
Guest post: Cyprus, when EMU broke and trust was undermined

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Part of the **A CYPRIOT PRECEDENT SERIES**

The 'Cypriot precedent' and experiment with capital controls, a first for the eurozone, are still reverberating around the EU. Gilles Thieffry, a Partner at GTLaw, Geneva, writes on possible legal implications.

Since March 1998, when I co-authored "Thinking the unthinkable – the break-up of monetary union" with my then-partner Charles Proctor (now a partner at Fladgate), I have published several articles on the weaknesses of EMU.

Considering this scenario was felt to be doubtful as to its political correctness. Since 2008 more lawyers and economists have studied the possible break-up of EMU. The creation of a currency without a single sovereign left the union exposed to a clear historical weakness – a sovereign-less currency system. The Cyprus crisis has just precipitated the issue. Cyprus – while a minute part of the EU – may become a larger threat to EMU as the decisions taken over the last few days undermine the concept of monetary union.

In Mann's *Legal Aspects of Money*, the classic text on monetary law, Dr Mann noted that the abolition of both overt and covert exchange controls was a prerequisite to the creation of a monetary union. So much so that the Treaty establishing the European Community, and then the Treaty on the functioning of European Union, dedicated four articles to this important principle.

As Article 63 of the TFEU (Article 56 under the TEC) states:

1. Within the framework of the provisions set out in this Chapter, all restrictions on the movement of capital between Member States and

between Member States and third countries shall be prohibited.

2. Within the framework of the provisions set out in this Chapter, all restrictions on payments between Member States and between Member States and third countries shall be prohibited.

As noted by Proctor (Mann on the Legal Aspects of Money – Sixth Edition – 25.34):

Although they are stated to be subject to various exceptions, the rules contained in the revised Article 56 are clear and unambiguous, and are mandatory in their terms. As a result, the European Court of Justice decided in the Sanz de Lera case that Article 56 had direct effect in Member States and was thus capable of creating individual rights.

In the Sanz de Lera case (1995), the ECJ stated:

[Article 63 of the TFEU (Article 56 under the TEC)], may be relied on before national courts and may render inapplicable national rules inconsistent therewith.

The current restrictions on the free transfer of funds from Cyprus, and the extended closure of the banking system within Cyprus (which could be construed as a covert exchange control measure), are undeniably in breach of monetary union and of the EC treaty. In essence a euro in Cyprus is not worth a euro in Paris or Frankfurt. In substance they no longer are the same currency.

Some try to justify the actions taken in Cyprus by claiming the moral high ground. It is alleged that Cyprus – an offshore centre – has been used by Russians for money-laundering purposes.

Besides the despicable stigmatisation of one nationality (stigmatisation that is utterly unacceptable), the template that is being used to confiscate wealth is of a nature rarely seen in modern history and creates a dangerous precedent. No doubt that it is too early to assess the exact damages, but the legal challenges against the decisions taken over the last few days will undoubtedly be numerous and long-lasting.

In 2011, I wrote that:

Indecisive action or unilateral decisions will lead to the unknown, recrimination and the rebirth of nationalism that the European construction was meant to make a thing of the past.

Unfortunately, two years hence, issues have been left to fester. Violent and ill-founded decisions will lead to more problems and undermine trust in the very core of the international financial system. It is about time to dismantle EMU in an orderly fashion rather than await the political backlash that all see coming.

By Gilles Thieffry

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