integration of the euro area both among the euro area members and those outside. The case of the UK illustrates the need also to secure direct popular support for European integration, including for the relationship between the 'ins' and the 'outs', and to reconcile euro area development with the integrity of the internal market.