

The European Union's Structural Deficiency and the Cypriot Bail-in

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Abstract: The European Union's response to the exceptional conditions created by the economic crisis reveal two levels of structural deficiency: the practical and the theoretical. By analysing the case of Cyprus and the bail-in the paper discusses the effects of the EU's crisis management mechanisms on European democracy. Moreover, by analysing the case of Cyprus through the work of Carl Schmitt, the paper argues that the European constitutional framework has been deformed to the extent of being transformed.

With the outbreak of the economic crisis in Europe, the structural deficiency of the Union was revealed. Using the case of Cyprus as an example, the paper attempts to trace the EU's structural deficiency in two levels: the practical and the theoretical. At the practical level, the constant migration of power from democratic institutions to executive bodies signalled the mark of a post-democratic era in European governance. At the theoretical level, the EU's lack of theoretical grounding renders the constitutional framework contingent and therefore susceptible to change. Against this background and by employing Schmittian theoretical tools the paper argues that in exceptional moments such as the case of Cyprus, the EU's constitutional arrangement can be deformed to the extent of being transformed.

Practical Structural Deficiency

With the Cypriot banking sector on life support and the ECB threatening to pull the plug on the economy by ending the Emergency Liquidity Assistance (ELA), the newly elected government of Cyprus was invited to negotiate a rescue package with European institutions and international creditors. In an attempt to avoid a costly bail-out, European institutions and the IMF adopted a harsh and rather rigid stance against Cyprus, insisting that depositors should contribute to the restructuring of the banks. During the course of the negotiations it became evident that the Troika and the ministers comprising the Eurogroup would not retreat from their initial declarations². Faced with outright blackmail, the Cypriot government was left with no alternative but to give in to the demands of the Eurogroup and agree to a depositors bail-in (Orphanides 2013). Usually, the bail-in is employed in order to include debt holders and shareholders (investors) share the burden of a defaulting banking institution. However, in the case of Cyprus the definition of a creditor was extended to include depositors. Therefore, the bail-in required all creditors (bond holders and depositors)

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² In an interview to public broadcaster ARD, German Finance Minister Wolfgang Schäuble claimed that: "It was the position of the German government and the International Monetary Fund that we must get a considerable part of the funds that are necessary for restructuring the banks from the banks owners and creditors - that means the investors,» , eKathimerini 17 March 2013, http://www.ekathimerini.com/4dcgi/w_articles_wsite2_1_17/03/2013_488337

of a bank to bear the burden of the institution's failure by having their debt (bonds and deposits) written off. Initially the agreement involved a tax levy, otherwise termed as a "horizontal haircut" (6.75% for deposits below €100.000 and 9.9% for uninsured deposits over €100.000), applicable to all banks and every depositor. This first agreement was rejected by the Cypriot Parliament, sending the government back to another Eurogroup meeting. With the banks closed and the economy of the island paralysed, the need for an agreement reached an apogee. Despite fierce public criticism and the rejection of the first agreement by the Parliament, the Eurogroup insisted on a depositor's bail-in. It was soon made clear that no other solution would be accepted; it was either a bail-in or bankruptcy. A second, harsher some have argued, agreement was reached whereby a 'haircut' would be implemented on all uninsured deposits in Laiki Bank and 47.5% on uninsured deposits in the Bank of Cyprus. Crucially, in order to facilitate this agreement a new law was introduced³, changing pre-existing insolvency law and the order of priorities (Jack and Cassels 2013, 450-463). Following the bail-in, Cyprus would receive a €10billion loan subject to a Memorandum of Understanding which would introduce and regulate a series of strict austerity measures.

Drawing from the case of Cyprus, we can observe the dominance of executive actors to the expense of democratic institutions. European institutions such as the Council, the Commission, the European Central Bank in addition to executive bodies which were created specifically in order to face the economic crisis such as the Euro Summit and the Eurogroup, are no longer confined to "normative, rule-making governance", but can now influence internal matters of member-states such as budgets and macroeconomic policy, indicating a shift from "economic governance" to "economic government" (Curtin 2014, 1-32 : 3-6). As we have seen in Cyprus, these decisions are taken by the executives on the EU and imposed upon other member-states. The process of *legitimisation* through national democratic parliaments is therefore nothing but a formal requirement with no real significance. Once again, Cyprus is a good example to illustrate this since the parliament had no other option but to accept a worst deal than the one it previously rejected. As a judge of the Supreme Court of Cyprus has put it, the decisions taken by the Eurogroup and the Troika lacks transparency, accountability and democratic legitimacy while ignoring fundamental European principles⁴. What we have therefore is a *structural deficiency* in the way the economic crisis is handled, allowing for the constant empowerment of executive actors to the extent that democratic institutions only act as a "formal shell" (Crouch 2004; Crouch 2013), leading to the effective hollowing of European democracy (Curtin 2014, 1-32; Mair 2013).

Theoretical Structural Deficiency

It becomes clear that amidst the financial crisis Europe lacks a constitutional arrangement that can safeguard basic democratic principles and effectively regulate the exercise of power. Consequently, the rules of the game are made and remade according to particular circumstances, ignoring any form of significant deliberation

³ *The Resolution of Credit and Other Institutions Law 2013*

⁴ *Myrto Christodoulou v Central Bank of Cyprus, The Governor of the CBC and the Minister of Financial Affairs*, Supreme Court of Cyprus, 7 June 2013, per Justice Erotocritou G.

with the affected countries. Habermas describes this new stage of European governance as a “post-democratic ... executive federalism”, where a self-authorising European Council exercises political authority over internal matters such as fiscal and economic policy, social policy, education, health and employment (Habermas 2012). Others have characterised it as a post-democratic style of rule albeit the preservation of a democratic organisation of power, leading to a form of autocracy coupled with “institutional structures of democratic government” (Azmanova 2013, 23-38); as the emergence of a “Distributive Regulatory State” (Chalmers 2012, 667-693) or as “Authoritarian Managerialism” (Joerges and Weimer 2012). Common to all of these accounts tracing the constitutional reality of the European Union is the lack of “any theoretical / conceptual paradigm” (Joerges 2012). Therefore, what the crisis calls us to consider is not the democratic deficit of the EU, which focuses on the democratic effectiveness of institutional proceedings, but instead divert our focus to the structural theoretical deficiency of European integration. Certainly, the question of a democratic deficit does not become irrelevant, however, it is time to consider the cause, not the effects, of the problem.

Ever since its inception, the European Union puzzled constitutional lawyers and political theorists. Described as a polity without political theory (Muller 2000, 1777 : 1777), the Union’s political arrangement remains, to this day, unclear. A democratic constitution, to be characterised as such, needs to be created by the “direct decision and political participation of the sovereign popular subject, outside all forms of pre-existing authority”(Kalyvas 1999, 1525 : 1540). This is what we term as the *constituent power* and is located prior to and above any constitutional formation (Schmitt 2008). Negri defines constituent power as the power “to make a constitution and therefore to dictate the fundamental norms that organize the powers of the State. In other words, it is the power to establish a new juridical arrangement, to regulate juridical relationships within a new community” (Negri 1999 :2). *Constituted* power, on the other hand, is the result of the operations of constituent power and can be defined as “the positive constitutional forms created by the constituent subject, which determine how public power is to be exercised and how ordinary laws are to be created” (Colón-Ríos 2010, 199 : 205). A democratic constitution therefore determines both the way through which power is legitimised and the way through which power is organised.

Determining the actual constitutional formation of the EU, in other words what the EU *actually is*, has not been an easy task, primarily due to the constant evolution and reformation of the Union. However, we can draw upon certain characteristics in order to picture Europe’s constitutional arrangement. It is apparent that there has been some sort of constitutionalization through Treaties and certain European Court of Justice judgments such as the cases of Van Gend en Loos⁵ and Costa v ENEL⁶, establishing the principle of direct effect and supremacy respectively. These developments shaped the EU into a “kind of Rechtsstaat - i.e. an entity which guarantees the rule of law” (Muller 2000, 1777 : 1777). Nevertheless, such a constitutional arrangement can neither be called a state nor a federation, allowing some commentators to argue for a *sui generis* formation “suspended between *Bundeststaat* (federal state) and *Staatenbund* (federation of states)” (Muller 2000, 1777 : 1777-1778). In order to

⁵ (1963) Case 26/62

⁶ [1964] ECR 585 (6/64)

describe this sort of “federalism beyond the state”, in other words this middle ground, political thought created a new word – supranationalism (Schütze 2012 : 48). The EU was therefore perceived as containing intergovernmental, supranational and infranational elements, mixing “aspects of ‘representative government’, in the broadest sense, with ‘confederal, consociational’ democracy, which aims at decisional efficiency and inter-executive-elite accommodation” (Muller 2000, 1777 : 1790. See also: Weiler 1999; Chrysochoou 1998). Notwithstanding the democratic deficit such an ambiguous process of integration the European *demos* has silently accepted the non-democratic turn in European politics. Since the EU could not draw legitimacy from its constitutional arrangements but was nevertheless accepted by the people, lawyers and political scientists created a new term to define this form of legitimacy: output legitimacy; “a notion of ‘self-legitimation’ based on instrumental criteria” (Muller 2000, 1777 : 1778). It becomes clear that despite the above-mentioned elements, the EU has no political form; in other words, the Union’s political structure remains *contingent* and, by extension, *undefined*.

Despite its contingent nature, the EU’s constitutional framework depends upon one constant variable and that is the presupposition of a sovereign nation state. This is evident in Jan Muller understanding of the constitutional order of the European union under conditions of *normalcy and economic prosperity*. Muller argues that the Union started off as an “intergovernmental enterprise” where sovereign member-states, representing their people, agreed to form a Union, constituting a Community of nations. Therefore, the “initial constituent power was a plural one” and despite the initial “direct democratic deficit...there was no lack of a democratically constituted plural constituent power”. The paradox arising from this formation is that the constituent power is already constituted, rendering it both within the constitution (due to the appearance of member-states in the Council of Ministers) and “outside, as in those moments when the member-states, as high contracting parties redesigned the constituent power”. A key aspect of this interpretation is that in “*exceptional* moments of constitutional remaking of the Union, the member-states reassert their sovereignty” whereby a decision is then affirmed, or authorized, by the member-state’s own constituent power (Muller 2000, 1777 : 1791-3). However, Muller’s account of the European constitutional formation presupposes a sovereign member-state. With the continuous transferring of power to the executives and the unprecedented influence of these executives in the internal affairs of those member-states affected by the crisis, this fundamental presupposition is disputed.

Schmitt defines the sovereign as he who decides on the exception, indicating the capability of either a person or an institution firstly to decide whether a situation is to be considered as an emergency and, secondly, to dissolve the normative legal order in order to decide on the act in response to the emergency (Schmitt 2005). Analysing the case of Cyprus using Schmitt’s conception of sovereignty reveals the new, or previously concealed, dimension of the European constitutional formation; this time under moments of an exceptional crisis. As we have seen in the case of Cyprus, the ensemble of European institutions imposed a decision upon a member-state without any regard to democratic procedures or the will of either the government or the citizens. It could be argued here that the exceptional circumstances were both determined and defined by the financial conditions. However, the decision of what is to be done in this exceptional case rests with the executive institutions of the EU. They operated outside the normative legal order by bypassing every democratic

procedure, they decided on the bail-in and they constructed a new insolvency regime to facilitate this decision. Therefore, in moments of crisis European institutions⁷, acting as sovereigns decide on the exception (Schmitt 2005. Also, for a similar argument and conclusion see: Douzinas 2013 :100). The moment when European institutions are capable of deciding issues such as fiscal and budgetary policy, which previously fell within the ambit of sovereign states, is the moment when the constitutional arrangement of both the EU and the member-states was altered. If we accept this proposition, it means that the case of Cyprus challenges our theoretical understanding of the EU in one vital respect. Member-states no longer operate outside the constitution in the sense that they can no longer act as constituting powers since the constitutional order can be altered without their consent - as in the case of Cyprus. What we have is a new political formation, one that the political lexicon cannot capture nor describe adequately.

Conclusion

As the Union loses every form of legitimacy, the need for a radical re-imagination of European integration and politics becomes more evident. Political theory is called to reconceive basic principles of social organisation such as the role and position of the state, the nature of sovereignty, the conditions for legitimacy and the basis of constitutionality, the role and limits of power as well as the rights and obligations of individuals. A descriptive analysis focusing on the practical and theoretical deficiency of the EU serves as propaedeutic for the pressing debate arising from the economic crisis which is nothing more than the question of what kind of European integration do Europeans want to achieve.

⁷ It is, admittedly, challenging to determine the locus of sovereignty in this case since. A number of European institutions (the Commission and the Eurogroup) and other stakeholders (such as the ECB and the IMF) or the conglomeration of such institutions (Troika), as well as powerful member-states (such as Germany), each played a crucial role in imposing the decision of the bail-in in Cyprus. However, it is vital to recognise that in a state of emergency it was the combination of the above-mentioned forces, which was capable of acting as a sovereign.

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