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The transformation of the euro: law, contract, solidarity

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The Transformation of the Euro: *Law, Contract, Solidarity*

V. BORGER

The Transformation of the Euro:
Law, Contract, Solidarity

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Previously published work

This thesis contains and/or builds on the following previously published work by the author:

Borger V, 'De eurocrisis als katalysator voor het Europese noodfonds en het toekomstig permanent stabilisatiemechanisme' (2011) 59 SEW 207.

Borger V, 'The ESM and the European Court's Predicament in *Pringle*' (2013) 14 GLJ 113.

Borger V, 'How the Debt Crisis Exposes the Development of Solidarity in the Euro Area' (2013) 9 EuConst 7.

Borger V, 'The European Stability Mechanism: a crisis tool operating at two junctures' in Matthias Haentjens and Bob Wessels (eds), *Research Handbook on Crisis Management in the Banking Sector* (Edward Elgar 2015) 150.

Borger V, 'Outright Monetary Transactions and the Stability Mandate of the ECB: *Gauweiler*' (2016) 53 CML Rev 139.

Borger V and Cuyvers A, 'Het Verdrag inzake Stabiliteit, Coördinatie en Bestuur in de Economische en Monetaire Unie: de juridische en constitutionele complicaties van de eurocrisis' (2012) 60 SEW 370.

Van den Bogaert S and Borger V, 'Twenty Years After Maastricht: The Coming of Age of the EMU?' in De Visser M and Van der Mei AP (eds), *The Treaty on European Union 1993-2013: Reflections from Maastricht* (Intersentia 2013) 451.

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Preface

> 'It's not a bad idea, and I would support it if you were to pursue it, but you should consider doing a thesis on a different topic. Why not write on the euro crisis ... '

It was spring 2010 and I had travelled to Leiden to discuss possibilities for PhD research with Stefaan Van den Bogaert. Several weeks earlier I had approached him with a research proposal on the prohibition on discrimination on grounds of nationality and third-country nationals. It was closely connected to my studies in European law at Maastricht University, which I was about to finish. Now, however, my former teacher in Maastricht, who had just moved to Leiden, challenged me to explore a completely different topic, one that was all over the news but that I had hardly touched upon during my own years in Maastricht. That did not show a blind spot in the curriculum I had followed there, which had given me a very solid training in European law. It simply reflected the general thrust of European legal scholarship on its 'classics', such as the law on free movement and competition and the institutional issues to which their development had given rise. The law on economic and monetary policy, by contrast, received little attention. Certainly, since its inclusion in the Treaty of Maastricht the currency union had occasionally been the subject of debate, even of litigation, yet these instances of heightened legal attention had contributed to, instead of negated, its status as a special policy area; one that belonged first and foremost to the province of politics and economics, and only secondarily to that of law.

Crisis developments during the first months of 2010, and their coverage by the media, only strengthened this perception, at least for me personally. With increasing frequency political leaders convened in the *Justus Lipsius* building in Brussels to discuss the situation of Greece and other debt-stricken member states that had come under fire in the markets.[1] After every meeting, often lasting deep into the night, they would come out and confront an army of journalists and reporters that had gathered in the building in tense anticipation of the decisions taken. Almost immediately, these would then be commented on by economic experts and pundits on radio and television. Usually, they would sketch the conditions for a viable euro and explain how 'at the

1 Since 2017 the European Council meets in a new venue, the 'Europa building'.

moment of truth' politicians had displayed a lack of determination by settling for a 'compromise' that fell far short of the ideal scenario. Law did not figure prominently in their commentaries, if at all. At most, they would point out that the rescue actions in support of financially distressed states blatantly 'violated' the rules on which the euro was founded.

I was therefore not immediately won over by the idea of writing a thesis on the crisis. What could I possibly say about it as a legal scholar? Would I not just be trying to do research that scholars from other disciplines were much better placed to carry out? At the same time, I was captivated by the prospect of exploring an area of law that was new to me. And the more I delved into the facts and the law of the crisis, the more I realised that it was too important to be left to economists alone. Behind the talk of 'sovereign defaults', 'spreads' and 'financial contagion', there was a political and legal reality waiting to be discovered. When months later I started my research project on the crisis, this had taken on systemic proportions, threatening not just Greece, or even the euro, but the Union itself. In the period that followed I would be carrying out my research while the events unfolded.

This thesis is about these events and how they have changed the euro. For me, as a legal scholar, writing it was a great challenge. Where to start? The overhaul of budgetary rules, the new procedures for economic policy coordination, the recapitalization of financial institutions, or perhaps the bond-buying action of the Central Bank? Changes to the euro have been so numerous that it is easy to get bogged down in them, even if one has the privilege – like I did – of spending a lot of time studying. And what to figure out about these changes? Whether they are legal? Doing that, or to put it more adequately: doing *just that*, was not a very satisfying prospect. The reform of the currency union was so profound, so clearly changing the rules of the game on which the euro had originally been founded, that I felt more could, and should, be said about it.

The crisis itself helped me find out what exactly. Each day I could see on the news and read in the papers how law was being made. Heads of state negotiating in Brussels over rescue funds, national parliaments voting on amendments to the Union Treaties, courts assessing their constitutionality ... it made me realise that the law is much more than a set of rules; it is also *history*. This historical dimension to law has been aptly put by former law professor and American President Barack Obama. Looking back at his years in law school he tells how 'poring through cases and statutes…. The study of law can be disappointing at times, a matter of applying narrow rules and arcane procedure to an uncooperative reality'. 'But that's not all the law is',

he continues. 'The law is also memory; the law records a long running conversation, a nation arguing with its conscience'.[2]

Whereas this is true for any legal system, it has special relevance for the Union.[3] In 1950, in his proposal for the creation of a Coal and Steel Community, Robert Schuman predicted that Europe would 'not be made all at once, or according to a single plan' but instead 'through concrete achievements….'[4] Over the following decades he was proven right. The Union evolves gradually, and often under the pressure of events, when it needs to adapt to a changed reality. At such moments, it is up to politics, to executive and legislative authorities, to decide; to act and reposition the Union in the face of a new situation. And courts are called upon to scrutinise the actions. Its constitution is consequently both shaped by and a reflection of such acts and judgments. History, in other words, is part and parcel of it.

The euro crisis was a momentous event, or rather sequence of events. When it erupted late 2009 it caught the Union and its member states off guard. The currency union was ill-prepared for taking on the market forces that were unleashed upon it. Its toolbox was poor and primitive. The law, central to European integration and one of its great achievements, could not show the way this time. The answer had to come from politics. And it came. At the height of the crisis, from 2010 to 2012, European politics saved the euro, and with it the Union, through a constitutional make-over of its set-up.

When it comes to *how* the euro was saved, the critics are lining up. Renowned economist and Nobel laureate Joseph Stiglitz, to name one, in his recent book *The Euro and Its Threat to the Future of Europe* reflects on the currency union and on what needs to be done to make it work. The story of the euro, Stiglitz argues, is one of 'platitudes, uttered by politicians unschooled in economics who create their own reality, of positions taken for short-term political gain that have enormous long-term consequences'.[5] He consequently sees the currency union as 'flawed at birth' and its crisis as an accident waiting to happen.[6] And now, after years of bad crisis management, the Union is facing a tough choice: either it takes a great leap forward through the creation of a common bank deposit insurance scheme and pooling of debt or it drops the euro, either through the exit of several states, the creation of multiple currency blocs or by putting in place more 'flexible' monetary arrangements. Anything in between these two extremes, which Stiglitz calls 'muddling through',[7] only

2 Barack Obama, *Dreams From My Father* (Canongate 2016) 437.
3 WTE, 'The European Way. History, Form and Substance' (2005) 1 EuConst 5, 5-6.
4 Schuman Declaration, 9 May 1950.
5 Joseph E Stiglitz, *The Euro and Its Threat to the Future of Europe* (Penguin 2016) xx.
6 Stiglitz (n 5) 7.
7 Stiglitz (n 5) 32.

puts off the evil hour and threatens to 'sacrifice' the Union 'on the cross of the euro'.[8]

But Stiglitz is missing the point. 'Men make their own history', Karl Marx once famously said, 'but they do not make it just as they please in circumstances chosen by themselves; rather they make it in present circumstances, given and inherited'.[9] When Europe's political leaders had to decide on a single currency in the early 1990s a perfect monetary union, one that could count on the support of economists like Stiglitz, was not on the menu. 'It was *this* monetary union, or *no* monetary union', as the late Dutch Central Bank Director André Szász has pointed out.[10] And in a Europe shaken to its foundations by the fall of the Wall, they chose monetary union. Likewise, when the euro was on the brink of collapse early 2010, the choice was not between letting it fail or moulding it to perfection. Constrained by electorates, competing priorities and, paradoxically, the very law on monetary union that had been put in place two decades earlier, political leaders had to operate within the bounds of possibility. Still, they decided to defend the euro, changing its set-up step by step during the years that followed. And any future reforms, I dare say, will also fall short of perfection.

This does not mean that one may not criticise the actions politicians have taken in defence of the euro. One certainly may. Yet, to dismiss them as aberrations, as point-blank wrong, simply because they do not correspond to economic textbook solutions does not do justice to their action in the situation. More importantly, it does not help us understand the deeper meaning of these actions, what they tell us about the foundations of the Union and how it operates.

This thesis consequently takes a different approach. It does not argue for or against the euro. Likewise, it does not contain a plea for or against the severe austerity measures and structural reforms that member states like Greece, Portugal and Spain have had to implement over the past years and the enormous hardship this has caused in their societies. And it certainly does not make claims about the desirability of possible future reforms of the currency union. What it does do, is to look back and show how, in the face of a crisis unprecedented in the Union's history, political leaders and other authorities, among which law courts, managed to save the Union and its currency by drawing on transformative powers under the constitution that hitherto had gone unnoticed.

Leiden, 03-07-2017

8 Stiglitz (n 5) 326.

9 Karl Marx, 'The Eighteenth Brumaire of Louis Bonaparte (Terrell Carver tr)' in Mark Cowling and James Martin (eds), *Marx's Eighteenth Brumaire: (Post)modern interpretations* (Pluto Press 2002) 19.

10 André Szász, 'Een Duits dilemma: de euro van geloofwaardigheids- naar vertrouwenscrisis' (2012) 66 Internationale Spectator 137 (emphasis added, translation by the author).

Table of contents

PREFACE VII

PROLOGUE 1

When the banks stopped dancing … 2
Sovereign despair 8
The transformation 11
Solidarity 16

PART I – SOLIDARITY BETWEEN THE MEMBER STATES 21

1 THE CONCEPT OF SOLIDARITY 23
1 Introduction 23
2 Aristotelean friendship 28
3 Rousseau's social contract 34
4 Durkheim's mechanical and organic solidarity 39
5 Parsons' normative solidarity 44
6 Conclusion 46

2 SOLIDARITY BETWEEN THE MEMBER STATES 49
1 Introduction 49
2 Political obligations in states and between them 51
2.1 The nature of political obligation 51
2.2 Joint commitments as emergent phenomena 53
2.3 Commitment and political obligation 57
3 The solidary cohesion between the member states 61
3.1 Time, commitment and solidarity 61
3.2 The strands of solidarity 63
4 Commitment and Union law 69
5 Conclusion 72

PART II – THE ORIGINAL STABILITY CONCEPTION 75

3 COMMITTING TO STABILITY 77
1 Introduction 77
2 Calling for monetary union 79
2.1 The Hague, 1-2 December 1969 79
2.2 Hannover, 27-28 June 1988 86

3 The stability perspective 93
3.1 Explaining the original set-up 93
3.2 Price stability as the overriding aim 96
4 The constitutional position of the European Central Bank 100
4.1 The stability argument for independence 100
4.2 Legal safeguards for independence 103
5 Economic policy: fiscal prudence as a safeguard for stability 109
5.1 Hopes and fears for a *gouvernement économique* 109
5.2 Primary law and the logic of discipline 113
5.2.1 The logic of discipline 113
5.2.2 Market discipline 116
5.2.3 Public discipline 119
5.3 Secondary law and the logic of discipline 123
5.3.1 Waigel's proposal for a Stability Pact 123
5.3.2 The Stability and Growth Pact 125
6 Accession to the currency union 131
6.1 Negotiating accession: stability versus inclusiveness 131
6.2 The balance between stability and inclusiveness 135
6.3 The stability focus of the 'outs' 141
7 Conclusion 146

4 Law and economic wisdom 149
1 Introduction 149
2 The whimsicality of markets 152
2.1 From extreme tranquillity to absolute panic 152
2.2 Searching for an explanation ... 154
2.3 ... that fits central bank action 157
3 The weakness of public discipline 160
3.1 Fiscal politics under the original Pact 160
3.2 Testing public discipline in court 168
3.3 Changing the Pact: flexibility versus discipline 171
4 The fixation on fiscal policy 178
4.1 The private roots of fiscal problems 178
4.2 The stifling embrace between states and banks 181
5 The narrow reading of stability 183
5.1 Financial stability and the lender of last resort 183
5.2 The search for a lender of last resort for banks ... 187
5.3 ... and possibly for states too 194
6 Conclusion 196

PART III – THE NEW STABILITY CONCEPTION 199

5 The shift in solidarity 201
1 Introduction 201
2 Saving Greece 205
2.1 Changing the Contract 205

2.2 Specifying the change 211
2.3 The 'Greek' facility 216
3 Saving the currency union 220
3.1 The call for a crisis fund 220
3.2 The mechanism 223
3.3 The facility 226
3.4 The search for 'flexibility' 229
4 Incorporating the shift in the Treaties 232
4.1 The chiefs back at the steering wheel 232
4.2 A stroll on the shores of Deauville 236
4.3 Scaling back ambitions 241
4.4 The permanent mechanism 245
5 Conclusion 252

6 Contractual change and Central Bank action 255
1 Introduction 255
2 Crossing the Rubicon 257
3 Calling for a 'compact' 264
4 Doing whatever it takes 271
5 Conclusion 280

7 Reconciling the Contract with the Treaties 281
1 Introduction 281
2 Accommodating the shift in solidarity 285
2.1 The boundary between economic and monetary policy 285
2.2 The Court's struggle with history 292
2.2.1 Reading the ban on bail-out 292
2.2.2 The struggle with history 298
2.3 Union assistance and the deal of Cameron 305
3 Approving central bank action 311
3.1 Weidmann's replay 311
3.2 The policy nature of bond purchases 318
3.2.1 The battle over objectives 318
3.2.2 The futility of the battle 324
3.3 The Court's struggle with the present 328
3.4 Courts and central banks in a stability community 333
4 Conclusion 338

8 Conclusion – Preserving the Contract in an emergency 341
1 The euro's rescue, the Court and legal justification 341
2 Emergency and constitution 343
3 Solidarity, loyalty and the Contract 349
4 The Contract and the Court 353

SAMENVATTING 363
BIBLIOGRAPHY 373
CASES 401
DOCUMENTS 403
ACKNOWLEDGEMENTS 415
CURRICULUM VITAE 417

Prologue

When Chancellor Merkel appeared in the *Bundestag* on 27 February 2012, the currency union had been in crisis for almost two years, threatening not just the currency – the euro – but the Union itself. In attempts to stem the crisis, member states had received billions in assistance. Yet, nothing seemed to help. After every rescue operation the markets calmed down temporarily, but then soon doubled their attacks. In fact, it appeared increasingly likely that Greece, the debt-stricken state at the centre of the crisis, that had been the first to receive assistance in May 2010, would have to be helped out a second time. Conscious of the scepticism among Germany's parliamentarians to once more draw on taxpayers' money, the chancellor told them:

> 'The European sovereign debt crisis shows how closely interwoven the fates of the euro-states, but as well those of all other member states, are nowadays. Every member state bears responsibility for itself, but in the end always also for the currency union as a whole and the European Union. This self- and joint responsibility must be seen alongside unbreakable European solidarity when it comes to averting risks to the currency union at large.'[1]

How to read this statement? Is the appeal to solidarity merely political rhetoric, a calculated move of a political leader seeking parliamentary support for a highly controversial measure? Or is there indeed such a thing as vital and even 'unbreakable' solidarity between the member states?

The present study argues that there is. What is more, it argues that solidarity is central to the constitution and to the legal and constitutional changes made to the currency union due to the crisis; to its very development.

This prologue serves as an introduction to this study and to the argument it makes about solidarity and constitutional change. Following that argument requires first of all a basic understanding of the roots of the crisis. Cris*es*, one should say. True, the man in the street may have perceived all economic hardship as just one big crisis. And why blame him? What matters to him

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▪ This prologue contains and/or builds on previously published work by the author. See especially Vestert Borger, 'How the Debt Crisis Exposes the Development of Solidarity in the Euro Area' (2013) 9 EuConst 7.

1 Regierungserklärung von Bundeskanzlerin Merkel zu Finanzhilfen für Griechenland und Europäischer Rat am 1/2 März 2012 in Brüssel (translation by the author).

is that after 2007 the European economy took a dramatic turn for the worse with devastating consequences for economic activity, employment and welfare systems. In fact, Europe was racked by two crises. First, at the end of 2007, it was hit by the global financial crisis in its banking sector. Then, early 2010, it was struck by the debt crisis during which some of the states in the currency union came under heavy attack from the markets which had lost faith in their creditworthiness. Although it is this second crisis that is at the centre of this study, it is inherently linked to the one that tortured banks worldwide. Indeed, had it not been for the crisis in the banking sector, the debt crisis and even the eurocrisis might not have taken on the systemic proportions it did over the ensuing years.

When the banks stopped dancing ...

The origin of the banking crisis lay across the Atlantic, in the 'sub-prime' mortgage market.[2] Favourable interest rates, facilitated by a 'loose' monetary policy of the Federal Reserve and capital pouring in from Asia, had boosted credit growth in the United States during the 2000s, in turn causing a huge rise in real estate prices.[3] Captured by the fantasy that this hike in prices would never stop, mortgage brokers became increasingly lenient in granting loans. As Markus Brunnermeier explains, 'they offered teaser rates, no-documentation mortgages, piggyback mortgages (a combination of two mortgages that eliminates the need for a down payment), and NINJA ("no income, no job or assets") loans'.[4] People who up till then had not been able to own real estate due to their doubtful creditworthiness could now also live the American dream.

Another factor behind this wave of optimism was a change in the business model of banks. During the 1990s and 2000s banks had been increasingly resorting to an 'originate and distribute' model.[5] This means that contrary to the conventional practice of keeping loans on their own balance sheets, they

2 For a detailed discussion of the underlying causes of the global financial crisis see Paul De Grauwe, 'The Banking Crisis: Causes, Consequences and Remedies' (CEPS Policy Brief No 178, November 2008); Markus K Brunnermeier, 'Deciphering the Liquidity and Credit Crunch 2007-2008' (2009) 23 Journal of Economic Perspectives 77; Jacopo Carmassi, Daniel Gros and Stefano Micossi, 'The Global Financial Crisis: Causes and Cures' (2009) 47 JCMS 977; Jakob de Haan, Sander Oosterloo and Dirk Schoenmaker, *Financial Markets and Institutions: A European Perspective* (2nd ed, CUP 2012) 29-68.

3 De Haan, Oosterloo and Schoenmaker (n 2) 53-54. See also Brunnermeier (n 2) 77; Carmassi, Gros and Micossi (n 2) 979-980.

4 Brunnermeier (n 2) 82.

5 Brunnermeier (n 2) 78-79. See also De Haan, Otterloo and Schoenmaker (n 2) 29-30, 54-55. For a detailed analysis of the US subprime mortgage market and the process of securitization see Dwight Jaffee and others, 'Mortgage Origination and Securitization in the Financial Crisis' in Viral V Acharya and Matthew Richardson (eds), *Restoring Financial Stability: How to Repair a Failed System* (John Wiley & Sons 2009) 61ff.

introduced 'structured' or 'securitized products'.[6] Banks grouped together different kinds of mortgages and other assets in 'portfolios' and subsequently 'sliced' them into distinct 'tranches', which were often cleverly devised so as to obtain particular 'ratings' by credit rating agencies.[7] Investors could then buy a tranche matching their taste for risk and profit, allowing the selling bank to 'offload risk'.[8] To make matters even more complicated, banks very often operated through 'off-balance sheet vehicles'.[9] Such vehicles would take on the task of managing the structured products, whereas the bank would merely act as an ultimate 'backstop' by providing them with a 'credit line'.[10] As 'capital requirements' for such credit lines were at the time significantly less onerous compared to those that applied when banks were holding the assets on their own balance sheets, this created a loophole enabling them to lower the capital they were required to have by law and take on more 'leverage'.[11]

This process of securitization contributed to an enormous expansion and increased complexity of the financial system and further fuelled the housing bubble as it lured financial actors into thinking they were masters of risk management. Even as the first cracks in the financial system already became visible, Citigroup's *Chief Executive Officer* (CEO), Chuck Prince, told the *Financial Times* in July 2007 that he:

> '[D]ismissed fears that the music was about to stop for the cheap credit-fuelled buy-out boom ... [he stated that] "When the music stops, in terms of liquidity things will be complicated. But as long as the music is playing, you've got to get up and dance. We're still dancing."'[12]

Only months later Chuck Prince came down to earth with a bump when he had to step down as CEO in the face of mounting losses at Citigroup. A year later the bank had to be rescued by the US government through a capital injection of $20bn and state guarantees totalling $306bn.[13]

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6 Brunnermeier (n 2) 78-80. See also De Haan, Oosterloo and Schoenmaker (n 2) 30-31, 54-55.
7 Brunnermeier (n 2) 78-79.
8 Brunnermeier (n 2) 78-79.
9 Brunnermeier (n 2) 79-80. See also De Haan, Oosterloo and Schoenmaker (n 2) 30-31, 56-57.
10 Brunnermeier (n 2) 80. See also De Haan, Oosterloo and Schoenmaker (n 2) 30.
11 Brunnermeier (n 2) 80-81; De Haan, Oosterloo and Schoenmaker (n 2) 30-31. For a detailed analysis of how banks used off-balance sheet vehicles and other techniques to improve their 'leverage' see Viral V Acharya and Philipp Schnabl, 'How Banks Played the Leverage Game' in Viral V Acharya and Matthew Richardson, *Restoring Financial Stability: How to Repair a Failed System* (John Wiley & Sons 2009) 83ff.
12 Quoted in Michiyo Nakamato and David Wighton, 'Bullish Citigroup is "still dancing" to the beat of the buy-out boom' *Financial Times* (10 July 2007). See also Christopher J Green, '"The day the music died": the financial tsunami of 2007-2009' in Christopher J Green, Eric J Pentecost and Tom Weyman-Jones (eds), *The Financial Crisis and the Regulation of Finance* (Edward Elgar 2011) 9; Brunnermeier (n 2) 82.
13 Greg Farrell, Henny Sender and Andrew Ward, 'US agrees bail-out for Citigroup' *Financial Times (FT.Com)* (24 November 2008). See also Green (n 12) 9.

What had happened?[14] Since late 2006 the sub-prime mortgage market had started to unravel as more and more households were experiencing problems paying off their mortgage. With banks groping in the dark about the risks each of them had taken on, they became increasingly averse to lending each other money, triggering a 'liquidity crisis'.[15] To make matters worse, in a desperate attempt to raise funds they all started to dispose of their assets.[16] Such large scale 'fire sales', however, brought down the price of these assets even further, which in turn negatively affected the capital position of banks and weakened their solvency.[17] To avoid a 'meltdown' of the financial system, authorities had to intervene.[18] The Federal Reserve started to inject massive amounts of liquidity into the banking system and the government got involved in the rescue of important financial institutions like investment bank Bearn Stearns, mortgage enterprises Fannie Mae and Freddie Mac and insurance giant AIG. In fall 2008, Congress eventually decided on a massive bail-out scheme of $700bn by adopting the 'Emergency Economic Stabilization Act' which, among other things, allowed the Treasury to buy 'troubled assets' from financial institutions.[19] By that time, however, problems had crossed the Atlantic to hit the European Union.

Already in 2007, Europe had started to feel the negative effects from the financial crisis.[20] But things really took a turn for the worse in September 2008 when US authorities, wanting to signal that they were not prepared to rescue every troubled institution with taxpayers' money, refused to bail-out investment bank Lehman Brothers.[21] The collapse of Lehman sent shockwaves through global finance and created enormous panic on the markets, forcing central banks around the world to intervene. The actions of the European Central Bank (hereafter 'Bank') focused first and foremost on the 'interbank market'.[22] Contrary to the United States, where there is greater reliance on financial markets to obtain financing, banks play a crucial role in allocating

14 For a detailed analysis of the various liquidity and solvency problems banks faced during the crisis see Brunnermeier (n 2) 91-95.
15 De Haan, Oosterloo and Schoenmaker (n 2) 57.
16 De Haan, Oosterloo and Schoenmaker (n 2) 57-58.
17 De Grauwe (n 2) 1.
18 De Haan, Oosterloo and Schoenmaker (n 2) 58-59. For an event logbook of the key events in the financial crisis during 2007-2008 see Brunnermeier (n 2) 82-91.
19 Archit Shah, 'Emergency Economic Stabilization Act of 2008' (2009) 46 Harv J on Legis 569, 574-577.
20 For a discussion of the ECB's actions during the first phase of the crisis in 2007 see European Central Bank, 'The ECB's Response To the Financial Crisis' (ECB Monthly Bulletin, October 2010) 63-70.
21 De Haan, Otterloo and Schoenmaker (n 2) 59.
22 Philippine Cour-Thimann and Bernhard Winkler, 'The ECB's non-standard monetary policy measures: the role of institutional factors and financial structure' (2012) 28 Oxf Rev Econ Policy 765, 771ff.

funds in the European economy.[23] A drying up of the interbank market can therefore seriously frustrate the Bank's ability to 'steer' monetary policy through the setting of official interest rates.[24] If all goes well these rates affect 'refinancing conditions' on the money, or interbank, market and,[25] as a result, 'retail interest rates' (i.e. rates on loans or savings concerning individuals and firms).[26] However, during a liquidity crisis the Bank's official rates and money market rates tend to get disconnected, which can seriously constrain the Bank in its ability to reach the 'real' economy and deliver on its mandate to secure price stability.[27]

The first thing the Bank did was to lower its interest rates significantly.[28] Together with other central banks around the world, it brought down its key interest rate with 50 basis points (0.5%) in October 2008.[29] The Bank subsequently further reduced its 'main refinancing rate' – the chief instrument through which it lends funds to banks and manages liquidity conditions –[30] with 325 basis points, as a result of which it reached the unprecedented low of 1% in May 2009.[31] In tandem with this assertive use of its 'standard' interest rate instrument, the Bank also resorted to several 'non-standard' measures.[32] Termed 'enhanced credit support' by its President Jean-Claude Trichet,[33] these measures served as a 'complement' to the Bank's conventional interest rate tool and aimed to ensure that the latter's 'signals' could still be 'transmitted' throughout the currency union.[34]

Three of these exceptional measures deserve to be singled out.[35] First of all, the Bank decided to put in place a 'fixed rate full allotment tender procedure' for all of its 'refinancing operations'.[36] From 2000 until the crisis, it had employed a 'variable rate' procedure.[37] Under such a procedure private banks

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23 Cour-Thimann and Winkler (n 22) 768-769.
24 Cour-Thimann and Winkler (n 22) 770-771.
25 Broadly speaking, the 'money market' relates to the market for 'short-term funds' (ie with a maturity of a year or less). The interbank market concerns the transactions in the money market in which banks lend to one another. For more information see De Haan, Otterloo and Schoenmaker (n 2) 136-140.
26 European Central Bank, 'The ECB's Response To the Financial Crisis' (n 20) 60-61.
27 European Central Bank, 'The ECB's Response To the Financial Crisis' (n 20) 60-63.
28 European Central Bank, 'The ECB's Response To the Financial Crisis' (n 20) 65; Cour-Thimann and Winkler (n 22) 772.
29 ECB Press Release, 'Monetary Policy Decisions' (ECB, 8 October 2008).
30 European Central Bank, 'The Monetary Policy of the ECB' (3rd ed, ECB 2011) 96, 104.
31 European Central Bank, 'The ECB's Response To the Financial Crisis' (n 20) 65.
32 European Central Bank, 'The ECB's Response To the Financial Crisis' (n 20) 66.
33 Jean-Claude Trichet, 'State of the Union: The Financial Crisis and the ECB's Response between 2007-2009' (2010) 48 JCMS Annual Review 7, 12.
34 Cour-Thimann and Winkler (n 22) 781-783.
35 For an overview of all measures see European Central Bank, 'The ECB's Response To the Financial Crisis' (n 20) 66; Cour-Thimann and Winkler (n 22) 772-774.
36 European Central Bank, 'The ECB's Response To the Financial Crisis' (n 20) 66.
37 For an explanation of 'fixed' and 'variable' tender procedures see European Central Bank, 'The Monetary Policy of the ECB' (n 30) 104-106.

('counterparties') can make 'bids' to obtain certain amounts of liquidity at an interest rate level equal to, or above, a 'minimum rate' set by the Bank.[38] The latter subsequently distributes a pre-determined amount of liquidity to the bidding banks, starting with those offering the highest rate.[39] Under the fixed rate full allotment procedure, however, the Bank satisfies all liquidity needs of its counterparties at a predefined rate.[40] At the same time, and this leads to the second measure, it broadened the pool of assets that could serve as collateral in such refinancing operations.[41] In line with Article 18.1 of the Statute of the Bank, all credit operations need to be based on adequate collateral so as to shield the Bank from losses. By (temporarily) accepting a larger group of assets as collateral, the Bank eased access to liquidity.[42]

The Bank's third move was to put in place additional 'longer-term refinancing operations'.[43] Contrary to 'main refinancing operations', which have a maturity of one week, longer term ones normally have a maturity of 3 months.[44] By introducing additional longer term refinancing operations, initially with a maximum maturity of 6 months and later on with one year, the Bank sought to further ease the liquidity stress of banks. More specifically, it aimed to address the 'mismatch' between their borrowing and lending activities.[45] Given that banks 'are in the business of borrowing short and lending long',[46] liquidity problems in the market can significantly impair their ability to obtain 'short-term funding' and place them in a precarious position.[47] With the additional longer term refinancing operations the Bank aimed to tone down these problems and stimulate banks to keep extending credit to customers.[48]

38 European Central Bank, 'The Monetary Policy of the ECB' (n 30) 105.
39 European Central Bank, 'The Monetary Policy of the ECB' (n 30) 105.
40 European Central Bank, 'The Monetary Policy of the ECB' (n 30) 105.
41 European Central Bank, 'The ECB's Response To the Financial Crisis' (n 20) 66.
42 In relation to changes to the Bank's collateral framework during the crisis a distinction should be made between 'temporary' and 'standard' changes. Temporary changes were specifically launched in response to the crisis and laid down in separate legal instruments. Standard changes, however, regularly occur and are not necessarily crisis related. During the past years, however, several temporary measures have found their way into the standard collateral framework. For more information about all changes to the collateral regime, temporary and standard, that have occurred during the crisis years 2008-2013 see European Central Bank, 'The Eurosystem collateral framework throughout the crisis' (ECB Monthly Bulletin, July 2013) 71-86.
43 European Central Bank, 'The ECB's Response To the Financial Crisis' (n 20) 66.
44 European Central Bank, 'The Monetary Policy of the ECB' (n 30) 104-106.
45 European Central Bank, 'The ECB's Response To the Financial Crisis' (n 20) 66.
46 De Grauwe (n 2) 1. See also Brunnermeier (n 2) 91-92.
47 European Central Bank, 'The ECB's Response To the Financial Crisis' (n 20) 66.
48 European Central Bank, 'The ECB's Response To the Financial Crisis' (n 20) 66; Cour-Thimann and Winkler (n 22) 772-773.

Though the Bank acted swiftly and boldly, it could not take on the crisis by itself. Some financial institutions did not only face liquidity problems, they were struggling with their solvency too. Yet, it took time for Europe to realise the magnitude of this problem and the need for collective action. As late as 24 September 2008, after Lehman Brother's collapse, Commissioner Almunia, responsible for economic and monetary affairs, had been saying to the European Parliament that contrary to the United States 'The situation we face here in Europe is less acute and Member States do not at this point consider that a US-style plan is needed'.[49] Only days later the facts on the ground proved him wrong.[50] On 28 September the Belgian, Dutch and Luxembourg governments had to rescue Fortis bank through a capital injection of 11.2bn.[51] When during the next week this move appeared insufficient, the Dutch government even decided to completely take over the Dutch activities of the bank while its other parts moved to the French bank BNP Paribas.[52] At around the same time Dexia received a capital injection of € 6.4bn by the Belgian, Luxembourg and French governments.[53] In Germany authorities and private banks together saved the commercial property lender Hypo Real Estate by putting in place a credit line,[54] whereas the United Kingdom nationalised mortgage lender Bradford and Bingley.[55] All over Europe, moreover, governments were stepping in to guarantee bank deposits. Telling is the case of Ireland. On 30 September 2008 its government decided to fully guarantee the liabilities of its banks, not only deposits but also their debts, for a period of two years.[56]

Amid fears that these unilateral actions could lead to 'beggar thy neighbour' policies and disrupt the European banking system,[57] French President Sarkozy decided to convene (and create) the first 'Eurosummit'.[58] On 12 October 2008 euro area Heads of State or Government reached agreement on a European

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49 Joaquín Almunia, 'Situation of the world financial system and its effects on the European economy' (European Parliament Plenary Debate, 24 September 2008). See also Martin Heipertz and Amy Verdun, *The Politics of the Stability and Growth Pact* (CUP 2010) 186.

50 See also Heipertz and Verdun (n 49) 186-187; De Haan, Oosterloo and Schoenmaker (n 2) 61.

51 Peter Thal Larsen, Michael Steen and Tony Barber, 'Fortis thrown 11.2bn lifeline' *Financial Times (FT.Com)* (28 September 2008).

52 Michael Steen, 'Dutch government takes over Fortis units' *Financial Times (FT.Com)* (3 October 2008); Michael Steen, Joshua Chaffin and Peter Thal Larsen, 'Belgium in Fortis deal with BNP' *Financial Times* (6 October 2008).

53 Scheheradze Daneshky and Ben Hall, 'Dexia receives €6.4bn funding from European governments' *Financial Times* (1 October 2008).

54 James Wilson and Bertrand Benoit, 'Berlin agrees second package to save Hypo' *Financial Times* (6 October 2008).

55 Jane Croft, 'B&B deal holds banks to account' *Financial Times* (30 September 2008).

56 Esther Bintliff, 'Government guarantee boosts Irish banks' *Financial Times* (1 October 2008); John Murray Brown, 'Irish solution is not an answer EU wants' *Financial Times* (1 October 2008).

57 Heipertz and Verdun (n 49) 187.

58 See also text to n 479 (ch 3) and n 95 (ch 6).

action plan aiming 'to restore confidence and proper functioning of the financial system'.[59] It contained general guidelines on facilitating the funding of banks, their recapitalisation and cooperation among governments. A few days later, on 16 October 2008, the action plan was endorsed by the European Council.[60]

In December of that year the European Council also decided to combat the effects of the financial crisis on the real economy.[61] Fearing a recession, and acting on plans of the Commission,[62] it launched a 'European Economic Recovery Plan' in order to provide a budgetary stimulus to the economy of € 200bn, amounting to 1.5% of the Union's GDP.[63] Although part of this stimulus (0.3%) was paid out of the pockets of the Union and the European Investment Bank, the bulk of it had to be provided by the member states (1.2%) and came on top of 'automatic stabilizers', such as lower tax revenues and higher social security payments, that were already doing their work.[64] A significant deteriorating of states' fiscal positions was bound to come. Or to put it in the words of the Commission assessing the fiscal prospects for 2009 and beyond: 'Looking ahead to 2009 and 2010, the public finance situation is expected to dramatically deteriorate'.[65]

Sovereign despair

The financial crisis indeed left member states fiscally weakened, turning them into easy prey for the markets. Greece was their first victim. Concerns about its fiscal position had already been present for years. As early as 2004 the Commission had criticised it for acting 'inconsistent[ly] with a prudent fiscal policy' and for providing it with data that was 'not satisfactory'.[66] But as a result of the crisis Greece's fiscal situation suddenly gained a higher urgency. It even caused Prime Minister and leader of the New Democracy Party Kostas Karamanlis to call for general elections late 2009. He had looked at the overdue maintenance of the Greek economy, and then to his slim majority in parliament of just one seat, and had judged that without a renewed mandate from the people he would not be able implement the severe austerity measures and

59 Summit of the Euro area countries, 'Declaration on a concerted European Action Plan of the euro area countries', 12 October 2008, para 4.
60 European Council, Conclusions, Brussels, 15-16 October 2008, para 3.
61 Heipertz and Verdun (n 49) 189.
62 Commission, 'A European Economic Recovery Plan' (Communication of 26 November 2008) COM (2008) 800 final.
63 European Council, Conclusions, Brussels, 11-12 December 2008, para 9.
64 COM (2008) 800 final, 7.
65 Commission, 'Public Finances in EMU 2009' (European Economy No 5, 2009) 22.
66 Commission, 'Greece: Report of 19 May 2004 prepared in accordance with Article 104(3) of the Treaty' SEC (2004) 623 final, 10.

reforms his country so desperately needed.[67] His assessment turned out to be correct, but the Greeks had no appetite for his reform agenda, instead giving their trust to George Papandreou, leader of the social democratic PASOK Party.[68] Having lost the elections twice in 2004 and 2007, Papandreou now managed to secure victory by repudiating Karamanlis' austerity talk, telling his electorate that 'We can't have recovery if we don't take steps to get the economy moving again'.[69]

Despite the fact that dark clouds were already gathering above the Acropolis, Papandreou was still optimistic about Greece's future when entering office. In the victory speech he gave on election night on 4 October he told the Greek people:

> 'Today we set off together to build the Greece we want and need. We have no time to waste. We want it, we can do it, we will succeed. Nothing will be easy. I will always be honest and upfront with the Greeks.'[70]

And honest Papandreou had to be, probably even a little more and a little earlier than he had expected. Right at the start of his term, he had to admit that the fiscal data the previous government had shared with its European partners had been a pack of lies. Contrary to deficit estimations varying between 6 to 8% of GDP that his predecessor had communicated only weeks earlier, and shockingly far above the forecast of 3.7% the Commission had published as late as January 2009,[71] Papandreou told the public he expected it to reach a staggering 10% that year.[72] Markets, which were already very sceptical about Greece, started to panic.[73] Rating agencies were downgrading the state's credit rating notch by notch, fuelling a rise in the interest rate it had to pay on its government bonds. The price of 'credit default swaps' – instruments offering the buying party insurance against a Greek 'credit event' (i.e. a 'default' or 'bankruptcy') – rose dramatically.[74] The situation became untenable when the Commission issued a report on Greece's fiscal statistics in January 2010. It found that the misreporting in 2009 'was neither without

67 Kerin Hope, 'Weakened Karamanlis calls snap election in Greece' *Financial Times* (3 September 2009); See also Matthew Lynn, *Bust: Greece, the Euro, and the Sovereign Debt Crisis* (Bloomberg Press 2011) 113.

68 See also Lynn (n 67) 113-114.

69 Quoted in Kerin Hope, 'Greek socialists ride wave of popular discontent' *Financial Times* (3 October 2009).

70 Quoted in Rachel Donadio and Anthee Carassava, 'Voters give Greek socialists a landslide win' *The New York Times* (5 October 2009). See also Lynn (n 67) 113.

71 Commission, 'Public Finances in EMU 2009' (n 65) 32.

72 Tony Barber, 'Greece rapped for understating deficit' *Financial Times (FT.Com)*(20 October 2009).

73 Lynn (n 67) 127-128.

74 For more information on credit default swaps see De Haan, Oosterloo and Schoenmaker (n 2) 162-163.

precedent nor an isolated episode' and that unless bold action was taken 'the reliability of the Greek deficit and debt data will remain in question'.[75]

At the beginning of 2010 it was clear to everyone that Greece had no future in the currency union unless it was helped out by its European partners. The interest rate on Greek 10-year government bonds was approaching 7%, a level widely considered to be unsustainable for any state. But politicians had difficulty in coming to terms with this reality, not least the Greek government itself. Behind the scenes it was conducting difficult negotiations about an assistance package, while to the outside world it was maintaining that it could handle the situation on its own by implementing ambitious, yet unrealistic austerity programmes aimed at bringing its deficit below the 3% limit within three years.[76] 'We are in a state of emergency, it's true', Papandreou told the press, 'but we can turn this crisis into an opportunity. This year will be one of radical reforms both of the economy and the public administration'.[77] But by April even Papandreou could no longer keep up appearances when Eurostat, the Union's office for statistics, further adjusted Greece's fiscal deficit of the previous year upwards to 13.6% and the interest rate soared to 9%.[78] On 23 April Papandreou appeared on public television and told his people:

> 'Yesterday the data was announced on the real size of the 2009 deficit….It reminded us all of the incomprehensible mistakes, omissions, criminal decisions and storm of problems we inherited from the previous government. We all inherited – today's government and the Greek people – a ship ready to sink; a country with no authority and credibility which had lost the respect of even its friends and partners; an economy exposed to the mercy of doubt and the appetite of speculators.'[79]

The prime minister subsequently explained how the government saw no other option but to draw on a 'lifeline' from the Union and the IMF of € 45bn that had been hammered out the months before.[80] Very soon, however, it became clear that almost a threefold of that amount would be required to shield Greece from the markets for several years.[81] On 2 May 2010 the finance ministers of the currency union eventually reached agreement on a joint assistance

75 Commission, Report of 8 January 2010 on Greek government deficit and debt statistics' COM (2010) 1 final, 6, 29.

76 Kerin Hope, 'Greek PM rejects fears over eurozone' *Financial Times* (14 January 2010); Lynn (n 67) 133-135.

77 Quoted in Hope, 'Greek PM rejects fears over eurozone' (n 76).

78 Kerin Hope, Stanley Pignal and Anousha Sakoui, 'Greece downgraded as deficit revised up' *Financial Times (FT.Com)* (22 April 2010); Lynn (n 67) 147.

79 Quoted in 'Greece's Papandreou Requests EU, IMF Financial Lifeline: Video' *Bloomberg News* (23 April 2010) (as cited in Lynn (n 67) 147).

80 Tony Barber, Kerin Hope and Gerrit Wiesmann, 'Greece grasps €30 bn lifeline' *Financial Times* (24 April 2010).

81 Public officials already knew that the amount of €45bn would only suffice for one year. See also Eurogroup statement of 11 April 2010 and text to n 97 (ch 5).

package from their states and the International Monetary Fund (IMF) worth €110bn.[82]

Coming out of the meeting, the ministers were eager to point out that all of the currency union's woes had been solved by rescuing Greece. French Finance Minister and future IMF Governor Christine Lagarde said that 'Greece and Portugal and Spain and Italy and whoever are different cases. Greece is very peculiar in the sense that the numbers, the statistics that were given over the years were wrong'.[83]

But markets assessed the situation very differently. They had not just doubts about Greece, they were panicking about pretty much the whole of the currency union's 'periphery'. Being financially closely tied to each other Ireland, Portugal, Spain and Italy all found themselves within a ring of fire, as interest rates on their government bonds started to soar. Greece's rescue had been merely the beginning of a debt crisis that would haunt the currency union for years to come.

The transformation

In fighting the debt crisis, the Union and its member states had to take measures that have profoundly changed the set-up of the currency union.[84] As a result, it now differs fundamentally from what it was when it was introduced in the early 1990s by the Treaty of Maastricht. Yet, this change has come about with hardly any formal amendment to the Union's 'basic constitutional charter',[85] the Treaties.[86] How to understand the form of this change? Not surprisingly, many legal scholars have studied it using the concept of 'transformation'.[87] This is by no means a concept peculiar to Union law, far from

82 Statement by the Eurogroup, Brussels, 2 May 2010. For greater detail about the Greek assistance package and its legal nature see text to n 101 (ch 5).

83 Quoted in Kerin Hope, Nikki Tait and Quentin Peel, 'Eurozone agrees Greek bailout' *Financial Times* (3 May 2010).

84 The European Union is certainly not the only union in which financial distress and constitutional change are closely connected. For a discussion of America's sovereign debt crisis in the 1780s and its connection to the transformation from a confederal to a federal union see Aart Loubert, 'Sovereign Debt Threatens the Union: The Genesis of a Federation' (2012) 8 EuConst 442.

85 Case 294/83 *Les Verts* [1986] ECLI:EU:C:1986:166, para 23.

86 The only formal amendment is the insertion of Art 136(3) into the TFEU. For an analysis of this amendment see text to n 308 (ch 5).

87 Among the contributions that even include the notion in their titles are Christian Joerges and Carola Glinski (eds), *The European Crisis and the Transformation of Transnational Governance: Authoritarian Managerialism versus Democratic Governance* (Hart Publishing 2014); Nicole Scicluna, 'Politicization without democratization: How the Eurozone crisis is transforming EU law and politics' (2014) 12 ICON 545; Mark Dawson, Henrik Enderlein, and Christian Joerges (eds), *The Governance of Europe's Economic, Political and Legal Transformation* (OUP 2015); Michael Ioannidis, 'Europe's New Transformations: How the EU Economic Constitution Changed During the Eurozone Crisis' (2016) 53 CML Rev 1237; Damien Chalmers,

it.[88] The German public lawyer Georg Jellinek already distinguished between 'amendment' and 'transformation' in analysing constitutional change. In his *Verfassungsänderung und Verfassungswandlung* of 1906 he writes:

> 'By constitutional amendment, I mean change in the text of the constitution through a purposeful act of will; by constitutional transformation, I mean change that allows the text to remain formally unchanged and is caused by facts that need not be accompanied by an intention or awareness of the change. I need hardly mention that the theory of transformation is much more interesting than that of amendment.'[89]

Constitutional transformation is indeed much more interesting than constitutional amendment. Operating on the intersection between *law* and *politics*, between *legality* and *power*,[90] it challenges lawyers to look beyond text and procedure and recognise that constitutions can validly change shape without formal amendment.[91] Or to put it in the words of Bruce Ackerman: it invites them to be receptive to 'constitutional moments' other than amendment, moments whose 'deeper structures' they should strive to understand, 'both how they operated in the past and how they may discipline the future'.[92]

In the context of the Union legal order, the notion of transformation does have great potential for understanding this order precisely because it looks into the direction of both law *and* politics. Arguably the first to explicitly recognise this was Joseph Weiler. In *The Transformation of Europe* he describes how during the first decades of the (then) Community's existence, its relationship with the member states changed spectacularly over the course of several 'distinct phases'.[93] During a first 'foundational' phase the Court of Justice (hereafter 'Court') 'constitutionalised' the Community's legal order through the introduction of doctrines like direct effect, supremacy, implied powers

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Markus Jachtenfuchs and Christian Joerges, 'The retransformation of Europe' in Damien Chalmers, Markus Jachtenfuchs and Christian Joerges (eds), *The End of the Eurocrats' Dream: Adjusting to European Diversity* (CUP 2016) 1-28.

88 See also Ioannides (n 87) 1241-1244.

89 Georg Jellinek, *Verfassungsänderung und Verfassungswandlung: Eine staatsrechtlich-politische Abhandlung* (Verlag von O Häring 1906) 3. The translation follows, notwithstanding a minor change, the one of Julian Arato, 'Treaty Interpretation and Constitutional Transformation: Informal Change in International Organizations' (2013) 38 Yale J Int't L 289, 290.

90 See also Arato (n 89) 303: 'Constitutions do not belong exclusively to the province of pure legal theory; they are not just about law, but also about power. In establishing institutions, rights and obligations, constitutions create and regulate power, and as such they also belong to the realm of politics'.

91 Ioannides (n 87) 1242-1243.

92 Bruce Ackerman, *We the People II: Transformations* (HUP 1998) 15.

93 JHH Weiler, 'The Transformation of Europe' (1990-1991) 100 Yale LJ 2403, 2408. Weiler discusses three phases: a 'foundational' one (1958-mid 1970s), one of 'mutation of jurisdiction and competences' (1973-mid 1980s) and one concerning '1992 and beyond'. Reference is made here only to the first two phases.

and human rights.[94] Then, in a second phase, the Community expanded its jurisdiction and competences, not least by 'absorbing' those of the member states and by adopting an extensive reading of the 'residual' clause in what is now Article 352 TFEU, as a result of which 'the principle of enumerated powers ... substantially eroded'.[95]

Confronted with constitutional developments of such magnitude, and the Court's prominent role in them, lawyers may be inclined to assess and explain them on purely legal grounds. Weiler, however, guards against such an approach. Not only does he consider the debate about the legal permissibility of these developments, which such an approach risks degenerating into, rather futile in the face of their broad acceptance among key constitutional players, it also fails to recognise that they were truly the result of the interaction between law *and* politics.[96]

Decisive for the Community's transformation, Weiler argues, was the 'interplay of Exit and Voice'.[97] The constitutionalisation of the Community in the foundational phase, constraining the ability of member states to escape its obligations ('the closure of selective Exit'), was possible only because of the fact that the states managed to increase their hold on decision-making through initiatives like the Luxembourg Accord and the establishment of the European Council ('increased Voice').[98] This increase in Voice also explains why the subsequent phase witnessed a relatively quiet expansion of Community jurisdiction. In federations, Weiler argues, such changes usually take place only after fierce battles between the central government and the constituent units.[99] In the Community, however, such battles were largely absent as 'the constituent units' power *was* the central power'.[100]

One does not need to subscribe to Weiler's specific proposition about 'Exit' and 'Voice' to support his more general argument that one cannot fully account for the transformation of the Community during its first decades through legal analysis only. It needs broadening to include politics, in particular the role played by the member states. At the same time, it is precisely this combination of law and politics which leads to the concept of 'transformation' risking

94 Weiler (n 93) 2410-2431.
95 Weiler (n 93) 2434-2435.
96 According to Weiler (n 93) 2407 it may 'lead to flawed analysis' and risks 'suggesting that the cardinal material locus of change has been the realm of law and that the principal actor has been the European Court'. This is 'deceptive', he argues as 'legal and constitutional structural change have been crucial, but only in their interaction with the Community political process'.
97 Weiler (n 93) 2411.
98 Weiler (n 93) 2412, 2423-2431.
99 Weiler (n 93) 2449.
100 Weiler (n 93) 2449.

inflation. To some extent that risk has materialised during the crisis.[101] This becomes apparent once one distinguishes between '*institutional*' and '*substantive*' transformations.[102] Although fully aware of the impossibility to separate them strictly, one could say that the first kind of transformation concerns changes in the Union's system of decision-making and institutions, whereas the second relates to changes in the meaning and substance of the policies the Union needs to implement.

It is in relation to its institutional dimension that the concept of transformation has experienced inflation. A host of scholars assessing institutional developments during the crisis have uttered the concept or twin notions like 'constitutional mutation' or a changing 'constitutional balance' or 'architecture'.[103] In support of their position they point to phenomena like a shift towards intergovernmental decision-making, in particular the rise of the European Council and related fora,[104] the resort to intergovernmental treaties

101 Note that 'inflation' as employed here concerns the use of the concept of 'transformation' in relation to constitutional change. Some scholars, however, have used the concept more generally to assess substantive and institutional legal changes during the crisis, without necessarily linking them to constitutional change. Thomas Beukers, for example, uses it to review and discuss the literature covering the 'substantive' and 'institutional' changes experienced by the Union, not all of which relates to constitutional change. See Thomas Beukers, 'Legal Writing(s) on the Eurozone Crisis' (EUI Working Papers No 11, 2015) 5-11.

102 Bruno De Witte, 'Euro Crisis Responses and the EU Legal Order: Increased Institutional Variation or Constitutional Mutation?' (2015) 11 EuConst 434, 436-437. De Witte in turn bases the distinction on the one made by Beukers (n 101).

103 See eg Mark Dawson and Floris De Witte, 'Constitutional Balance in the EU after the Euro-Crisis' (2013) 76 MLR 817, 818 alleging a 'disregard of the *constitutional balance* laid down in new institutional arrangements (and indeed, the rejection of the treaties' normative structure altogether)' (emphasis added); Koen Lenaerts, 'EMU and the EU's Constitutional Framework' (2014) 39 EL Rev 753, 753 arguing that the reforms to the currency union have 'altered the constitutional balance on which the European Union is founded.' Augustín José Menéndez, 'Editorial: A European Union in Constitutional Mutation?' (2014) 20 ELJ 127, 127: 'The ongoing European constitutional *transformation* is the cumulative result of decisions ... taken off the beaten constitutional track through ordinary law-making procedures, through peculiar intergovernmental negotiations and ... through the toleration of new institutional practices' (emphasis added). Paul Craig, 'Economic Governance and the Euro Crisis: Constitutional Architecture and Constitutional Implications' in Maurice Adams, Federico Fabbrini and Pierre Larouche (eds), *The Constitutionalization of European Budgetary Constraints* (Hart Publishing 2014) 40: 'The economic and financial crisis has had profound effects on the EU, including its *constitutional architecture*' (emphasis added). Federico Fabbrini, *Economic Governance in Europe: Comparative Paradoxes and Constitutional Challenges* (OUP 2016) 10 arguing that 'the Euro-crisis, and the legal and institutional responses to it, have changed the *constitutional architecture* of economic governance in Europe' (emphasis added). See also Kaarlo Tuori and Klaus Tuori, *The Eurozone Crisis: A Constitutional Analysis* (CUP 2014) 117 (using the notion of *constitutional mutation* to denominate their assessment of legal developments during the crisis, including institutional ones).

104 See eg Edoardo Chiti and Peidro Teixeira, 'The Constitutional Implications of the European Responses to the Financial and Public Debt Crisis' (2013) 50 CML Rev 683, 685-690; Dawson and De Witte (n 103) 830-832; Christian Joerges, 'Europe's Economic Constitution in Crisis

outside the Union legal order,[105] or differentiated integration.[106] However, although these developments are certainly important, they do not amount to a genuine transformation. Rather, they show an increase in certain *modus operandi* that, in principle, are already known to Union law. Instead of speaking about a transformation, Bruno De Witte therefore prefers to regard them as signs of 'increased institutional variation' within the existing legal order.[107] Or to put it even more simply: these developments are highly significant *politically*, yet *legally* their significance is not of such depth as to justify the label 'transformation'.

Things are different in relation to the substantive dimension of constitutional transformation. In this respect, the Union *has* witnessed constitutional change as crucial policy provisions of the currency union's legal set-up have been given a new *meaning*. Surprisingly, however, scholarly attempts to understand this transformation are less numerous than those covering its (alleged) institutional counterpart. The most elaborate one so far comes from Michael Ioannidis.[108] Central to his analysis are assistance operations for financially distressed member states and government bond purchases by the Bank. Both, he argues, are evidence of a change in the policy rationale underlying the currency union. Whereas it used to be based on the idea that states themselves are responsible for their financial commitments and dependent on the markets to satisfy any financing needs exceeding their tax revenues, it has transformed into one that allows for financial support.[109] This development, moreover, has generated a shift from 'market discipline' to 'bureaucratic discipline'.[110] To address the risk of 'moral hazard' that accompanies the granting of assistance and bond buying, the Union and its member states have put in place 'public control' mechanisms, in particular by attaching strict conditions to these actions.[111] This too, Ioannidis argues, amounts to a transformation as it constitutes a departure from the currency union's original set-up under which states were supposed to be solely disciplined by the markets through interest rates matching their fiscal health and economic record.

In analysing both transformations Ioannidis attributes central importance to the Court. 'Although the executive and other constitutional actors also play

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and the Emergence of a New Constitutional Constellation' (2015) 15 GLJ 985, 1001; Fabbrini (n 103) 123-128.

105 See eg Menéndez (n 103) 137; Dawson and De Witte (n 103) 833, 838-839, 841; Chiti and Teixeira (n 104) 690-697; Scicluna (n 87) 557ff; Fabbrini (n 103) 128-135.

106 See eg Menéndez (n 103) 134-135; Chiti and Teixeira (n 104) 693, 695-697; Tuori and Tuori (n 103) 192-194.

107 De Witte (n 102) 453.

108 See, however, also Chiti and Teixeira (n 104) 697-701, 703; Tuori and Tuori (n 103) 181-188; Joerges (n 104) 1009-1013.

109 Ioannidis (n 87) 1249-1263.

110 Ioannidis (n 87) 1263-1274.

111 Ioannidis only speaks about 'bureaucratic discipline' in the abstract to his article as well as in its conclusion. Yet, he seems to use 'public control' as its equivalent.

a role in establishing new meaning in textually-unaltered constitutional provisions', he reasons, 'it is the constitutional adjudicator that essentially sanctions a constitutional transformation'.[112] In the present context, the Court did so in *Pringle* and *Gauweiler*.[113] There, it declared both transformations compatible with the currency union's legal set-up, in particular the no-bailout clause in Article 125 TFEU, the prohibition on monetary financing in Article 123 TFEU and the mandate of the Bank.

Now, as Ioannidis argues, the assistance operations of the Union and its member states as well as the bond purchases of the Bank, all legally devised between February 2010 to September 2012, are indeed key to the substantive transformation experienced by the currency union during the debt crisis. However, the shift to assistance and 'bureaucratic discipline' are not its defining characteristics. The currency union, this study argues, has experienced a *single* transformation, one that is ultimately driven by a change in its conception of stability. Whereas it used to grant overriding importance to *price stability*, it has transformed into one that also explicitly takes into account *financial stability*.

Moreover, to argue that the Court 'sanctioned' this transformation in *Pringle* and *Gauweiler* is to only tell half the story. The Court *had* to sanction the transformation. Or to be more precise, the Court could not disapprove it. Primacy did not lie with the *judiciary* but with *politics*.[114]

Understanding the transformation of the euro, and the role played in it by the Court, is the central concern of this study. *Solidarity* is its lens.[115]

Solidarity

'Solidarity' is by no means a concept unfamiliar to Union law. In fact, there is an abundance of references to it in the Treaties. The preamble to the TEU states that the contracting states desire to 'strengthen the solidarity between their peoples'. Article 2 TEU even lists solidarity among the Union's founding values. Solidarity also serves as an objective. Article 3(3) TEU states that the Union should promote 'solidarity between generations', just as it should strive for solidarity between its member states and, in its relations with the outside world, among peoples more generally.

112 Ioannidis (n 87) 1244.

113 Case C-370/12 *Pringle* [2012] ECLI:EU:C:2012:756; Case C-62/14 *Gauweiler* [2015] ECLI:EU:C:2015:400.

114 This is not to say that in the context of transformation primacy can never lie with the Court. The study only claims that in the context of the debt crisis it lay with politics.

115 See also WT Eijsbouts, 'The European Way. History, Form and Substance' (2005) 1 EuConst 5, 9: 'Whatever else a constitution is about, it must express some fundamental commitments of solidarity between those involved'.

Besides these general references, solidarity features in numerous specific policy provisions. In the area of external relations, the Union's actions should be guided by the principle of solidarity,[116] whereas its common foreign and security policy should be based on 'mutual political solidarity' among its member states.[117] In the provisions on the Union's area of freedom, security and justice the notion also figures prominently. Not only should policy concerning this area likewise be based on solidarity between the member states,[118] its implementation should also 'be governed by the principle of solidarity' where it relates to border checks, asylum and immigration.[119] Moreover, in the area of economic policy the Council may, 'in a spirit of solidarity', decide on appropriate measures in the event of 'severe difficulties … in the supply of certain products', especially in relation to energy.[120] Similar wording features in the 'solidarity clause' in Article 222 TFEU. When a member state is hit by a 'terrorist attack' or struck by 'a natural or man-made disaster', its first paragraph makes clear, 'the Union and its member states shall act jointly in a spirit of solidarity'. The Charter, finally, dedicates a whole Title to solidarity.[121] It contains important social rights such as the right to collective bargaining or to fair and just working conditions.

This study does not employ an overarching concept of solidarity that covers all its different uses, no matter the specific context or actor. Instead, it focuses on solidarity between the *member states*, referred to in general by Article 3(3) TEU. Moreover, it does not approach this solidarity as merely a legal concept.[122] This calls for two clarifications. First, as chapter 2 will explain, the study adopts the premise that states do not only have an existence in law. States are more than legal 'fictions' that serve to make legal sense of actions that are really those of someone else.[123] They are *real*. More specifically, the study presumes that states can be seen as social groups held together by joint

116 Art 21(1) TEU.

117 Art 24(2) TEU. The remainder of Ch 2 of Title V of the TEU contains various references to this kind of solidarity in the context of the Union's common foreign and security policy. See eg Arts 24(3), 31(1) and 32 TEU.

118 Art 67(2) TFEU.

119 Art 80 TFEU.

120 Art 122(1) TFEU. See also Art 194(1) TFEU which more generally makes clear that the Union's energy policy should be based on 'a spirit of solidarity' between the member states.

121 See Title IV of the Charter of Fundamental Rights of the European Union.

122 Note, however, that it does not claim the contrary, ie that it should not be studied as a legal concept. As far as the nature of solidarity as a legal principle is concerned see text to n 57 (conclusion).

123 For such a view see Colin Wight, *Agents, Structures and International Relations: Politics as Ontology* (CUP 2006) 196, 220-221. Wight argues that the 'notion of the state as a legal person is, I think unobjectionable', only to continue later that 'the state does not and cannot exercise power. It is not a unified subject that possesses the capacity to exercise power', nor is it 'capable of independent action'.

commitments.[124] Second, just as states have an existence in reality wider than the law, so does solidarity. It is a *mode of group cohesion as a result of which individual members act in unison*, operating in full reality.[125]

On that basis, this study defends the thesis that i) the Union has gone through a constitutional transformation, which can be understood through the lens of solidarity as it allows to ii) conceptualise the unity between the member states; and iii) analyse how that unity was preserved during the crisis; and iv) why this substantively changed the single currency's legal set-up; and v) why the Court could not turn against this change.

Much of this study is *doctrinal*. It *interprets* and *systematises* legal principles and provisions, case law, documents, declarations and statements so as to understand the currency union's legal set-up, both as it stood before the debt crisis and as it subsequently developed. By adopting a certain reading of the law using accepted canons of interpretation, especially in relation to some of the currency union's most fundamental provisions that were subject to judicial scrutiny in *Pringle* and *Gauweiler*, it is naturally also *argumentative*.[126]As it ultimately aims to contribute to the theory of constitutional change in the Union legal order, the study engages with constitutional theory too.

Doctrine and jurisprudence alone, however, will not suffice. Examining constitutional *change*, and thus the development of law over time, this study necessarily has a historical dimension to it.[127] Moreover, as constitutional transformation operates at the intersection between law and politics, it must also reach out to other disciplines so as to place the law in its appropriate context.[128] It does so, aware of its own limitations. Neither does it claim to

124 See text to n 6ff (ch 2).

125 This definition is inspired by the much more elaborate definition used by William Rehg, 'Solidarity and the Common Good: An Analytical Framework' (2007) 38 Journal of Social Philosophy 7, 8. He uses 'the term solidarity to refer to a quality of human association, specifically the cohesive social bond that holds the people of a group together in an association they both understand themselves to be part of and value. In other words, solidarity is *a mode of group cohesion* based on some level of conscious or intentional commitment….on the part of the members' (emphasis added). In addition it is based on the theoretical discussion of social solidarity in Graham Crow, *Social Solidarities: Theories, Identities and Social Change* (Open University Press 2002) 11 (stating that the concept of 'social solidarity' can be used to discover 'what it is that people have in common that makes it possible and desirable for them to *act in unison*') (emphasis added). I have already introduced the definition in Vestert Borger, 'How the Debt Crisis Exposes the Development of Solidarity in the Euro Area' (2013) 9 EuConst 7, 9.

126 Explaining that legal doctrine is essentially a hermeneutic discipline in which interpretation and argumentation are inherently linked is Mark Van Hoecke, 'Legal Doctrine: Which Method(s) for What Kind of Discipline?' in Mark Van Hoecke (ed), *Methodologies of Legal Research: Which Kind of Method for What Kind of Discipline?* (Hart Publishing 2011) 4-5.

127 On the close relation between historical and legal interpretation see Carel Smith and others, 'Criteria voor goed rechtswetenschappelijk onderzoek. De omgekeerde route' (2008) 83 NJB 685ff.

128 On 'law in context' see Francis Snyder, *New Directions in European Community Law* (Weidenfeld and Nicolson 1990) 14-30.

master methodologies of other disciplines, nor to carry out truly interdisciplinary research. Yet, it is open to social and political philosophy as well as to the insights of economists and political scientists as this serves its essential purpose, which is firmly legal: understanding the transformation of the euro.

To get to that objective, this study takes three steps. The first part, spanning chapters 1 and 2, examines the solidarity that exists between the member states. Chapter 1 contains a general exploration of the concept of solidarity. It pays particular attention to a specific kind of solidarity, 'social solidarity', and discusses its evolution over time. Chapter 2 uses this exploration to conceptualise the solidarity that exists between the member states. This conceptualisation helps to understand both *why* they may act in support of their unity and the *kind* of acts this requires them to display. It also provides insight into the relation between such acts and the demands that Union law places on member states.

The second part, covering chapters 3 and 4, shifts attention to the currency union's original stability conception. Chapter 3 shows why the drafters of the Treaty of Maastricht attached overriding importance to price stability, how this has influenced the currency union's legal set-up and what kind of solidarity member states consequently had to display in support of their currency. Chapter 4 subsequently discusses several major flaws of this set-up that have been exposed by the debt crisis.

The third part, consisting of chapters 5 to 7, looks at the transformation of the euro. Chapter 5 shows how a commitment to safeguard financial stability, made by the member states at an early stage of the crisis, lies at the basis of this transformation. It argues that this commitment is a fundamental act of solidarity, one that has led to a widening of the currency union's stability conception. Under this new stability conception member states are required to grant financial assistance to states in need, signifying a change in the kind of solidarity they have to display. Chapter 6 then shows how the government bond programmes of the Bank are linked to this commitment and therefore form an intrinsic part of the transformation. Chapter 7 subsequently looks at how the Court managed to approve of this transformation in *Pringle* and *Gauweiler* despite the fact that it put massive strain on the law, which still largely reflected a stability conception from the past.

The conclusion winds up the various chapters, to show why the Court simply could not disapprove of the transformation; and then further even to argue why the Court should have acted on that duty not by assessing the transformation on the merits, but by silence.

Part I

Solidarity between the member states

1 The concept of solidarity

1 INTRODUCTION

Thorough analyses of solidarity are rare, especially in comparison to other notions that are central to legal and philosophical thinking, such as 'justice', 'liberty' and 'equality'.[1] This may come as a surprise, given that solidarity features widely in contemporary language, in particular political language. Some say that the reason for this lack of treatises on solidarity lies in the fact that much of ethical and political theory focuses on the individual and the necessity to protect the latter's freedom and rights from unwarranted interferences by the state or other individuals.[2] Solidarity, on the contrary, primarily focuses on the collective and the individual's relation to it. This difference in perspective would make it difficult for scholars to incorporate the notion in their theories, including those focusing on law.

That is not to say that solidarity is unfamiliar to legal scholars, nor to law itself. In fact, it started off as a legal notion. Roman law contained the *obligatio in solidum* according to which 'any of the parties entitled or liable could sue or be sued on the obligation for the whole of what was due'.[3] The notion *in solidum* stemmed from the Latin adjective *solidus*,[4] meaning 'undivided', 'unimpaired', 'whole'. The *obligatio in solidum* inspired the French *Code Civil* of 1804 to use the notion of *solidarité* to similarly indicate entitlement or liability

1 Kurt Bayertz, 'Four Uses of "Solidarity"' in Kurt Bayertz (ed), *Solidarity* (Kluwer 1999) 3.

2 Bayertz (n 1) 4. See also Véronique Munoz-Dardé, 'Fraternity and Justice' in Kurt Bayertz (ed), *Solidarity* (Kluwer 1999) 83-85.

3 Joseph AC Thomas, *Textbook of Roman Law* (North Holland Publishing Company 1976) 255-256. The institutes of Justinian (3.16.1) stated in this regard: 'Ex huiusmodi obligationibus et stipulantibus *solidum* singulis debetur et promitentes singuli *in solidum* tenentur.' (Where obligations are created in this way each stipulator is owed the whole amount, and each promissor is liable for the whole amount.) Text and translation are obtained from Peter Birks and Grant Mcleod, *Justinian's Institutes* (with the Latin text of Paul Krueger, Duckworth 1987) 108-109 (emphasis added). See also Robin Evans-Jones and Geoffrey MacCormack, 'Obligations' in Ernest Metzger (ed), *A Companion to Justinian's Institutes* (Duckworth 1998) 139-140.

4 Jürgen Schmelter, *Solidarität: Die Entwiklungsgeschichte eines socialethischen Schlüsselbegriffs* (Inaugural dissertation, University of München 1991) 7-8.

for everything owed.[5] Many legal systems, especially those with a civil law tradition, nowadays employ it in their law on obligation.[6]

In Union law, the prologue to this study showed, solidarity has shaken off this private law connotation as it features in a great variety of contexts.[7] Yet, to discover its true potential as a lens for understanding the transformation of the currency union, this study needs to broaden its horizon and first examine how the concept of solidarity is employed *outside* the law.

By the time *solidarité* came to figure in the *Code Civil*, it had already left the legal sphere as a result of the French Revolution that had broken out in 1789. The Revolution had its roots in the financial crisis in which France found itself at the end of the 18th century. The inability of the French government to deal with an ever expending debt pile, caused by a century of warfare, had severely weakened Louis XVI's royal authority and had forced the masses to cry for the improvement of social conditions.[8] What began as a reaction to economic hardship, rapidly developed into a more fundamental state of civil unrest, targeting the *ancien régime* itself and eventually resulting in the overthrow of Louis XVI on 10 August 1792.[9] Shortly after the king's deposition a National Convention assembled to come up with a constitution for the new republic. On 1 April 1793 Georges Danton spoke to the convention and proclaimed:

> '*Nous sommes tous solidaires par l'identité de notre conduite*'. (We are all solidary through the identity of our behaviour)[10]

5 Art 1197 Code Civil: 'L'obligation est *solidaire* entre plusieurs créanciers lorsque le titre donne expressément à chacun d'eux le droit de demander le paiement du total de la créance, et que le paiement fait à l'un d'eux libère le débiteur' (An obligation is joint and several between several creditors, where the instrument of title expressly gives to each of them the right to demand payment of the whole claim, and payment made to one of them discharges the debtor). Art 1200 Code Civil: 'Il y a *solidarité* de la part des débiteurs, lorsqu'ils sont obligés à une même chose, de manière que chacun puisse être contraint pour la totalité, et que le paiement fait par un seul libère les autres envers le créancier' (There is joint and several liability on the part of debtors where they are bound for a same thing, so that each one may be compelled for the whole, and payment made by one alone discharges the others towards the creditor). The translations have been obtained from <www.legifrance.gouv.fr> accessed 11 May 2017 (emphasis added).

6 Examples are Belgium (Arts 1197 CC ff), Luxembourgh (Arts 1197 CC ff) and Italy (Arts 1292 CC ff).

7 See text to n 116 (prologue).

8 Sylvia Neely, *A Concise History of the French Revolution* (Rowman & Littlefield Publishers 2008) 29ff.

9 Neely (n 8) 155-161.

10 Ferdinand Brunot, *Histoire de la langue française des origines à 1900 – IX: La Révolution et l'Empire* (Librairie Armand Colin 1937) 745. See also Rainer Zoll, *Was ist Solidarität heute?* (Suhrkamp 2000) 20-21; Hauke Brunkhorst, *Solidarity: From Civic Friendship to a Global Legal Community* (The MIT Press 2005) 1 (this translation follows the one of Brunkhorst).

It is one of the first instances in which solidarity clearly takes up a meaning that exceeds the realm of law, where it becomes politicised. Here, solidarity is used to further the ends of the Revolution by appealing to a desire for cohesiveness in a society divided by strife and unrest.

At first, solidarity was not the preferred notion for expressing this desire.[11] Among revolutionaries it lost out to fraternity, which features in the famous 'rallying cry': *egalité, liberté, fraternité*.[12] But during the 19th century, solidarity gained ever greater prominence, pushing fraternity into the background.[13] It came to feature in a broad variety of contexts, making it far from a uniform concept. That does not mean it does not have a common core. In its essence, solidarity is a *mode of group cohesion* as a result of which individual members act in unison.[14] From this essence flow three features which are inalienable to solidarity as employed outside the law, no matter the specific context.[15]

First of all, as Sally Scholz explains, 'solidarity mediates between the community and the individual'.[16] It should therefore not be equated with groups as such. It *ties* individuals to the group, it *underlies* cohesion. This makes it a difficult concept to examine, given that the focus is neither exclusively on the group's constituent elements, the individuals, nor on the group as such. It is 'neither individualism nor communalism'.[17] Solidarity is best located in between the individual and the group. Second, as a result of solidarity, 'unity' is created.[18] Solidarity forges a group out of individuals. It ties them to one another. Not every unity, however, is based on solidarity. Solidarity is *a* mode of group cohesion, but by no means the only one. Groups held together merely through the use of force, for example, form a unity to some degree, but this unity is not solidary in nature. Third, solidarity carries with it 'positive obligations'.[19] It requires individuals to act in support of, and in conformity with, the group.[20] Solidarity therefore differs greatly from concepts like justice and liberty. The point of departure is not that obligations are regarded as 'claims made of the individual' in need of justification,[21] but rather that they are an instrument of cohesion, bridging the collective and the individual.

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11 Brunkhorst (n 10) 1.
12 Brunkhorst (n 10) 1; Andreas Wildt, 'Solidarity: Its History and Contemporary Definition' in Kurt Bayertz (ed), *Solidarity* (Kluwer 1999) 210.
13 Wildt (n 12) 210-211. See also Schmelter (n 4) 9; Brunkhorst (n 10) 1, 59.
14 See text to n 125 (prologue).
15 Sally J Scholz, *Political Solidarity* (The Pennsylvania State University Press 2008) 17-21.
16 Scholz (n 15) 18-19.
17 Scholz (n 15) 18. See also H Tristram Engelhardt, Jr, 'Solidarity: Post-Modern Perspectives' in Kurt Bayertz (ed), *Solidarity* (Kluwer 1999) 295.
18 Scholz (n 15) 19.
19 Bayertz (n 1) 4; Scholz (n 15) 19.
20 Acting, that is, in the broadest meaning possible, given that solidarity can also oblige one to refrain from behaviour that is detrimental to group cohesion.
21 Bayertz (n 1) 4.

Apart from these three general features, however, solidarity is a multifaceted concept, with differing implications depending on the context in which it features. To understand these implications it is useful to distinguish between three kinds of solidarity: 'social solidarity', 'welfare solidarity', and 'oppositional solidarity'.[22]

Social solidarity primarily pertains to the 'cohesiveness' of a group and can be traced back to Auguste Comte.[23] During the 19th century, the concern for social cohesion embodied in the revolutionary notion of *fraternité* did not remain confined to the political realm, but became an object of academic study. The industrial revolution, migration into cities and the rise of individualism profoundly changed societies and laid bare the 'precariousness of social integration'.[24] Comte was one of the first to study the problem of social integration and to do so in relation to the concept of social solidarity.[25] In his view, solidarity forms a 'mechanism of social cohesion'.[26] One of its engines, he claims, is the 'division of labour'.[27] This is not just a matter of economic concern, but a driver of cohesion as it makes people dependent on one another.[28] Comte's insight that individualism and interdependence do not necessarily lead to a demise of cohesion, but may actually generate and strengthen it, was ground-breaking and has profoundly influenced thinking about modern society.

Welfare solidarity arguably relates most to the use of solidarity in everyday parlance. It is also closely bound up with politics given that it relates to the 'redistribution' of money through the state so as to help those members of society that require it most.[29] At its core, welfare solidarity concerns the idea that due to their membership of the same society people are subject to a mutual duty of assistance in case of need.[30] Some argue that it is just a specific manifestation, a branch, of social solidarity, giving expression to the solidary ties between the members of society.[31] Yet, although the two are certainly related, welfare solidarity differs from social solidarity in that it shifts the focus from

22 This distinction is inspired by and based on the one made by Sally Scholz. See Scholz (n 15) 21-38. See also Bayertz (n 1) 5ff.

23 Scholz (n 15) 21. See also Bayertz (n 1) 12; Karl H Metz, 'Solidarity and History. Institutions and Social Concepts of Solidarity in 19th Century Western Europe' in Kurt Bayertz (ed), *Solidarity* (Kluwer 1999) 194.

24 Steinar Stjernø, *Solidarity in Europe: The History of an Idea* (CUP 2004) 30-31.

25 Auguste Comte, *System of Positive Polity* (John H Bridges tr, Longmans, Green & Co. 1875).

26 Metz (n 23) 194.

27 Metz (n 23) 194.

28 Metz (n 23) 194; Bayertz (n 1) 12.

29 Bayertz (n 1) 21.

30 Bayertz (n 1) 21.

31 Kees Schuyt, 'The Sharing of Risks and the Risks of Sharing: Solidarity and Social Justice in the Welfare State'(1998) 1 Ethical Theory and Moral Practice 297, 297. See for a discussion of this point Scholz (n 15) 30.

the members of society to the state as the 'institutionalised' vehicle through which welfare support is granted.[32] It is also for this reason that some argue that welfare solidarity has come under strain in recent times.[33] The development and growth of the welfare state has led to an 'anonymisation' and 'professionalisation' of welfare support, putting emphasis on the entitlements to support which one may have against the state, but at the same time losing out of sight the solidary ties between the members of society that have to sustain the system.[34]

Oppositional solidarity results from the need to defend 'common interests'.[35] Individuals rally together in order to fight against a state of domination or to promote a particular cause.[36] Political solidarity is therefore 'target-oriented',[37] making it different from social solidarity.[38] Whereas in the case of the latter group cohesion results from the ties between individuals, there is no such causal link in the case of oppositional solidarity. Such relations may well follow from the solidary cohesion pertaining to the group, but they are not the driving factor behind its coming into existence, which rather lies in its aim.[39] As it is closely related to the notion of 'struggle',[40] oppositional solidarity is 'adversative' in nature.[41] Fights over rights have to be won, wrongs have to be brought to an end by challenging those in control.[42] In short, the solidary cohesion of the group arises out of opposition against, and conflict with, others.

The classic example of oppositional solidarity can be found in the workers' movement that started in the 19th century.[43] In fact, it developed there into a particular niche, appealing to the Marxist concept of 'class solidarity', built around the idea that once workers became aware of their common state of hardship, they would unite and organise themselves in order to oppose, and transform a capitalist driven society.[44] A more recent example of oppositional solidarity in the workers' movement occurred in the 1980s in Poland. In September 1980 *Solidarność*, the first independent trade union in a Warsaw Pact

32 Bayertz (n 1) 22.
33 Schuyt (n 31) 300-301; Bayertz (n 1) 22, 24-25.
34 Schuyt (n 31) 299-301, 305-306, 308-311.
35 Bayertz (n 1) 16.
36 Scholz (n 15) 34.
37 Klaus Peter Rippe, 'Diminishing Solidarity' (1998) 1 Ethical Theory and Moral Practice 355, 357. Rippe therefore calls this kind of solidarity 'project-related solidarity'. See also Bayertz (n 1) 16; Scholz (n 15) 34, 37.
38 Rippe (n 37) 357; Scholz (n 15) 34.
39 Rippe (n 37) 357; Scholz (n 15) 36-37.
40 Scholz (n 15) 34.
41 Bayertz (n 1) 17. See also Scholz (n 15) 36-37. Scholz emphasizes the 'oppositional nature' of this kind of solidarity, yet terms it 'political solidarity'.
42 Bayertz (n 1) 17-18.
43 Bayertz (n 1) 16-17.
44 Stjernø (n 24) 42-46. See also Bayertz (n 1) 17-19.

country, was established after heavy strikes in several ports on the Baltic Sea.[45] What started off as a trade union soon developed into a popular movement challenging the Polish communist regime throughout the 1980s.[46] The success of the movement reached its height with the first semi-free elections in 1989, followed by the instalment of a *Solidarność* led government in August that year, and the election of Lech Wałęsa, the movement's leader, as president in December 1990.[47]

The three kinds of solidarity are archetypes. In practice, the boundaries between them are not clear-cut and solidary groups may display elements of more than one kind.[48] Nonetheless, this chapter will focus on social solidarity as it is most central to this study and its understanding of the solidarity that exists between the member states of the Union. It will do so by discussing the ideas of four great minds. Two of them, Émile Durkheim and Talcott Parsons, are social theorists who have explicitly engaged with the concept of solidarity by building on Comte's ideas. Before turning to them, however, this chapter will examine the thoughts of two other, more ancient, thinkers.[49] One of them is Jean-Jacques Rousseau whose social contract theory has greatly contributed to the concept of solidarity as aroused by the French Revolution. But a thorough understanding of solidarity requires us to go even further back in time. For even if solidarity itself is a relatively modern concept, its roots are much older. They go back to antiquity; they go back to Aristotle.

2 Aristotelean friendship

'Friendship', Aristotle writes, 'seems to keeps cities together, and lawgivers seem to pay more attention to it than to justice'.[50] The phrase provides evidence of the interest of the ancient philosopher in societal cohesion, and how he saw friendship (*philia*) as indispensable in bringing it about. In his ethical treatises *Eudemian Ethics* and *Nicomachean Ethics*, the political work *Politics*, and his treatise on the art of persuasion, the *Rhetoric*, Aristotle explains in detail

45 Idesbald Goddeeris, 'Solidarność, the Western World and the End of the Cold War'(2008) 16 European Review 55, 56.

46 Goddeeris (n 45) 56; Scholz (n 15) 8-9.

47 For a thorough discussion of the history of *Solidarność* see Timothy Garton Ash, *The Polish Revolution: Solidarity* (YUP 2002).

48 Scholz (n 15) 20, 39-46.

49 This study is not the first to identify the ties between these sociologists and more ancient thinkers. Especially interesting, as well as an important source for this study, is the one by Douglas Challenger which analyses the influence of Aristotle and Rousseau on Durkheim. See Douglas F Challenger, *Durkheim Through the Lens of Aristotle: Durkheimian, Postmodernist, and Communitarian Responses to the Enlightenment* (Rowman & Littlefield Publishers 1994).

50 Aristotle, *Nichomachean Ethics* (Christopher Rowe tr, Sarah Broadie and Christopher Rowe eds, OUP 2002) 209.

how friendship is constitutive of society. His ideas have influenced those of Enlightenment thinkers on the proper form of society and,[51] as such, have contributed to our modern understanding of solidarity.

According to Aristotle, 'man is a civic being, one whose nature is to live with others'.[52] He has a natural drive to enter into relationships with fellow men to serve his needs and eventually to satisfy his ultimate aim in life, that for which he is meant to live: 'happiness'.[53] In Aristotle's view, happiness is only within reach for those striving for '*virtue*',[54] those acting 'nobly'.[55] Observing virtue requires that one acts as 'reason' prescribes.[56] Acting in line with reason, in turn, implies that one aims for 'the mean' or 'the middle' in everything one does and undertakes.[57]

In line with man's social drive, Aristotle argues, he requires friends.[58] Friendships are first of all an elementary prerequisite for life.[59] A man living in confinement simply cannot meet all of his needs, he will not manage on his own. Yet, the value of friendship exceeds this level of brutal necessity as it is also indispensable for leading a virtuous life.[60] Only by having friends does man have a chance of achieving that for which he ultimately lives: happiness. For a true friend, Aristotle explains, is 'another self'.[61] Having such friends helps to acquire 'self-knowledge' and thus to act according to reason, essential for a life lived in virtue.[62]

Aristotelean friendship is a much broader notion compared to what contemporary societies perceive it to be.[63] Its reach is not confined to 'ordinary' friends but extends to the ties between family members, trading partners and even citizens. Nonetheless, its essence is uniform and ever-present.[64] 'Let being friendly', Aristotle states, mean 'wanting for someone what one thinks are

51 Challenger (n 49) 76.
52 Aristotle, *Nichomachean Ethics* (n 50) 236.
53 Challenger (n 49) 35-37.
54 Challenger (n 49) 37-38.
55 Ernest Barker, *The Political Thought of Plato and Aristotle* (Dover Publications 1972) 265-266. See also Challenger (n 49) 38.
56 Challenger (n 49) 37-38.
57 Challenger (n 49) 41-45.
58 Barker (n 55) 236; Challenger (n 49) 62-64, 66-67.
59 Barker (n 55) 265-266; Challenger (n 49) 62-63.
60 Barker (n 55) 236, 266; Challenger (n 49) 62-63, 70.
61 Aristotle, *Nicomachean Ethics* (n 50) 230, 238.
62 John M Cooper, *Reason and Emotion: Essays on Ancient Moral Psychology and Ethical Theory* (Princeton University Press 1999) 338, 340-345. The claim that friendships contribute to self-knowledge is especially true for 'virtue friendships', discussed below.
63 Challenger (n 49) 66; Sibyl A Schwarzenbach, 'On Civic Friendship' (1996) 107 Ethics 97, 99; Cooper (n 62) 312-313.
64 See Cooper (n 62) 313, 316; Schwarzenbach (n 63) 99-100; Eleni Leontsini, 'The Motive of Society: Aristotle on Civic Friendship, Justice and Concord' (2013) 19 Res Publica 21, 25.

good things for him, not what one thinks benefits oneself, and wanting what is potentially productive of these good things'.[65] 'A friend', he continues, 'is one who loves and is loved in return'.[66] 'Friendship', therefore, 'is good will between reciprocating parties'.[67]

Apart from this inalienable core, Aristotle divides friendly relations into three categories based on what it is that is loved.[68] '[I]t seems that not everything is loved', he argues, 'only what is lovable, and that the lovable is good, or pleasant, or useful'.[69] Therefore, 'If there is to be friendship, the parties must have goodwill towards each other' and this needs to be 'brought about by one of the three things mentioned'.[70] Accordingly, the three kinds of friendship are 'virtue friendship', 'pleasure friendship' and 'advantage friendship'.[71] Virtue friendship, Aristotle explains, 'exists between good people, those resembling each other in excellence'.[72] Such friendships are characterised by the fact that one 'wishes good things for the other in so far as he is good'.[73] Pleasure friendships are present when people 'feel affection' for one another 'for the pleasure they themselves get from them'.[74] Likewise, in the case of advantage friendships people like each other 'in so far as some good accrues to each of them from the other'.[75]

For Aristotle, virtue friendship is the supreme, cardinal form of friendship.[76] In such a friendship someone is loved because of his 'good character', because of what he is like simply as a person.[77] This bestows the friendship with considerable permanence given that 'excellence is something lasting'.[78] Although those who like each other for some pleasure or advantage are certainly also friends, they are so only 'incidentally'.[79] 'Such friendships', Aristotle reasons, 'are easily dissolved, if the parties become different; for if they are no longer pleasant or useful, they cease loving each other. And the useful is not something that lasts, but varies with the moment'.[80]

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65 Aristotle, *On Rhetoric: A Theory of Civic Discourse* (George A Kennedy tr, OUP 2007) 124.
66 Aristotle, *On Rhetoric* (n 65) 124.
67 Aristotle, *Nicomachean Ethics* (n 50) 210.
68 Aristotle, *Nicomachean Ethics* (n 50) 210: 'There are, then, three kinds of friendship, equal in number to the objects of love'. See also Challenger (n 49) 67; Cooper (n 62) 315-317; Leontsini (n 64) 24-25.
69 Aristotle, *Nicomachean Ethics* (n 50) 210.
70 Aristotle, *Nicomachean Ethics* (n 50) 210.
71 Challenger (n 49) 67; Cooper (n 62) 315-317; Leontsini (n 64) 25.
72 Aristotle, *Nicomachean Ethics* (n 50) 211.
73 Aristotle, *Nicomachean Ethics* (n 50) 211.
74 Aristotle, *Nicomachean Ethics* (n 50) 211.
75 Aristotle, *Nicomachean Ethics* (n 50) 210-211.
76 Challenger (n 49) 68-70; Cooper (n 62) 325-326; Leontsini (n 64) 25.
77 Cooper (n 62) 325-326.
78 Aristotle, *Nicomachean Ethics* (n 50) 211.
79 Aristotle, *Nicomachean Ethics* (n 50) 211.
80 Aristotle, *Nicomachean Ethics* (n 50) 211.

Aristotelean friendship, then, ties people to one another and thereby enables man, first of all, to see to his needs, and secondly, to lead a virtuous life. However, and in line with Aristotle's statement that it keeps cities together, friendship also links them to the city state (*polis*).

To comprehend this latter function of friendship, it is important to realise that Aristotle employs an '*organic*' understanding of the city state.[81] Citizens are to the city state what different organs are to the physical body. Regarding something as an organic 'whole' or 'unity', Ernest Barker explains, requires two things.[82] First of all, there needs to be a division of function, meaning that each organ contributes in its own way to the success of the whole of which it forms a part. Second, the existence of each of the organs separately should be tied up to that of the whole. Both these elements are present in Aristotle's view on the city state.[83] The element of division of function becomes visible when Aristotle reasons that 'A city state consists not only of a number of people, but of people of different kinds, since a city state does not come from people who are alike',[84] and 'things from which a unity must come differ in kind'.[85] The element of dependency becomes clearly apparent when Aristotle states that the city state 'comes to be for the sake of living'.[86]

Now, at the basis of this organic unity constituting the city state lies friendship.[87] Living in a city, Aristotle thinks, cannot simply be equated with the 'sharing of a common location' nor 'exchanging goods'.[88] If it meant only this, its value would not exceed that of the relation between two *different* city states that trade with each other yet whose citizens are not 'concerned with what sort of people the others should be'.[89] What characterises the *polis*, however, is that the citizens who make it up do have such genuine concern for one another.[90] The city state, in other words, is a community of friends.[91] It is friendship, Aristotle explains, that unites people in 'marriage ... brotherhoods, religious sacrifices, and the leisured pursuits of living together'.[92] The city state is the community that brings all these more limited social environments together: 'All the different kinds of community, then, are evidently parts of the political one; and along with community of each sort will go friendship

81 Barker (n 55) 231, 234, 276-281 (emphasis added). See also Challenger (n 49) 64.
82 Barker (n 55) 234, 277.
83 Barker (n 55) 232-233, 277; Challenger (n 49) 63, 162-163; Cooper (n 62) 357, 362-363; Ann Ward, 'Friendship and Politics in Aristotle's Nicomachean Ethics' (2011) 10 European Journal of Political Theory 443, 450-452.
84 Aristotle, *Politics* (CDC Reeve tr, Hackett Publishing Company 1998) 27.
85 Aristotle, *Politics* (n 84) 27.
86 Aristotle, *Politics* (n 84) 3.
87 Barker (n 55) 235-236; Cooper (n 62) 368.
88 Aristotle, *Politics* (n 84) 81.
89 Aristotle, *Politics* (n 84) 80.
90 Cooper (n 62) 365-366, 370-371; Ward (n 83) 452-453.
91 Cooper (n 62) 368; Leontsini (n 64) 26.
92 Aristotle, *Politics* (n 84) 81.

of the same sort'.[93] Thus the city state achieves the status of an organic whole, endowed with an 'independence' and 'self-sufficiency' that man needs yet cannot achieve on his own.[94]

The friendship existing between people within the city state, which Aristotle calls 'civic' or 'political' friendship, is an 'advantage friendship'.[95] In line with the reasoning that the city state is made up of people different in kind, each performing a distinct role within the unity to which they all belong, it is advantage that first brings them together:

> 'For people make their way together on the basis that they will get some advantage from it, and so as to provide themselves with some necessity of life; and the political community too seems both to have come together in the beginning and to remain in place for the sake of advantage ... and people say that what is for the common advantage is just.'[96]

Yet, as this statement shows, civic friendship is a special kind of advantage friendship. The advantage obtained through it is not, or not only, reducible to distinct advantages enjoyed by each citizen separately.[97] It is a 'common advantage', a '*common good*', linked to the city state as such and from which all citizens profit through their membership of the *polis*.[98]

As a result of this link with the common good, the strength and persistence of the friendship that underlies the city state exceeds that of ordinary friendships based on advantage, which lack stability due to their incidental nature.[99] Indeed, Aristotle's statement, cited above, that the city state comes into being 'for the sake of living', is followed by the addition that 'it remains for the sake of living well'.[100] Ultimately, he thinks, 'political communities must be taken to exist for the sake of noble actions'.[101] Part of what it means to act nobly is 'that citizens share judgements about what is advantageous, reach the same decisions, and do what has seemed to them jointly to be best',[102] thereby supporting the common good.[103]

Creating the conditions for a virtuous life, the city state is thus inherently linked to man's nature.[104] Socially driven, man has to share his life with

93 Aristotle, *Nicomachean Ethics* (n 50) 219.
94 Barker (n 55) 233-234, 265, 269-270.
95 Schwarzenbach (n 63) 105; Cooper (n 62) 333, 370; Ward (n 83) 450; Leontsini (n 64) 25-26.
96 Aristotle, *Nicomachean Ethics* (n 50) 218. See also Leontsini (n 64) 26.
97 Cooper (n 62) 372
98 Cooper (n 62) 372 (emphasis added). See also Barker (n 55) 236.
99 Ward (n 83) 452-453. See also Barker (n 55) 268.
100 Aristotle, *Politics* (n 84) 3.
101 Aristotle, *Politics* (n 84) 81.
102 Aristotle, *Nicomachean Ethics* (n 50) 232.
103 Cooper (n 62) 375 Leontsini (n 64) 31-32.
104 Barker (n 55) 236, 265, 268-270; Challenger (n 49) 66-67, 73-74.

others so as to secure his needs and achieve happiness. The city state, as the community of all communities, provides the ultimate context in which this goal can be achieved. Man thus truly is a civic being.

Aristotle, then, presents the city state as an organic unity in which people are dependent on each other and on the state itself in order to live, but above all to live well. It is friendship that creates and sustains this unity by tying people to one another and eventually to the city state. To Aristotle, it is therefore only logical to state that it is reciprocity, belonging to the unalienable core of friendship,[105] 'that preserves cities'.[106] Yet, in the unity created in this way, man's own being and existence are not thrown by the wayside. The city state is not created at the expense of the latter.[107] To the contrary, it is through the city state that man can live a virtuous life and attain happiness. Friendship thus functions as a mediating mechanism between man and state, between the individual and the collective.

Nonetheless, Aristotle's organic conception of society is a qualified one.[108] '[N]ot everyone without whom there would not be a city state is to be regarded as a citizen', he argues.[109] Indeed, 'a city-state is a community of free people'.[110] The unfree (i.e. 'slaves'), and in some communities also 'vulgar craftsmen' and 'hired labourers', lack the opportunity 'to engage in virtuous pursuits' and are therefore excluded from the common good which the city state aims at.[111] Aristotle consequently employs a distinction between those elements of the organic unity which fully partake in the city state, 'the integral parts', and those which do sustain it, 'the contributory parts', yet do not reap its benefits.[112] As a result, there is an inherent inequality to civic friendship.

Aristotle's organic conception of society resonates in Jean-Jacques Rousseau's thoughts on the social contract.[113] Contrary to Aristotle, however, Rousseau carries the organic conception of society all the way through by making all people participate equally in it. It was this vision of society as a unity of equal and free people that gained great favour during the French Revolution and it was solidarity that would come to operate as the instrument sustaining it.

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105 See also Cooper (n 62) 317; Brunkhorst (n 10) 14.
106 Aristotle, *Politics* (n 84) 27. See also Leontsini (n 64) 23.
107 Barker (n 55) 232, 234, 280-281; Challenger (n 49) 65-66.
108 See Barker (n 55) 279-280; Cooper (n 62) 364-365.
109 Aristotle, *Politics* (n 84) 74.
110 Aristotle, *Politic*s (n 84) 77.
111 Aristotle, *Politics* (n 84) 74. See also Barker (n 55) 279-280; Cooper (n 62) 365.
112 Barker (n 55) 279-280.
113 This is not to say that the modern understanding of solidarity has not been informed by concepts other than Aristotelean friendship or Rousseau's social contract. Hauke Brunkhorst, for example, shows how it has also been informed by the Christian notion of 'brotherliness'. See Brunkhorst (n 10) 23-54.

3 Rousseau's social contract

Rousseau's ideas on society can only be understood by placing them in the political environment of 18th century France before the Revolution. The state was controlled by the *ancien régime*, characterised by the absolute power of the king which arguably reached its height with Louis XIV who supposedly declared: '*L'état c'est moi*' (I am the state).[114] Given the absolute position of the king, it was for him to decide on and articulate the general interest of the nation.[115]

Over the course of the 18th century, and as a result of the Enlightenment, political philosophers came to criticize this state of affairs. They challenged the idea of a single, absolute monarch with the capacity to ensure the state's interests and looked for better options.[116] So too Rousseau. He condemned the idea that the 'sovereign will' could be located in a single person only, and searched for an alternative in which it is exercised by all those making up society under conditions of freedom and equality.[117] In his treatise *Du Contrat Social* (On the Social Contract) he formulated this quest as follows:

> 'To find a form of association that will defend and protect the person and goods of each associate with the full common force, and by means of which each, uniting with all, nevertheless obeys only himself and remains as free as before.'[118]

The key to this, Rousseau argued, is the social contract.

Just like Aristotle, Rousseau takes the view that man is socially driven. Contrary to Aristotle, he believes this is not a character trait that man has possessed from the very start, but one he has developed over the course of time.[119] In the *Discours sur l'origine et les fondements de l'inégalité parmi les hommes* (Discourse on the Origin and the Foundations of Inequality Among Men) Rousseau explains how in the 'state of nature' in which man originally found himself, his existence was one of 'self-sufficiency', characterised by the fact that he did not have to rely on others to see to his needs.[120] He imagines 'savage man' as 'satisfying his hunger under an oak tree, quenching his thirst at the first stream, finding his bed at the foot of the same tree that supplied his meal;

114 Neely (n 8) 2.
115 Jeremy Jennings, 'Rousseau, social contract and the modern Leviathan' in David Boucher and Paul Kelly (eds), *The Social Contract From Hobbes to Rawls* (Routledge 1994) 116.
116 Jennings (n 115) 116-117.
117 Jennings (n 115) 116-117.
118 Jean-Jacques Rousseau, 'Of the Social Contract or Principles of Political Right' in Victor Gourevitch (ed), *The Social Contract and Other Later Political Writings* (CUP 1997) 49-50.
119 Challenger (n 49) 110, 114-115, 119.
120 Challenger (n 49) 113-115. See also David James, 'Rousseau on Dependence and the Formation of Political Society' (2011) 21 European Journal of Philosophy 343, 348.

and thus all his needs are satisfied'.[121] Man thereby knew 'neither good nor evil, and had neither vices nor virtues',[122] as he was 'left by nature to instinct alone'.[123]

Man's wants being extremely basic, not extending 'beyond his physical needs',[124] 'the products of the earth provided him with all the help he needed'.[125] The relation between savage man and his surroundings was therefore one of 'harmony',[126] as a result of which he experienced 'happiness'.[127] Man's 'imagination depicts nothing to him; his heart asks nothing of him', Rousseau reasons.[128] 'His soul, agitated by nothing, is given over to the single feeling of his own present existence'.[129] Man, in other words, possessed 'natural freedom'.[130]

Over time, Rousseau argues, this harmony somehow became distorted,[131] making it necessary for man to 'count on the assistance of his fellow man'.[132] With this he means that men came to rely on one another and had to cooperate in order to adapt to this new reality and support themselves.[133] Gradually, man evolved into a social and moral being with emotions, cravings and the capability to reason.[134] Once having left the state of nature, the tide could no longer be turned and the bond between men became ever more intense.[135]

The shift from the state of nature to the 'civil state' is problematic,[136] however, as the harmonious 'balance' characteristic of the former is not a given in the latter.[137] Rousseau illustrates this problem by distinguishing between 'dependence on *things*' and 'dependence on *men*'.[138] At the very beginning

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121 Jean-Jacques Rousseau, 'Discourse on the Origin and Foundations of Inequality Among Men' in Donald A Cress (ed), *Basic Political Writings of Jean-Jacques Rousseau* (first published 1755, Donald A Cress tr, Hackett Publishing Company 1987) 40.

122 Rousseau, 'Discourse on the Origin and Foundations of Inequality' (n 121) 52.

123 Rousseau, 'Discourse on the Origin and Foundations of Inequality' (n 121) 45.

124 Rousseau, 'Discourse on the Origin and Foundations of Inequality' (n 121) 46.

125 Rousseau, 'Discourse on the Origin and Foundations of Inequality' (n 121) 60.

126 Émile Durkheim, *Montesquieu and Rousseau: Forerunners of Sociology* Ralph Manheim tr, The University of Michigan Press 1960) 88. See also Challenger (n 49) 113-114.

127 Challenger (n 49) 113-114.

128 Rousseau, 'Discourse on the Origin and Foundations of Inequality' (n 121) 46.

129 Rousseau, 'Discourse on the Origin and Foundations of Inequality' (n 121) 46.

130 James (n 120) 345.

131 Durkheim, *Montesquieu and Rousseau* (n 126) 79-81; Challenger (n 49) 115.

132 Rousseau, 'Discourse on the Origin and Foundations of Inequality' (n 121) 61.

133 Durkheim, *Montesquieu and Rousseau* (n 126) 81; Challenger (n 49) 115.

134 Durkheim, *Montesquieu and Rousseau* (n 126) 80-81; Challenger (n 49) 114-115; James (n 120) 350.

135 Durkheim, *Montesquieu and Rousseau* (n 126) 80-81; Challenger (n 49) 115.

136 Indeed, Rousseau regards his *Discours* as an attempt to discover 'the forgotten and lost routes that must have led man from the *natural state* to the *civil state*'. See Rousseau, 'Discourse on the Origin and Foundations of Inequality' (n 121) 80 (emphasis added).

137 Durkheim, *Montesquieu and Rousseau* (n 126) 88. See also Challenger (n 49) 115.

138 Durkheim, *Montesquieu and Rousseau* (n 126) 88 (emphasis added). See also Challenger (n 49) 115; James (n 120) 343, 348.

of his existence, man had to rely solely on things.[139] All his needs could be met through the products and materials provided by nature, whereas man had the capacity to utilise them by himself. Consequently, he had to submit only to the 'laws of nature', to 'natural necessity'.[140] For Rousseau, this goes to show that freedom implies 'restraint'.[141] In the state of nature, man lived in freedom and happiness because nature acted as a 'superior force' controlling him.[142]

In the civil state man can no longer manage on his own but has to rely on others. Yet, the constraint which this dependence exercises on man is not as solid and fixed as that emanating from nature.[143] Consequently, it brings on 'inequality' and 'vice', both of which are 'fatal to happiness and innocence'.[144] In so doing, the civil state 'destroyed natural liberty, established forever the law of property and of inequality ... and for the profit of a few ambitious men henceforth subjected the entire human race to labor, servitude and misery'.[145] It is for this reason that Rousseau explicitly rejects Aristotle's perception of slavery and inequality as natural phenomena. Aristotle was certainly right in observing these phenomena, Rousseau reasons, 'but he mistook the effect for the cause'.[146] Inequality is not inherent in nature, but springs from the civil state and dependence on men.

However, man is not sentenced to a life characterised by inequality and a lack of freedom. Instead, the challenge is to mould the civil state such that man comes to stand to society in a similar fashion as he had done to nature at the very beginning of his existence.[147] This can be done, Rousseau argues, by devising a force in the civil state that benefits from an 'impersonality' and solidity corresponding to those that used to characterise the force emanating from nature.[148] And 'since men cannot engender new forces, but only unite and direct those that exist', they have 'to form by aggregation, a sum of forces', 'set them in motion by a single impetus', and 'make them act in concert'.[149] Men have to conclude a *social contract*.

The social contract is 'the act of association',[150] whose substance 'may never have been formally stated' yet is 'everywhere tacitly admitted and recog-

139 James (n 120) 348.
140 James (n 120) 348.
141 Challenger (n 49) 115-116.
142 Durkheim, *Montesquieu and Rousseau* (n 126) 88. See also Challenger (n 49) 115-116.
143 Durkheim, *Montesquieu and Rousseau* (n 126) 88; Challenger (n 49) 116.
144 Rousseau, 'Discourse on the Origin and Foundations of Inequality' (n 121) 64.
145 Rousseau, 'Discourse on the Origin and Foundations of Inequality' (n 121) 70.
146 Rousseau, 'Of the Social Contract' (n 118) 43.
147 Durkheim, *Montesquieu and Rousseau* (n 126) 93; Challenger (n 49) 117.
148 Durkheim, *Montesquieu and Rousseau* (n 126) 94. See also Challenger (n 49) 117-118, 121; James (n 120) 344.
149 Rousseau, 'Of the Social Contract' (n 118) 49.
150 Rousseau, 'Of the Social Contract' (n 118) 51.

nized', whereby 'each ... puts his person and his full power in common under the supreme direction of the general will'.[151] The general will stems from each distinct 'will' of those who have concluded the contract, those who make up society.[152] Yet, it also exceeds them, constituting 'a moral and collective body',[153] to act as the supreme, impersonal force that used to restrain man in the earliest days of his existence.[154]

This supreme force that constitutes the general will makes people support 'the common good'.[155] As such it is bound up closely with reason. 'In instinct alone, man had everything he needed in order to live in the state of nature', Rousseau argues, 'in a cultivated reason, he has only what he needs to live in society'.[156] In other words, just like man relied on *instinct* in the state of nature he has to act upon *reason* in the civil state.[157] The general will achieves precisely this by making man feel 'the voice of duty' to 'consult his reason before listening to his inclinations'.[158] In so doing, the social contract restores the harmony between man and his surroundings as a result of which he again experiences freedom.[159] And whereas in the state of nature this freedom was characterised by the fact that man could get by on his own, in the civil state it shows itself in the fact he possesses 'the freedom to want the good'.[160]

With his social contract, then, Rousseau, as Aristotle had done before him, yet in his own way, portrays society as an 'organic' entity.[161] By concluding the social contract men convert their distinct wills into a 'whole'.[162] And this whole, in turn, does not simply form an 'aggregation' of these various wills,[163] but becomes a collective body with 'a will of its own, "the general

151 Rousseau, 'Of the Social Contract' (n 118) 50.
152 Durkheim, *Montesquieu and Rousseau* (n 126) 98. See also Challenger (n 49) 123.
153 Rousseau, 'Of the Social Contract' (n 118) 50.
154 Durkheim, *Montesquieu and Rousseau* (n 126) 98-99, 101, 103; Challenger (n 49) 118-119, 123-124.
155 Rousseau, 'Of the Social Contract' (n 118) 57 (stating that 'the general will alone can direct the forces of the State according to the end of its institution, which is the common good'). See also Stanley Hoffmann, 'The Social Contract, or the mirage of the general will' in Christie McDonald and Stanley Hoffmann (eds), *Rousseau and Freedom* (CUP 2010) 118-119, 123-124.
156 Rousseau, 'Discourse on the Origin and Foundations of Inequality' (n 121) 52.
157 Challenger (n 49) 114, 121. See also Durkheim, *Montesquieu and Rousseau* (n 126) 74, 95-96; Hoffmann (n 155) 118-119.
158 Rousseau, 'Of the Social Contract' (n 118) 53. See also Hoffmann (n 155) 118.
159 Durkheim, *Montesquieu and Rousseau* (n 126) 99-101; Challenger (n 49) 121-122, 125.
160 Hoffmann (n 155) 119.
161 Durkheim, *Montesquieu and Rousseau* (n 126) 84-85, 97; George H Sabine and Thomas L Thorson, *A History of Political Theory* (4th edn, The Dryden Press 1973) 537, 541; Challenger (n 49) 108-109, 128-130.
162 Durkheim, *Montesquieu and Rousseau* (n 126) 98. See also Challenger (n 49) 123-124; Hoffmann (n 155) 119-120.
163 Sabine and Thorson (n 161) 539-540. See also Durkheim, *Montesquieu and Rousseau* (n 126) 82-83; Challenger (n 49) 123; Hoffmann (n 155) 120.

will"'.[164] The organic entity so created safeguards the common good. Or as Rousseau puts it:

> 'As soon as this multitude is thus united in one body, one cannot injure one of the members without attacking the body, and still less can one injure the body without the members being affected. Thus duty and interest alike obligate the contracting parties to help one another, and the same men must strive to combine in this two-fold relation all the advantages attendant on it.'[165]

The organic society that results from the social contract is not created at the expense of the individual.[166] To the contrary. It stems from the individual, as he is the one that concludes the contract, and it promotes the individual, given that it provides the social context in which man can experience freedom.

At its core, therefore, and just like Aristotle's civic friendship, the social contract forms an act of '*reciprocity*'.[167] The only reason, Rousseau explains, why man is obliged to act in the interest of the common good is that:

> 'The commitments which bind us to the social body … are mutual, and their nature is such that in fulfilling them one cannot work for others without also working for oneself.'[168]

Yet, contrary to Aristotle, whose civic friendship was not attainable for all those living in the city state, Rousseau opens up this reciprocal act to all.[169] Only when everyone participates in the contract is a free and equal society possible, because only under this circumstance a man who acts upon the general will, which stems from all distinct wills, in the end is acting upon his own 'law of reason'.[170] Consequently, as long as they are 'subjected only to conventions such as these, they obey no one, but only their own will'.[171]

Rousseau's conception of society came to enjoy prominence during the French Revolution as it placed the position of the government into a different perspective.[172] The latter has no 'vested right' in and of itself.[173] There is no sovereignty to government as such. Instead, the people is sovereign. The government

164 Sabine and Thorson (n 161) 541.
165 Rousseau, 'Of the Social Contract' (n 118) 52.
166 Hoffmann (n 155) 120 (describing Rousseau's 'ideal state' as one in which 'neither the state nor the individual dominates').
167 Hoffmann (n 155) 123-124 (emphasis added).
168 Rousseau, 'Of the Social Contract' (n 118) 61.
169 Brunkhorst (n 10) 2-3, 60-61.
170 Rousseau, 'Of the Social Contract' (n 118) 61. See also Challenger (n 49) 122; Hoffmann (n 155) 118.
171 Rousseau, 'Of the Social Contract' (n 118) 63.
172 Sabine and Thorson (n 161) 544; Challenger (n 49) 127.
173 Sabine and Thorson (n 161) 544.

is only 'the agent which unites and puts it to work in accordance with the directives of the general will'.[174] It only possesses powers attributed to it by the people, 'of which it is merely the minister'.[175]

The idea of a society based on a social contract particularly resonates in the revolutionary slogan: *égalité, liberté, fraternité*. The third notion, fraternity, was used to express each and everyone's attachment to, and responsibility for, the societal association within which equality and freedom could be realised.[176] As such, it can be seen as the egalitarian form of civic friendship, maintaining the latter's cohesive force, but doing away with its unequal nature.[177]

Upon this basis, solidarity started as a 'colloquial version' of fraternity, eventually replacing it over the course of the 19th century.[178] It then gradually branched off into several kinds, one of them being social solidarity. And if it was Comte who introduced this solidarity to the realm of sociology, the one who developed the first fully fledged, and arguably most well-known, account of it is Durkheim.[179]

4 Durkheim's mechanical and organic solidarity

In the 19th century the quest for social cohesion started to attract the interest of academics following the rise of individualism during the age of Enlightenment.[180] Durkheim can be seen as the primary exponent of this development. As Ritzer writes, 'In the less than 100 years between the French Revolution and Durkheim's maturity, France went through three monarchies, two empires, and three republics. These regimes produced fourteen constitutions'.[181] Much of Durkheim's work focuses on defining the interaction between the individual and society and explaining how the latter retains its cohesion in times of modernity.[182] Although primarily descriptive, it had an important normative dimension as well. Durkheim not only wanted to describe the forces behind societal cohesion, but also to develop a theory that

174 Rousseau, 'Of the Social Contract' (n 118) 82.
175 Rousseau, 'Of the Social Contract' (n 118) 82.
176 Brunkhorst (n 10) 59.
177 Brunkhorst (n 10) 61 (stating that 'The moment of freedom within the old civic association was *preserved*, its unequal distribution was *canceled*').
178 Wildt (n 12) 210. See also Schmelter (n 4) 9; Brunkhorst (n 10) 1, 59.
179 See also Arto Laitinen and Anne Birgitta Pessi, 'Solidarity: Theory and Practice. An Introduction' in Arto Laitinen and Anne Birgitta Pessi (eds), *Solidarity: Theory and Practice* (Lexington Books 2015) 3.
180 Challenger (n 49) 157, 190-191,199; George Ritzer, *Sociological Theory* (McGraw-Hill 2008) 82. See also text to n 23 (ch 1).
181 Ritzer (n 180) 82.
182 Ritzer (n 180) 82-83.

could provide guidance on how to maintain and strengthen it.[183] And in so doing, he was inspired by previous thinkers of cohesion, not least Aristotle and Rousseau.

In line with these two predecessors, Durkheim takes the view that man is socially driven.[184] 'Collective life is not born from individual life', he argues, 'it is, on the contrary the second which is born from the first'.[185] With this he means that society cannot be seen as a 'utilitarian' construct consisting of 'autonomous individuals' who merely seek to further their own interests.[186] Such an understanding of man and his surroundings denies the fact that the individual and society are inherently connected. Society arises out of man's natural drive to establish ties with others; it is rooted in such ties.[187] At the same time, however, it cannot be put on a par with the individuals who make it up.[188] On the contrary, it forms a 'reality *sui generis*' which provides the social and moral setting within which man operates.[189] Central to this vision of society is the notion of 'social fact'. A social fact, according to Durkheim, is:

> '[E]very way of acting, fixed or not, capable of exercising on the individual an external constraint; or again, every way of acting which is general throughout a given society, while at the same time existing in its own right independent of its individual manifestations.'[190]

Social facts, then, are 'the social structures and cultural norms and values that are external to, and coercive of, actors'.[191] Being 'general' in nature, they cannot be equated with the individuals from which they stem.[192] This generality also entails that they should be approached as 'things' whose existence and meaning can be discovered through empirical research.[193] In fact, for Durkheim it is this feature that lends sociology its right of existence as a separate discipline.[194]

183 Challenger (n 49) 191; Ritzer (n 180) 103-104;
184 Challenger (n 49) 148-149, 177.
185 Émile Durkheim, *The Division of Labor in Society* (George Simpson tr, The Free Press 1933) 279.
186 Challenger (n 49) 145-146, 176-177.
187 Challenger (n 49) 145-147, 176.
188 Challenger (n 49) 145-147, 161-162.
189 Challenger (n 49) 145-147, 149, 161-162, 168-169.
190 Émile Durkheim, *The Rules of Sociological Method* (Sarah A Solovay and John H Mueller trs, The Free Press of Glencoe 1962) 13 (without emphasis).
191 Ritzer (n 180) 75.
192 Ritzer (n 180) 75-76.
193 Challenger (n 49) 140-142, 150-152. See also Ritzer (n 180) 75
194 Challenger (n 49) 145-146, 152; Ritzer (n 180) 76.

One of the most elementary social facts in Durkheim's view is 'morality' as it is inherently connected to society itself.[195] Through his ties with others, man becomes subject to a coercive 'force' that 'naturally arises' from them.[196] This supreme force is crucial for achieving 'happiness' as it prevents men from chasing their own interests and preferences without end.[197] And only by being tempered in this way does man have any chance at happiness, for happiness resides 'in the *golden mean*'.[198] Like Aristotle, then, Durkheim argues that man has no possibility to live happily other than through society.[199] And similar to Rousseau, he believes that it is the supreme force that emanates from society which brings this about by having man act in the interest of a higher purpose shared with fellow members, the '*common good*' so to say.[200]

In his work *De la division du travail social* (The Division of Labor in Society) Durkheim aims to show how in times of modernity society does not necessarily lose its morality, and by consequence its cohesion, but rather changes in nature. In the first chapter of his work he resorts to Aristotle's discussion of friendship in order to illustrate the dynamic nature of societal cohesion:

> 'The Greeks had long ago posed this problem. 'Friendship,' says Aristotle, 'causes much discussion. According to some people, it consists in a certain resemblance, and we like those who resemble us: whence the proverbs "birds of a feather flock together" and "like seeks like," and other such phrases ... Heraclitus, again, maintains that 'contrariety is expedient, and that the best agreement arises from things differing, and that all things come into being in the way of the principle of antagonism'.'[201]

This distinction between 'resemblance' and 'divergence', between 'similarity' and 'difference', lies at the basis of Durkheim's distinction between *mechanical* and *organic* solidarity.[202]

Mechanical solidarity is characteristic of rudimentary, basic societies. The cohesion of such societies results from the 'likeness' of its participants.[203] They resemble each other in that they subscribe to a great extent to the same

195 Challenger (n 49) 168 (clarifying that later in his career Durkheim even 'defined the nature of morality….as synonymous with the social'). See also Ritzer (n 180) 78.
196 Challenger (n 49) 184, 187.
197 Challenger (n 49) 165-167, 177, 180-181, 183-184, 187.
198 Durkheim, *The Division of Labor in Society* (n 185) 237.
199 Challenger (n 49) 165-167, 177.
200 Challenger (n 49) 165, 168-169, 184, 187 (emphasis added).
201 Durkheim, *The Division of Labor in Society* (n 185) 54-55.
202 Challenger (n 49) 68-69, 162-163.
203 Durkheim, *The Division of Labor in Society* (n 185) 70 (speaking about 'mechanical solidarity through likeness').

'understandings, norms and beliefs'.[204] Durkheim terms this commonality of norms and beliefs *conscience collective* ('collective conscience') and describes it as follows:

> 'The totality of beliefs and sentiments common to average citizens of the same society forms a determinate system which has its own life; one may call it the *collective* or *common conscience* … it has specific characteristics which make it a distinct reality. It is, in effect, independent of the particular conditions in which individuals are placed; they pass on and it remains…. It is, thus, an entirely different thing from particular consciences, although it can be realized only through them.'[205]

The collective conscience, echoing Rousseau's idea of the general will, thus functions as a moral 'force' that results from individuals, yet is external from them, and which makes them act in support of societal cohesion.[206]

Durkheim argues that over time, as societies grow more 'voluminous and denser',[207] a shift occurs from mechanical to organic solidarity.[208] The latter kind of cohesion does not flow from similarity but, instead, from difference.[209] With the rise of modernity and individualism, societies become more intricate and sophisticated. In particular, the division of labour increases due to specialisation of functions and a rise in demand for a multitude of services.[210] In fact, according to Durkheim it 'varies in direct ratio with the volume and density of societies'.[211] Due to this division of labour the flourishing of society and its members hinges on the latter's interconnectedness and the different tasks they carry out.[212] It is for this reason that Durkheim, in furtherance of Aristotle and Rousseau who had already resorted to the organic metaphor, terms this kind of cohesion organic solidarity. Just like the physical body is dependent on its different organs and vice-versa, so too society in its entirety and the individuals of which it is made up are inherently linked.[213] It is foolish, Durkheim argues, to depict the members of sophisticated societies as secluded individuals as each stands to society as 'an organ or part of an organ having its determined function, but which cannot, without risking dissolution, separate itself from the rest of the organism'.[214]

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204 Ritzer (n 180) 79.
205 Durkheim, *The Division of Labor in Society* (n 185) 79-80.
206 Challenger (n 49) 109, 147, 167.
207 Durkheim, *The Division of Labor in Society* (n 185) 266.
208 Challenger (n 49) 163, 170-171.
209 Ritzer (n 180) 83.
210 Challenger (n 49) 170-173.
211 Durkheim, *The Division of Labor in Society* (n 185) 262 (without emphasis).
212 Challenger (n 49) 163.
213 Challenger (n 49) 129, 162-164, 172, 176, 178, 188-189.
214 Durkheim, *The Division of Labor in Society* (n 185) 280.

Although Durkheim considers that mechanical solidarity never becomes entirely irrelevant, as 'social similitudes' always play a role in society to some extent,[215] the equilibrium between the two kinds of solidarity definitely evolves with the passing of time. Yet, this shift towards organic solidarity does not mean that society ceases to be moral or cohesive.[216] On the contrary, mature, sophisticated societies are moral too:

> '[I]t is wrong to oppose a society which comes from a community of beliefs to one which has a co-operative basis, according only to the first a moral character, and seeing in the later only an economic grouping. In reality, co-operation also has its intrinsic morality.'[217]

Although modern societies are more dense and intricate and characterised by the rising importance of the individual, this does not mean that they merely form enterprises based on self-interest in which each is solely out for profit and ruthlessly pursues what is best for himself.[218] 'Every society is a moral society',[219] Durkheim explains, for 'if interest relates men, it is never for more than some few moments'.[220] In fact, 'There is nothing less constant than interest. Today, it unites me to you; tomorrow, it will make me your enemy. Such a cause can only give rise to transient relations and passing associations'.[221] '[A] contract', Durkheim consequently reasons, is 'not sufficient unto itself, but is possible only thanks to a regulation of the contract which is originally social'.[222]

In the case of organic solidarity, then, the interdependence between those making up society becomes moral itself.[223] 'Men cannot live together without acknowledging, and, consequently, making mutual sacrifices, without tying

215 Durkheim, *The Division of Labor in Society* (n 185) 229. See also Challenger (n 49) 167-168.
216 Challenger (n 49) 163-164.
217 Durkheim, *The Division of Labor in Society* (n 185) 228.
218 Challenger (n 49) 163-164, 175-180.
219 Durkheim, *The Division of Labor in Society* (n 185) 228.
220 Durkheim, *The Division of Labor in Society* (n 185) 203.
221 Durkheim, *The Division of Labor in Society* (n 185) 204.
222 Durkheim, *The Division of Labor in Society* (n 185) 215.
223 As Douglas Challenger explains, in Durkheim's view 'the social situation of interdependency….in highly developed societies included a complementary morality that the individual is not sufficient unto himself'. He also indicates that later in his career Durkheim would change and sharpen his views by arguing that 'the religion of humanity' and 'the cult of the individual' had become 'collective ideals' around which individuals could coalesce: 'the *conscience collective* had taken a new form in advanced societies – it enshrined the sacredness of the person'. See Challenger (n 49) 164, 174-175.

themselves to one another with strong, durable bonds'.[224] In other words, *reciprocity* as such gets bestowed with a moral, normative dimension.[225]

5 Parsons' normative solidarity

What Parsons teaches is that societal progression is not necessarily accompanied by an emergence of organic solidarity and a decline of the mechanical one, as Durkheim argued. Instead, in any society both kinds of solidarity can be present at the same time, each with its own function in light of societal cohesion. This argument is closely connected to Parsons' general theory about society. Without analysing this theory in great detail, one can say that its characteristic feature is that it approaches society as a 'social system' consisting of 'interaction' between individuals.[226] Similar to Durkheim, Parsons argues that due to this interaction the social system becomes a 'reality *sui generis*' which cannot be reduced to the individuals who belong to it, but instead constitutes an entity in its own right.[227]

Typical of the system is that it is built of four 'structural components': 'values', 'norms', 'collectivities' and 'roles'.[228] Values and norms relate to the system's 'normative order'.[229] Of these two, values rank highest as they legitimate and inform specific norms that serve to maintain cohesion.[230] Collectivities and roles serve to organise the individuals making up the system.[231] Society itself forms one great collectivity which in turn consists of many smaller ones that each pursue certain aims (e.g. companies, religious institutions etc.).[232] Within a collectivity individuals occupy positions in the context of which they are bestowed with a 'status' requiring them to perform certain 'roles'.[233] As a result, '*reciprocal* expectations' exist between individuals of how each of them, in line with their role, will act.[234]

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224 Durkheim, *The Division of Labor in Society* (n 185) 228.

225 Alvin W Gouldner, 'The Norm of Reciprocity: A Preliminary Statement' (1960) 25 American Sociological Review 161, 167, 170; Frank Adloff and Steffen Mau, 'Giving Social Ties, Reciprocity in Modern Society' (2006) 47 European Journal of Sociology 93, 103.

226 Talcott Parsons, *The System of Modern Societies* (Prentice-Hall 1971) 7. See also Heine Andersen, 'Functionalism' in Heine Andersen and Lars B Kaspersen (eds), *Classical and Modern Social Theory* (Blackwell Publishers 2000) 222.

227 Parsons, *The System of Modern Societies* (n 226) 7.

228 Talcott Parsons, *Societies: Evolutionary and Comparative Perspectives* (Prentice Hall 1966) 18.

229 Parsons, *Societies: Evolutionary and Comparative Perspectives* (n 228) 18 (without emphasis).

230 Parsons, *Societies: Evolutionary and Comparative Perspectives* (n 228) 11, 16-18; Parsons, *The System of Modern Societies* (n 226) 7-9, 13-15.

231 Parsons, *Societies: Evolutionary and Comparative Perspectives* (n 228) 18.

232 Parsons, *Societies: Evolutionary and Comparative Perspectives* (n 228) 16-18; Parsons, *The System of Modern Societies* (n 226) 7, 10-12. See also Ritzer (n 180) 245.

233 Parsons, *The System of Modern Societies* (n 226) 7. See also Ritzer (n 180) 243.

234 Parsons, *The System of Modern Societies* (n 226) 7 (emphasis added). See also Andersen (n 226) 222.

Now, when it comes to solidarity Parsons builds on Durkheim's thoughts but also argues that he unnecessarily juxtaposed mechanical and organic solidarity.[235] Both kinds, Parsons thinks, coexist in any social system. The key to this coexistence lies in Durkheim's notion of the *conscience collective*, the totality of beliefs and sentiments shared by the members of a society. Durkheim himself connected mechanical solidarity with the common conscience, arguing that it is through the latter that mechanical solidarity is brought about, yet he did not relate it clearly to organic solidarity. Parsons, however, argues that the common conscience consists of the values characteristic of society and that mechanical and organic solidarity serve to 'institutionalise' these values in different segments of the system.[236] Mechanical solidarity relates to governmental organisation and translates a society's values into norms that have to be followed by individuals acting in roles with a functional significance for this organisation.[237] Organic solidarity does the same in relation to a society's economy.[238]

For Parsons, then, solidarity – mechanical and organic – ultimately concerns an individual's obligation, one in furtherance of Durkheim he terms 'moral', to act for the sake of the 'integrity' of the collective.[239] He illustrates its significance by using the dichotomy between 'self'- and 'collectivity-orientation'.[240] When an individual, performing his role in the social system, is confronted with several options, but the choice for either one of them is not perceived as bearing on the integrity of the system, he can be said to be acting in light of self-orientation.[241] Yet, when the system's integrity is seen as being at risk, and there is an obligation to support it, he faces the choice between self- and collectivity-orientation. Parsons explains that:

> 'It is only when an action system involves *solidarity* in this sense that its members define certain actions as required in the interest of the integrity of the system itself, and others as incompatible with that integrity.'[242]

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235 Talcott Parsons, 'Durkheim on Organic Solidarity' in Leon H Mayhew (ed), *Talcott Parsons on Institutions and Social Evolution* (The University of Chicago Press 1982) 208.

236 Parsons, 'Durkheim on Organic Solidarity' (n 235) 206-207. Parsons therefore argues that both kinds of solidarity flow from a more basic kind of solidarity, 'diffuse solidarity', which is present in a society prior to the development of specialized segments relating to areas such as politics and the economy. See Parsons, 'Durkheim on Organic Solidarity' (n 235) 208-209.

237 Parsons, 'Durkheim on Organic Solidarity' (n 235) 206-208.

238 Parsons, 'Durkheim on Organic Solidarity' (n 235) 206-208.

239 Talcott Parsons, *The Social System* (Routledge 1991) 97-98. Note that the next chapter will present an account of solidarity between the member states that also encompasses obligations. They concern political obligations and do not necessarily have a 'moral nature'. See text to n 64 and n 98 (ch 2).

240 Parsons, *The Social System* (n 239) 97. See also Andersen (n 226) 223-224.

241 Parsons, *The Social System* (n 239) 97.

242 Parsons, *The Social System* (n 239) 97.

In these situations the individual *has* to act in the interest of the collective because he is obligated to do so on the basis of his role in it.[243] When he complies with his 'solidarity obligations',[244] he is 'taking *responsibility* as a member of the collectivity'.[245] If not, he disregards it.

6 Conclusion

This chapter has served to explore the concept of solidarity. Even though at first solidarity was a purely legal concept, rooted in the Roman law of obligations, the chapter has primarily examined its conceptual existence outside the law as knowledge thereof is crucial to understand the solidarity that exists between the member states of the Union. And outside the law, the concept of solidarity is much younger. It stems from the French Revolution where it started off as an alternative to fraternity, appealing to the ideal of a cohesive society characterised by freedom and equality. Gradually, it then developed into a multi-faceted concept. Its core, however, is inalienable and consists of three features. First, solidarity mediates between the individual and the group. Second, as a result of this mediation, unity is created. Third, solidarity carries with it positive obligations as it requires individuals to act in support of, and in conformity with, the group.

Beyond this unalienable core, however, solidarity can be best understood by looking at the context in which it features. This chapter has done so by distinguishing between three solidary archetypes: social solidarity, welfare solidarity and oppositional solidarity. It has focused on social solidarity and has shown that even though the concept is relatively modern, it can only be fully understood by acknowledging its roots in the ideas of more ancient thinkers like Aristotle and Rousseau. Indeed, one can discern a fascinating evolution in the thinking about this cohesion, starting with Aristotle's friendship and culminating in Parson's theory of solidarity as a normative obligation. Characteristic of this evolution is the search for a mechanism that ties the individual to the collective, yet without sacrificing the former for the sake of the latter; the search is for a mechanism *mediating* between the collective and the individual.

For Aristotle this mechanism is *philia*, friendship. It is friendship that ties people to one another, and eventually to the *polis*. Moreover, by portraying the city state as an organic entity that arises from, and is held together by, its people performing different functions, Aristotle's friendship becomes a truly mediating mechanism. The city state can only exist through the individuals

243 Parsons, *The Social System* (n 239) 98.
244 Parsons, *The Social System* (n 239) 98.
245 Parsons, *The Social System* (n 239) 99 (emphasis added).

as its constituent parts. But the individual equally needs the city state, not only to live, but also to live well.

What friendship is to Aristotle, the social contract is to Rousseau. By concluding the contract men undertake to respect the general will. This general will, in turn, does not simply aggregate men's distinct wills, but becomes a superior force with its own existence, an entity *sui generis*, which makes man act upon reason by aiming for the common good. Rousseau too then, in his own way, resorts to the organic metaphor to reconcile the individual with the collective. For the general will to exist individuals have to merge their good wills into one whole. At the same time, it is through the general will that the individual can experience freedom. Given that the general will stems from a social contract in which all those making up society participate, a man guided by the general will is in fact guided by his own reason.

Durkheim's dual account of solidarity builds upon the ideas of Aristotle and Rousseau in several ways. His mechanical solidarity is much inspired by Rousseau's idea of the general will. Similar to this will, Durkheim depicts the *conscience collective*, the totality of common societal beliefs and sentiments, as an entity *sui generis* which stems from individuals but also rises above them. The mechanical solidarity that results from the common conscience forms a bridge between the individual and the collective by having man act in support of societal cohesion. Durkheim's organic solidarity, on the other hand, is much influenced by Aristotle's organic account of the *polis* as arising from people who differ in kind. Indeed, it is the interdependence resulting from the division of labour which lies at the basis of societal cohesion.

Parsons completes the exercise by showing how both of Durkheim's mediating mechanisms, mechanical and organic solidarity, can co-exist at the same time in his 'social system'. Solidarity in his view occurs when one is obliged to act for the sake of the integrity of the collective. Mechanical solidarity and organic solidarity each contribute differently to this obligation as they serve to translate common values into norms that have to be followed by individuals in roles in relation to different segments of the social system. Mechanical solidarity performs this function in the area of government and politics, organic solidarity in the economy.

Aristotle, Rousseau, Durkheim and Parsons not only find each other in their search for a mechanism mediating between the individual and the collective. In this search each of them also resorts to two concepts that are closely related to these mechanisms themselves: reciprocity and the common good.

For Aristotle reciprocity belongs to the core of friendship as the latter consists of goodwill between reciprocating parties. He therefore reaches the conclusion that reciprocity preserves cities; that it sustains cohesion. Rousseau even bestows reciprocity with a normative force. Man is bound by the social contract because its commitments are mutual, as a result of which he not only acts for others when he acts upon the general will, but also for himself. Obliga-

tion and interest both accompany the social contract. Similar to Rousseau, Durkheim postulates reciprocity as a social norm. Although he does not say so explicitly, by reasoning that the interdependence created through the division of labour has an intrinsic morality, he lifts the reciprocal interdependence to the level of a social norm. Parsons too, resorts to reciprocity in his system theory. Given their roles in the social system, reciprocal expectations exist between individuals of how each of them, in line with their role, will act. To breach the obligation to act in accordance with one's role, is to violate the reciprocal solidarity underlying the system.

As far as the common good is concerned, Aristotle links it closely to civic friendship. Indeed, it is through the city state based on friendship that people can live a virtuous life and part of such a life is that they support the common good. Rousseau similarly attributes considerable importance to the common good. By 'signing' the social contract man agrees to act upon the general will, and by acting upon the general will man is not following his own inclinations but is supporting the common good. What the social contract achieves in Rousseau's theory, mechanical and organic solidarity achieve in Durkheim's. Both kinds of solidarity tie the individual to society. And for Durkheim society is bound up with morality as it makes us act not for the sake of self-interest but in the interest of a higher end, the common good. Finally, Parsons links the common good to solidarity by placing the latter in light of the dichotomy between self- and collective-orientation. When an actor defines actions as being required in the interest of the integrity of the social system, the common good, he is confronted with a solidary obligation.

Let us now see how this exploration of solidarity may serve to conceptualise the ties between the member states of the Union and thereby enrich our understanding of its legal set-up and the transformation it experienced during the crisis.

2 Solidarity between the member states

1 INTRODUCTION

The ideas of great minds like Durkheim and Parsons are enlightening when it comes to social solidarity and its capacity to generate cohesion and unity. Much of their work, however, focuses on *individuals* within settings that do not exceed the confines of *nation-state societies*.[1] Only on rare instances do they look beyond them. In the *Division of Labor in Society*, for example, Durkheim finds signs of awakening social ties in Europe when he states that:

> '[T]he different nations of Europe are much less independent of another, because, in certain respects, they are all part of the same society, still incoherent, it is true, but becoming more and more self-conscious. What we call the equilibrium of Europe is a beginning of the organization of this society.'[2]

Parsons even dares to leave individuals as the object of inquiry, explicitly focusing instead on solidarity between states, when he writes:

> 'It is also of particular importance to note that these solidarities that exist between formally "sovereign" states do not occur entirely in mutually exclusive groups, but that there are important cross-cutting elements ... .This means that the most significant nearly "ultimate" units do not function simply as "individual" units, or as a "mass", but are involved in a complex network of solidary associations …'[3]

The present research builds upon these thoughts to examine the concept of solidarity in a different context. In line with Durkheim, it shifts its focus from

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▪ This chapter contains and/or builds on previously published work by the author. See especially Vestert Borger, 'How the Debt Crisis Exposes the Development of Solidarity in the Euro Area' (2013) 9 EuConst 7.

1 Nowadays, social theory is still accused of 'methodological nationalism' as it regards nation-state societies as the 'basic units' of inquiry, which makes it difficult to apply its insights and instruments to other entities such as the Union. See Hans-Jörg Trenz, 'Social Theory and European Integration' in Adrian Favell and Virginie Guiraudon (eds), *Sociology of the European Union* (Palgrave Macmillan 2011) 198.

2 Émile Durkheim, *The Division of Labor in Society* (George Simpson tr, The Free Press 1933) 121.

3 Talcott Parsons, *Politics and Social Structure* (The Free Press 1969) 302.

the level of nation-states to that of the Union. And inspired by Parsons, it exchanges the individual as the unit of analysis for the state. In short, it aims to conceptualise solidarity between the member states. This conceptualisation, in turn, allows for an understanding later in this study of why states acted in the interest of the collective during the crisis and how this generated a transformation of the euro.

The chapter will conduct the conceptualisation in three steps. It starts by analysing the nature of political obligation. From times immemorial 'consent' has been an appealing source for such obligations, in particular when given through the conclusion of a contract. Agreements or contracts, this study argues, can indeed lead to political obligations, but not because they are based on consent. Rather, they are one of many instances in which people incur obligations through being *jointly committed* to a particular cause or goal. This chapter discusses how and why such commitments give rise to obligations, including those of a political nature, and shows that they may not only exist between individuals, but also between states.

Attention then shifts to the issue of political obligation and solidarity between states. Parsons' concept of solidarity as a normative obligation will serve as a starting point of analysis. This normative dimension forms a very important element of solidarity, but it does not capture the phenomenon it in its entirety. A thorough account of solidarity needs to recognise that a state's solidary actions may not only result from the political obligation to which it is subject but also from a desire to serve its own interests. This chapter aims to develop such an account by approaching the concept of solidarity on the basis of two spectrums. The first spectrum is the most important one and relates to the reasons for solidary behaviour. Its ends are taken up by *normative* and *factual* solidarity respectively.[4] The second spectrum is subsidiary in nature and relates to the kind of solidary behaviour displayed in the interest of the whole. Its ends are formed by *negative* and *positive* solidarity.[5]

The third part of the chapter deals with the relation between joint commitment and Union law. When the member states signed and ratified the Treaty

4 See also Kurt Bayertz, 'Four Uses of "Solidarity"' in Kurt Bayertz (ed), *Solidarity* (Kluwer 1999) 3: '"Solidarity" is now comprehended as a mutual attachment between individuals, encompassing two levels: a *factual* level of actual common ground between the individuals and a *normative* level of mutual obligations to aid each other, as and when should be necessary'.

5 The distinction between positive and negative solidarity in this study should not be equated with a similar distinction made by Durkheim, *The Division of Labor in Society* (n 2), 115-132 according to whom 'negative solidarity' corresponds to a certain class of legal rules 'linking things to persons, but not persons among themselves' (ie 'real rights', see text at 116-117) as opposed to 'positive solidarity', which can be subdivided in 'mechanical' and 'organic' solidarity. This study is not the first to distinguish between negative and positive solidarity in the context of the Union (legal system). See eg Epaminondas A Marias, 'Solidarity as an Objective of the European Union and the European Community' (1994) 21 LIEI 85, 94.

of Maastricht in 1992-93 they not only created a legal regime for their currency union, they also incurred a political obligation to uphold this very regime through the joint commitment that was established by these acts. What is more, they incurred an obligation to uphold the single currency, and even the Union itself. Treaty conclusion or amendment, however, are only two of many instances in which states can create joint commitments and consequently incur political obligations. Some of these other instances take place within the confines of Union law, such as when the European Council takes decisions by consensus. Others occur outside its boundaries or may even coincide with the establishment of new legal regimes. In each of these cases, however, states may incur political obligations that require them to act in the interest of the collective, yet not necessarily in a way that conforms to Union law.

2 Political obligations in states and between them

2.1 The nature of political obligation

Does one have an obligation to 'obey the law' of the state or, more generally, to 'uphold its political institutions'?[6] It is one of the classics of political philosophy and over time many who have tried to answer it positively have done so by seeking to ground the obligation in 'consent'.[7] People are under an obligation to uphold their institutions, so they reason, because they have consented to their 'authority'.[8] This line of thinking is old and has its roots in the works of great philosophers regarding a 'covenant' or 'contract' as the source of such consent.[9] Hobbes argued in his *Leviathan* that men could get

6 Political obligation encompasses more than just an obligation to 'obey the law'. See on this John Horton, *Political Obligation* (Palgrave Macmillan 2010) 14 who argues that 'although certainly part of the problem of political obligation, this way of formulating the question fails to encompass other aspects of it. Political obligation is not necessarily reducible simply to an obligation to obey the law of the polity of which one is a member. There may be other obligations or responsibilities … which are not enshrined in the law'. Consequently, this study rather speaks of a duty to 'uphold political institutions', an expression used extensively by Margaret Gilbert in *A Theory of Political Obligation: Membership, Commitment, and the Bonds of Society* (Clarendon Press 2006). For a discussion of the fact that political obligation goes beyond a duty to obey the law in the context of the Union see text to n 126 (ch 2).

7 John A Simmons, *Moral Principles and Political Obligations* (Princeton University Press 1979) 57; Gilbert, *Political Obligation* (n 6) 56.

8 Simmons, *Moral Principles and Political Obligations* (n 7) 57: 'The heart of this doctrine is the claim that no man is obligated to support or comply with any political power unless he has personally consented to its authority over him'.

9 Horton (n 6) 21-24 (also pointing out that it can even be traced further back in time to the work of Socrates and Plato). Over time a great variety of contract theories have been proposed, each with their own understandings and implications. For a general overview

out of the brutal state of nature, characterised by a 'war where every man is enemy to every man', through the conclusion of a covenant whereby they dispose of their natural freedom in exchange for a 'sovereign' securing 'their peace and common defence'.[10] Although less dismissive of the state of nature,[11] Locke too saw a contract as being key to political obligation. In *The Second Treatise on Government* he describes how men can 'enter into society to make one people, one body politic' through unanimous consent and can subsequently devise a proper system of government by 'consent of the majority'.[12] And also Rousseau, already referred to in the previous chapter, resorted to a contract in order to conceptualise the act of association through which each undertakes to obey the general will.[13] In his *Du Contrat Social* he argues that any such act precedes the establishment of a government, whose task is to implement the general will.

Consent, or contract, theory goes a long way in explaining the normativity pertaining between the state and its people,[14] but it has been criticised as well. Arguably, the most important and straightforward point of criticism relates to the fact that most people will not have expressly given their consent through the conclusion of such an agreement or by joining an already existing one.[15] Even if one allows for the possibility of 'tacit' consent,[16] the group of consenters will be modest.[17] Proponents may respond that this does not

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see Johann Sommerville, 'The Social Contract (Contract of Government)' in George Klosko (ed), *The History of Political Philosophy* (OUP 2011) 573-585.

10 Thomas Hobbes, *Leviathan* (first published 1651, John CA Gaskin ed, OUP 1998), especially chs 13 and 17.

11 For a comparison between Hobbes' and Locke's different conceptions of the state of nature see A John Simmons, 'Locke's State of Nature' in Christopher W Morris (ed), *The Social Contract Theorists: Critical Essays on Hobbes, Locke, and Rousseau* (Rowman and Littlefield Publishers 1999) 97-115.

12 John Locke, *Two Treatises of Government and A Letter Concerning Toleration* (first published in 1689, John Shapiro ed, YUP 2003), paras 87-133 (*Second Treatise*).

13 See text to n 147 (ch 1).

14 The present discussion does not concern so-called 'hypothetical contracts', that is: contracts that people would have entered into under imaginative, ideal circumstances. For such an account see John Rawls, *A Theory of Justice* (CUP 1999). On the difference between 'actual contract theory' and 'hypothetical contracts' see also Gilbert, *Political Obligation* (n 6) 55, 73.

15 See in this regard Simmons, *Moral Principles and Political Obligations* (n 7) 79 who states that 'The paucity of express consentors is painfully apparent. Most of us have never been faced with a situation where express consent to a government's authority was even appropriate, let alone actually performed such an act'. See also George Klosko, *The Principle of Fairness and Political Obligation* (Rowman & Littlefield Publishers 2004) 145; Horton (n 6) 38; Gilbert, *Political Obligation* (n 6) 71.

16 Gilbert, *Political Obligation* (n 6) 73.

17 As Gilbert, *Political Obligation* (n 6) 73 points out, 'tacit' consent is not the same thing as an 'implicit agreement', which covers situations in which 'there is neither an explicit agreement nor a tacit agreement….strictly speaking'. In such situations, however, real consent is lacking. Simmons, *Moral Principles and Political Obligations* (n 7) 88-93 illustrates this point by reference to actions like the use of public facilities or voting in elections. Such

invalidate the theory. It may simply mean that the number of people subject to political obligation is indeed limited.[18] Yet, such a reasoning sits uncomfortably with the fact that despite not having concluded or joined any agreement, many people consider themselves to be part of a 'political society' and, moreover, subject to political obligation.[19] From the perspective of contract theory the conclusion would have to be that they are mistaken.[20]

Considering this conclusion intuitively unattractive, Margaret Gilbert offers an interesting alternative reading of political obligation that stays close to contract theory but has a larger reach in terms of 'membership'.[21] Central to her reading is the notion of *joint commitment*. People are subject to political obligation not because they are necessarily party to an agreement, but because they participate in a joint commitment obliging them to support the political institutions of their society.

2.2 Joint commitments as emergent phenomena

Understanding the make-up of joint commitments and their obligating nature requires a return to Durkheim's notion of social fact. As shown in the previous chapter, Durkheim used it to describe the social structures that originate from individuals, yet at the same time have an existence of their own and exercise a controlling restraint on them.[22] Most importantly, he argued that social facts are general in nature and not reducible to the individuals from which they stem. This feature of social facts becomes especially apparent in the following passage from his book *Suicide*:

> 'Of course, the elementary qualities of which the social fact consists are present in germ in individual minds. But the social fact emerges from them only when they have been transformed by association since it is only then that it appears. Association itself is also an active factor productive of special effects. In itself it is therefore something new.'[23]

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actions, he argues, will normally not qualify as the giving of one's consent. The reason lies in the fact that they may be regarded as 'implying consent', which means that they are indicative of consent had the person in question been requested to give this, but not as actual 'signs of consent'. Only such a sign of consent constitutes a genuine 'expression of the actor's intention to consent'. See also Horton (n 6) 36-38.

18 Gilbert, *Political Obligation* (n 6) 71.

19 Gilbert, *Political Obligation* (n 6) 72.

20 Gilbert, *Political Obligation* (n 6) 74.

21 Gilbert, *Political Obligation* (n 6) 73, 183-286.

22 See text to n 184 (ch 1).

23 Émile Durkheim, *Suicide: A Study in Sociology* (John A Spaulding and George Simpson trs, The Free Press 1966) 310.

The above passage raises an important question when studied carefully. How, if at all, is it possible for a social fact to be grounded in, and stem from, individuals, yet at the same time form a new, '*sui generis*' entity?[24] Moreover, how can such a social fact generate effects which the individuals from which it originates cannot?[25] These questions are hotly debated in social philosophy and the present study does not intend to provide a definite answer. Instead, it draws on one particular theory, that of *relational emergence*, and uses it in the context of joint commitments.

A thorough account of this theory is given by Dave Elder-Vass.[26] He explains how it centres around the idea that 'wholes' can have certain particular qualities, called 'emergent properties', that do not belong to the 'parts' of which they are built.[27] Parts as well as wholes constitute 'entities'.[28] Any entity is made up of parts brought together in a 'structured combination', as a result of which its nature exceeds that of an ordinary 'aggregation'.[29] Moreover, an entity has the 'quality of persistence', which means that it has the ability to exist for more than just a brief moment.[30] Given these characteristics, Elder-Vass describes an entity as 'a persistent whole formed from a set of parts that is structured by the relations between these parts'.[31] Basic examples of entities are molecules or cells, yet they can also be much more complex and difficult to apprehend.[32] Indeed, as this study will argue below, groups of people can be entities too. This already shows that 'wholes' and 'parts' are relative notions as the same entities can serve as wholes as well as parts depending on the setting and level of examination.[33] Cells, for example, are built of molecules, whereas molecules themselves are made up of atoms.

A 'property' is the capacity of an entity to bring about causal effects.[34] It is 'emergent', Elder-Vass explains, when it belongs to the whole and not to the parts of which this whole is built.[35] Only because the parts are related, or 'structured', in a certain way does the whole have this capacity.[36] The obvious example of an emergent property is water.[37] Hydrogen and oxygen form the parts of water. Yet, their individual properties do not suffice to bring

24 R Keith Sawyer, *Social Emergence: Societies As Complex Systems* (CUP 2005) 103-105.
25 Sawyer (n 24) 103-105.
26 Elder-Vass, *The Causal Power of Social Structures: Emergence, Structure and Agency* (CUP 2010).
27 Elder-Vass (n 26) 16-17.
28 Elder-Vass (n 26) 16.
29 Elder-Vass (n 26) 16-17, 21.
30 Elder-Vass (n 26) 16-17, 23.
31 Elder-Vass (n 26) 17.
32 Elder-Vass (n 26) 16.
33 Elder-Vass (n 26) 17, 19.
34 Elder-Vass (n 26) 17, 40-63 (containing a detailed analysis of 'causal power' in this context).
35 Elder-Vass (n 26) 17.
36 Elder-Vass (n 26) 20-21.
37 Elder-Vass (n 26) 17.

about the specific qualities possessed by water. They will not allow you to wet your hair, irrigate land or extinguish a fire.[38]

It is important to stress the implications of the emergent property thesis. The fact that an entity has an emergent property, Elder-Vass reasons, does not mean that one cannot *explain* it by reference to its constitutive parts.[39] In relation to water, for example, one can describe the properties of oxygen and hydrogen atoms and show how they form water when they exist together in a certain combination. However, the fact that one can explain an entity in terms of its parts does not mean that one can do away with its original causal power. Hydrogen and oxygen atoms brought together in such a composition 'just *is* water'.[40] Elder-Vass explains it very clearly:

> '[I]f we explain a causal power in terms of (a) the parts of an entity *H*; plus (b) the relations between those parts that pertain only when they are organized into the form of an *H*; then because we have explained the power in terms of a combination – the parts and relations – that exists only when an *H* exists, we have not eliminated *H* from our explanation. The entities that are *H*'s parts would not have this causal power if they were not organized into an *H*, hence it is a causal power of *H* and not of the parts.'[41]

If the properties of an entity can only be understood by reference to its constitutive parts and their relations, one implicitly makes this superior entity part of the examination.[42]

Now, Gilbert argues that joint commitments are emergent phenomena and shows that by discussing the everyday activity of 'walking together'.[43] Imagine that two persons, say Stefaan and Jorrit, are walking through the city of Leiden towards the law faculty. They are both aware of the fact that they are walking together and they also realise that each of them has this awareness. In other words: this is 'common knowledge between them'.[44] Stefaan, however, walks much quicker than Jorrit, up to the point that the latter can no longer keep pace with his colleague. At a certain moment Jorrit may therefore urge him: 'Take it easy Stefaan, I'm having difficulty keeping up!' Realising

38 Or to put it in the words of Kevin Mihata (also referred to by Elder-Vass (n 26) at p 17): '[O]ne cannot quench thirst or put out a fire with oxygen and hydrogen'. See Kevin Mihata, 'The Persistence of "Emergence"' in Raymond A Eve, Sara Horsfall and Mary E Lee (eds), *Chaos, Complexity, and Sociology: Myths, Models, and Theories* (SAGE Publications 1997) 31.

39 Elder-Vass (n 26) 23-26, 53-58 .

40 Elder-Vass (n 26) 57.

41 Elder-Vass (n 26) 24.

42 Elder-Vass (n 26) 24, 26, 57 (calling this 'the redescription principle').

43 See Gilbert, *Political Obligation* (n 6) 101-116. The present discussion of walking together is based on that of Gilbert.

44 Gilbert, *Political Obligation* (n 6) 103, 121 (containing detailed analysis of 'common knowledge').

that Jorrit is in a position to criticise him for going too quick, Stefaan slows down, stands still for a moment, and then starts walking next to him.

In another scenario Stefaan and Jorrit are walking together just fine until all of a sudden Stefaan decides that he no longer wants to go to the law faculty and, without giving any further explanation, turns round and starts walking in a different direction. Surprised that Stefaan has unexpectedly withdrawn from their walk Jorrit may object: 'What are you doing? We're going to the law faculty!' Things could be very different if prior to discontinuing their walk Stefaan says to Jorrit: 'I'm terribly sorry, but I just realised that I have to pick up my sons from school in 15 minutes'. One can picture Jorrit replying: 'What are you waiting for, hurry up!'

These simple examples of walking together show, according to Gilbert, how being engaged in a 'joint activity' gives rise to several special phenomena.[45] First, those engaged in a joint activity are entitled, or rather have the 'standing', to require that one acts in ways conducive to the joint activity and to issue 'rebukes' if such acts remain undone.[46] If Stefaan draws ahead of Jorrit during their walk, the latter can therefore require the former to adjust his pace and criticise him for not doing so. Second, the fact that he has this standing also shows that the parties to a joint activity have 'rights' and 'correlative obligations' towards each other.[47] Thus, Stefaan is under an obligation to lower his pace when he draws ahead of Jorrit so as to return to walking next to him. Third, those performing a joint activity cannot 'unilaterally' set or change the terms of the activity or stop taking part in it.[48] If Stefaan out of the blue stops walking towards the law faculty, instead going somewhere else, Jorrit may therefore rightly feel taken aback and consider he is acting 'out of line'.[49] On the other hand, if Jorrit concurs with Stefaan about his departure he will probably not have this feeling as it has received their joint approval.

What 'grounds' these standings, rights and obligations associated with joint activities?[50] An agreement? That is possible, even sufficient, but not indispensable according to Gilbert.[51] Indeed, Stefaan and Jorrit may have started walking together without having agreed on this. Perhaps Stefaan bumped into Jorrit on the street, telling him that he was going to the law faculty. Jorrit says: 'What a great initiative to go there! Give me a second to tie my shoes'. 'No problem',

45 Gilbert, *Political Obligation* (n 6) 103-105.
46 Gilbert, *Political Obligation* (n 6) 104.
47 Gilbert, *Political Obligation* (n 6) 105-106 (calling this 'the obligation criterion').
48 Gilbert, *Political Obligation* (n 6) 106-115 (calling this 'the concurrence criterion').
49 Gilbert, *Political Obligation* (n 6) 107.
50 Gilbert, *Political Obligation* (n 6) 44 (talking about the 'grounding criterion' of political obligation)
51 Gilbert, *Political Obligation* (n 6) 116-121. The following illustration is again based on that of Gilbert.

Stefaan responds. The shoes tied, Stefaan and Jorrit subsequently proceed to the law faculty. What is essential, therefore, is not so much the presence of an agreement, but 'mutual expressions of readiness to engage in a joint activity' which, moreover, are 'common knowledge' to each of the participants.[52]

Through such expressions of readiness, Gilbert argues, the participants create a 'joint commitment of the will'.[53] This means, generally speaking, that 'the parties jointly commit to do X *as a body*'.[54] A joint commitment is therefore an emergent phenomenon as a result of which, as explained above,[55] it cannot be equated with the distinct aims and intentions of the individual parties.[56] It belongs to them as a 'single body', or 'plural subject'.[57] It is due to these joint commitments that the parties have rights and obligations connected to the implementation of the activity.

2.3 Commitment and political obligation

Participating in a joint commitment may give rise to obligations, but what does having an obligation actually mean? Answering that question requires consideration of the notions of *reason* and *normativity*. Acting intentionally, Joseph Raz explains, means that one is acting 'for a reason'.[58] Reasons, in turn, are 'facts in virtue of which those actions are good in some respect and to some degree'.[59] This makes them 'inherently normative' to the extent that one is acting rationally when one has the capacity to grasp the existence and importance of reasons and act as they require.[60]

An obligation, Gilbert argues, gives one '*sufficient* reason to act'.[61] This means that, not taking into account any other relevant considerations, rational-

52 Gilbert, *Political Obligation* (n 6) 121.

53 Gilbert, *Political Obligation* (n 6) 122-147. Besides Gilbert several other scholars have introduced theories about joint commitment and collective intentionality. See eg John R Searle, *Making the Social World: The Structure of Human Civilization* (OUP 2010); Raimo Tuomela, *Social Ontology, Collective Intentionality and Group Agents* (OUP 2013); Michael E Bratman, 'Shared intention' (1993) 104 Ethics 97.

54 Gilbert, *Political Obligation* (n 6) 136-137.

55 See also Elder-Vass (n 26) 123 (fn 8).

56 Gilbert, *Political Obligation* (n 6) 136-138, 157.

57 Gilbert, *Political Obligation* (n 6) 137, 144-146. Gilberts here also explains that the use of the first person plural pronoun is often indicative of the existence of such subjects. In other words, if someone speaks in terms of 'we agree…', 'we intend….', or 'we value…' chances are that a joint commitment is present.

58 Joseph Raz, *Engaging Reason: On the Theory of Value and Action* (OUP 1999) 22-23.

59 Raz, *Engaging Reason* (n 58) 23.

60 Raz, *Engaging Reason* (n 58) 68.

61 Gilbert, *Political Obligation* (n 6) 27-30. Gilbert prefers to speak of 'having reason to act' instead of 'having *a* reason to act' as she considers the latter formulation to focus too much on the nature of the act that needs to be performed, whereas a decision or obligation to perform the act may in itself give one (sufficient) reason to carry it out.

ity demands that one acts in the way prescribed by one's obligation. In principle, therefore, it takes precedence over one's 'personal inclinations' or 'self-interest'.[62] One may be obligated to act in a certain way even though it conflicts with one's well-being or prosperity. Having an obligation, however, does not necessarily constitute an 'absolutely conclusive reason' to act.[63] In other words, the situation may be such that rationality demands one not to act in line with one's obligation even though it gives one sufficient reason to act. Those who are jointly committed to commit a terrorist attack, for example, have sufficient reason to carry out this attack, yet moral considerations make it rational not to act on it.[64]

Not every sufficient reason, however, constitutes an obligation. What, then, defines an obligation? Following HLA Hart,[65] Gilbert emphasises that one of its characteristics is that it only exists between particular persons. More specifically, one '*owes*' an obligation to certain persons who have a 'correlative right'.[66] This provides the key to understanding why and how joint commitments give rise to obligations. Once a joint commitment is formed one can say that the parties together, as a plural subject, 'own' the acts in line with the joint commitment of each party individually, whereas each 'owes' the collective these acts until they are displayed.[67] Such 'obligations of joint commitment' give each sufficient reason to carry out the required act, in principle 'trumping' their own inclinations or self-interest.[68] They also ground the standing of each party, as a member of the plural subject, to require compliance of others and rebuke them if they fail to deliver.[69]

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62 Gilbert, *Political Obligation* (n 6) 32-33. See also Simmons, *Moral Principles and Political Obligations* (n 7) 7; Horton (n 6) 12.

63 Gilbert, *Political Obligation* (n 6) 31-32. Joseph Raz defines an 'absolute' reason such that one has an absolute reason to perform a certain act when there is no 'fact which would override it'. See Joseph Raz, *Practical Reason and Norms* (Hutchinson of London 1975) 27-28.

64 To put it in the words of Simmons, *Moral Principles and Political Obligations* (n 7) 7: '[T]o say that an obligation (or duty) is a requirement is not to say, as it might at first seem, that the existence of an obligation establishes an absolute moral claim on our action, or that obligations override all other sorts of moral considerations'. Gilbert, *Political Obligation* (n 6) 159-161 is even more specific by arguing that, contrary to obligations resulting from a joint commitment, 'moral requirements' are 'context sensitive'. This means that a moral requirement may 'disappear' if the circumstances change since a different moral requirement with another substance may take precedence. As a result, moral requirements cannot 'directly conflict'. Gilbert's conception of political obligations as not being moral in nature has been criticized. See eg Horton (n 6) 155-156.

65 See HLA Hart, 'Are There Any Natural Rights?' (1955) 64 The Philosophical Review 175, 179 (fn 7). It should be noted, however, that Hart identifies two other characteristics of obligations – that they 'may be incurred voluntarily' and 'that they do not arise out of the character of the actions that are obligatory but out of the relationship of the parties' – which are left out of the equation here.

66 Gilbert, *Political Obligation* (n 6) 39-40.

67 Gilbert, *Political Obligation* (n 6) 154-155.

68 Gilbert, *Political Obligation* (n 6) 156-158.

69 Gilbert, *Political Obligation* (n 6) 161.

The concept of joint commitment not only sheds light on everyday activities like walking together, Gilbert argues, but also on much more complex phenomena involving large groups of people characterised by considerable 'anonymity' and 'impersonality', including political obligation.[70] Those belonging to a 'political society' are under an obligation to uphold its institutions if, and to the extent that, they are jointly committed to do so.[71] More specifically, they owe each other observance of the commitment and enjoy corresponding rights. Such a commitment may stem from an agreement, but in large political societies it is unlikely that most members will have concluded or joined one. What suffices, however, is the existence of 'population common knowledge', which means that (most of) those making up a population have indicated to the others their willingness to engage in a joint commitment comprising (most of) the population.[72]

It is important to emphasise what such political obligation specifically amounts to. It is possible to be politically obligated to obey,[73] say, a law setting the minimum age for the consumption of alcohol without participating in a joint commitment to uphold that particular law. One only needs to be jointly committed to support a state's political or constitutional system.[74] The obligation to abide by the laws or other demands produced by the system derives from this more fundamental or 'basic' joint commitment.[75] One could say the latter forms the social contract that turns people, to use Rousseau's words, from a simple 'aggregation' into an 'association'.[76]

Gilbert considers it very conceivable that states form political societies held together by a joint commitment between their subjects to uphold their institutions, although she points out that when exactly such 'large-scale plural subjects' are present is an empirical issue.[77] Others, drawing on her work,

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70 Gilbert, *Political Obligation* (n 6) 173ff. Some disagree with the view that large groups of people can constitute plural subjects held together by a joint commitment, or consider it highly unlikely that such conditions can be met in practice. See eg A John Simmons, 'Associative Obligations' (1996) 106 Ethics 247, 258-259; Horton (n 6) 155; Abner S Greene, *Against Obligation: The Multiple Sources of Authority in a Liberal Democracy* (HUP 2012) 88-90.

71 Gilbert, *Political Obligation* (n 6) 185-214, 238-260.

72 Gilbert, *Political Obligation* (n 6) 174-179 (containing an analysis of 'population common knowledge').

73 On the difference between 'being obliged' and 'being obligated' and the fact that only the latter indicates the existence of an obligation proper see HLA Hart, *The Concept of Law* (3rd edn, OUP 2012) 82ff. See also Gilbert, *Political Obligation* (n 6) 30-31.

74 Gilbert, *Political Obligation* (n 6) 140-141, 212-214.

75 Gilbert, *Political Obligation* (n 6) 141.

76 Gilbert, *Political Obligation* (n 6) 15. On Rousseau and his vision of the social contract as an 'act of association' see text to n 147 (ch 1).

77 Gilbert, *Political Obligation* (n 6) 180, 242-245, 293-294. Indicative of such plural subjects, Gilbert argues, is the use of the pronoun 'we' in relation to internal affairs and international relations and related sentences such as 'our government', 'our constitution' etc. See also n 57 (ch 2).

leave out this disclaimer and simply argue that states can be seen as social groups with intentions that may differ from those of the people of which they are composed.[78] The present study adopts the presumption that the member states of the Union are indeed political societies held together by joint commitments,[79] leaving the empirical verification of this claim to others. Its purpose is to construe a *plausible* account of solidarity between these states. It neither pretends that it is the only account possible, nor that it is immune from refutation. Yet, it does claim such an account is helpful to understand the transformation of the currency union's setup during the crisis and its implications for Union law.

Crucially, the moment one regards states as political societies based on joint commitments it becomes clear that political obligations may not only exist *within*, but also *between* them. Gilbert puts it as follows:

> 'Once authorities have been designated in several associations, it is possible that the authorities from the different associations make an agreement or treaty on behalf of their associations. In so agreeing they may be said to create a further social group – one of a special kind. This is a group whose constituents are groups. According to my interpretation of agreements, the constitutive groups have together jointly committed themselves to endorse as a body the decision expressed in the agreement.'[80]

In other words, states may be jointly committed to uphold as a body certain goals and, consequently, be subject to political obligations. Take the Treaty on the European Stability Mechanism, which will be discussed in detail in chapter 5.[81] When the states of the currency union signed this Treaty on 2 February 2012 and subsequently ratified it, they formed or rather confirmed the existence of a special plural subject, one consisting of the states in the euro area. In so doing, they jointly committed themselves to uphold the ESM Treaty. In virtue of this joint commitment, then, each state is not only *legally* but also

78 See eg Alexander Wendt, 'The State as Person in International Theory'(2004) 30 Review of International Studies 289; John M Parrish, 'Collective Responsibility and the State', (2009) 1 International Theory 119, 133-134 (in particular fn 35).

79 By taking the view that states can be seen as plural subjects this research does not follow the view of those who deny the reality of such collectives. Such a view shines through, for example, in the work of Karl Popper according to whom 'the "behaviour" and the "actions" of collectives, such as states or social groups, must be reduced to the behaviour and to the actions of human individuals'. See Karl R Popper, *The Open Society and Its Enemies – Volume II The High Tide of Prophecy: Hegel, Marx and the Aftermath* (Princeton University Press 1971) 91. See on this point also Geoffrey M Hodgson, 'Meanings of methodological individualism' (2007) 14 Journal of Economic Methodology 211, 215-216. See also text to n 122 (prologue).

80 Margaret Gilbert, *Joint Commitment: How We Make the Social World* (OUP 2014) 352.

81 See text to n 308 (ch 5).

politically bound to respect the Treaty and enjoys a corresponding right to demand this of others as well.

Finally, a word of caution. In arguing that states can be seen as associations of people held together by joint commitments this research does not pronounce itself on their legal character, nor on that of the people. In the realm of law these notions have a meaning of their own, which may differ from the one given here.[82] Nonetheless, and as this chapter will show in greater detail below,[83] the argument has great relevance for the law, not least as it shows that states are capable of incurring a political obligation to respect it.

3 The solidary cohesion between the member states

3.1 Time, commitment and solidarity

Having explained the character and nature of political obligation between states, this study now turns to the solidary cohesion that exists between them. The previous chapter described how the concept of social solidarity has evolved over time, starting with Aristotle's account of friendship and ending with Parson's normative solidarity. According to Parsons, solidarity only comes into play in situations where one is normatively obliged to act for the sake of the integrity of the collective, the common good.[84] Faced with the choice of acting in line with either one's own or collective orientation, one shows solidarity, and thereby takes responsibility, to the extent that one acts in line with what the integrity of the collective requires. This normative dimension undeniably forms an important component of solidarity, yet does not capture solidarity in its entirety.

82 For an account of the diversity of meanings attributed to the notion of 'people' and a discussion of its legal significance see WT Eijsbouts, 'Wir Sind Das Volk: Notes About the Notion of 'The People' as Occasioned by the *Lissabon-Urteil*'(2010) 6 EuConst 199, 207ff. The fact that the legal notion of the people has a meaning of its own does not mean it cannot coincide with the plural subject one presented above. Margaret Gilbert herself states in this regard: 'That does not mean that the plural subject notion has no relevance to the situation of most of those who are citizens, legally speaking, of a given nation-state. Given that the concept of joint commitment is a fundamental element in the thought of human beings ... a large multitude *approximating* the citizenship of a nation-state may come to constitute a genuine plural subject'. See Margaret Gilbert, 'A Theory of Political Obligation: Responses to Jeske, Horton, Stoutland and Narveson (Review Symposium)' (2013) 4 Jurisprudence 301, 306.

83 See text to n 126 (ch 2).

84 See text to n 239 (ch 1).

To understand why it does not, one has to take into account the importance of '*time*'.[85] Marx once famously stated that 'men make their own history, but they do not make it just as they please in circumstances chosen by themselves; rather they make it in present circumstances, given and inherited'.[86] He thereby made two things clear. First, the social environment is 'prior' to the individual.[87] Individuals do not 'create' their social environment, it 'pre-exists' them.[88] One is not born in a social vacuum. On the contrary, we enter a world that is already there and influences our being to a great extent.[89] Nevertheless, and this leads to the second point, individuals do possess the capacity to *influence* their social environment, to 'make their own history' as it were.[90] Through their actions they can 'reproduce' or 'transform' their environment.[91]

Marx's statement relates to the social environment in its entirety, yet it is equally significant for specific parts of it, such as joint commitments. A sole focus on the normative dimension to solidarity, in the form of acts in line with such commitments, would leave out the significance of their participants. Solidary behaviour, whether displayed by individuals or larger groups of them such as states, would amount to little more than that of a puppet acting in accordance with the normative strings of the collective.[92] Yet, whereas joint commitments '*contribute*' to the actions of their participants, they do not '*determine*' them.[93] In other words, it is possible that a state acts on its political obligations flowing from joint commitments, thereby upholding this part of social structure, but one cannot take it for granted. A state may take the initiative to change the substance of a commitment or to 'terminate' it altogether, even though the actual realisation of such a change or termination

85 Margaret S Archer, *Realist Social Theory: The Morphogenetic Approach* (CUP1995) 154-161 (emphasis added). See also Roy Bhaskar, *The Possibility of Naturalism: A Philosophical Critique of the Contemporary Human Sciences* (Routledge 2000) 37.

86 Karl Marx, 'The Eighteenth Brumaire of Louis Bonaparte (Terrell Carver tr)' in Mark Cowling and James Martin (eds), *Marx's Eighteenth Brumaire: (Post)modern interpretations* (Pluto Press 2002) 19. See also Elder-Vass (n 26) 3.

87 Bhaskar (n 85) 33-34. See also Archer (n 85) 137-140.

88 Bhaskar (n 85) 33-34. To put it in Bhaskar's own words (at p 36): '[P]eople do not create society. For it always pre-exists them and is a necessary condition for their activity. Rather, society must be regarded as an ensemble of structures, practices and conventions which individuals reproduce or transform, but which would not exist unless they did so'.

89 Bhaskar (n 85) 33; Archer (n 85) 139.

90 Elder-Vass (n 26) 3.

91 Bhaskar (n 85) 33-34. See also Archer (n 85) 140.

92 Parsons has indeed been criticised for portraying actors as 'cultural dopes', following norms in a servile way. See eg Jeffrey C Alexander, 'The Centrality of the Classics' in Anthony Giddens and Jonathan H Turner, *Social Theory Today* (Polity Press 1987) 42.

93 Elder-Vass (n 26) 123-126, 134-138. See more generally on 'structure' and 'agency' Bhashkar (n 85) 35-36. Archer (n 85) 153-154 argues in this regard that 'the structural conditioning of action (by constraints or enablements) is *never* a matter of "hydraulic pressures"'. 'The conditional effects of structure upon action', she continues, should rather be conceptualized 'in terms of supplying reasons for different courses of action to those who are differently positioned'.

is subject to the approval of the other parties.[94] It can also decide to disregard a commitment and thereby disobey the obligation to which it is subject.[95]

Reversely, states may also support cohesion for reasons other than those relating to political obligation. What is more, they may do so because it serves their own interest. Parsons admits himself that actors can act in the interest of the collective without experiencing the normative constraints imposed on them. Given that in such cases the actor does not face the dilemma between self and collective orientation due to the fact that his own interest corresponds to that of the collective, the solidary obligations would be 'latent'.[96] Yet, this does not take away the fact that in such cases the actor still supports cohesion. In fact, and as chapter 5 will show, solidary behaviour may very well be inspired by a blend of normative and self-interested considerations. The dilemma of choosing between one's own or collective orientation, and thus of whether or not to show solidarity and take responsibility, may indeed occur but certainly not in each and every situation.

A thorough account of solidarity, therefore, needs to take into account the normative structure within which states operate, as well as a state's own capacity to decide on and shape its actions. Solidary behaviour may result from both.

3.2 The strands of solidarity

A thorough account of solidarity needs to recognise that solidary behaviour can be inspired by motives or reasons other than those relating to joint commitments in which states participate. More specifically, it needs to recognise that cohesive action can also be motivated by reasons of self-interest. This can be realized through a model consisting of two spectrums.[97] The cardinal spectrum deals with the different reasons for solidary action. In the realization that solidary behaviour may not only have normative roots, the two poles of the first spectrum are taken up by *normative* and *factual* solidarity. The second spectrum is subsidiary in nature and deals with the kind of solidary behaviour displayed by states. Here, the two poles constitute *negative* and *positive* solidarity. Each of the two spectrums will be discussed in turn.

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94 Gilbert, *Political Obligation* (n 6) 135, 138-144 (stressing the impossibility to 'unilaterally' make or 'terminate' a joint commitment). See also text to n 48 (ch 2).

95 Gilbert, *Political Obligation* (n 6) 143 (explaining that such disobedience in principle 'will not cancel the commitment').

96 Talcott Parsons, *The Social System* (Routledge 1991) 99.

97 The account of solidarity discussed here was already presented in rudimentary form in Vestert Borger, 'How the Debt Crisis Exposes the Development of Solidarity in the Euro Area' (2013) 9 EuConst 7. The present account, however, is modified at several points compared to the previous one.

As far as the first spectrum is concerned, at one end lies *normative* solidarity. This kind of solidarity stems from the social structure in which states operate,[98] more specifically their joint commitments. As explained above,[99] states taking part in a joint commitment are subject to a political obligation to act in a way conducive to the commitment's goal or, one could say, the *common good*. Given that all of them have these obligations, and are therefore *reciprocally* bound, each has a right to compliance by others as well. The commitment thereby gives them the standing to demand such actions of each other and issue rebukes if these remain undone.

When a state acts in line with the political obligations that exist in the group, it takes, to borrow Parson's words,[100] responsibility for the group. Solidarity and responsibility are therefore not each other's opposites, as one may think when reading Chancellor Merkel's statement at the beginning of this study.[101] There, she argues that financially distressed member states have to take responsibility for themselves (*Eigenverantwortung*) by implementing austerity measures and reforms, which should be met by other states with solidarity in the form of assistance. Both groups of states, however, take responsibility for the collective to the extent they are acting on their political obligations. Each therefore shows solidarity, be it of a different kind. Distressed states show solidarity by reforming their economies and budgets, whereas the others display it by granting assistance. That in doing so they all take responsibility for the group has also been recognised by Merkel herself as she has stated on several occasions that all members of the currency union have a shared responsibility (*gemeinsame Verantwortung*) for the euro.[102] In fact, as chapter 5 will show, all national political leaders recognised this shared responsibility at an early stage of the crisis.[103]

Obviously, normative solidarity is not limited to *European* states. Indeed, any group of states may enter into joint commitments amongst themselves. This also follows from Parsons' statement, cited at the beginning of this chapter,[104] about solidary associations between states. Characteristic of such associations, he argues, is that they constitute 'communities of interest' which are

98 See in this respect also Jürgen Habermas, *The Lure of Technocracy* (Polity Press 2015) 23: 'What differentiates….appeals to solidarity from law and morality is the peculiar reference to a "joint involvement" in a network of social relations. That involvement grounds both another person's demanding expectations, which may even go beyond what law and morality command, and one's own confidence that the other will behave reciprocally in the future if need be' (footnote omitted).

99 See text to n 70 (ch 2).

100 See text to n 243 (ch 1).

101 See text to n 1 (prologue).

102 See eg Regierungserklärung von Kanzlerin Merkel zum Europäischen Rat und zum Eurogipfel, Berlin, 26 October 2011; Pressekonferenz von Bundeskanzlerin Merkel zum ausserordentlichen Treffen der Staats- und Regierungschefs der Eurozone, Brussels, 7 July 2015.

103 See text to n 51 (ch 5).

104 See text to n 3 (ch 2).

embedded in some degree of 'normative order' capable of cohesion beyond the use of 'sheer power'.[105] Parsons observed such associations among all kinds of states, not necessarily European ones.[106] Yet, the joint commitments that exist between the member states of the Union are of such scope and depth that the influence they exercise on them is much more significant than that of most other commitments between states.

As explained above, however, states are not completely controlled by their joint commitments. Although these condition their acts, they do not determine them given that states have the capacity to reflect on an obligation, weigh it against other norms and interests, and decide on how to act. In recognition of this capacity, the other end of the spectrum is formed by *factual* solidarity. It reflects the fact that behaviour in support of the collective may not only result from the normative structure within which member states operate, but also from a desire to safeguard own interests.

The account of solidarity given here, therefore, is less dismissive of self-interest than Durkheim's. As the previous chapter showed,[107] Durkheim considered self-interest to be a fragile, unworkable basis for solidarity due to its inability to unite actors on a durable basis. The present account takes a different stance, one that is closer to Aristotle's reading of political friendship. It should be recalled that Aristotle argued that political friendship is based, at least initially, on advantage. A special kind of advantage, however, that is common in nature and of which all citizens benefit by participating in the *polis*.[108] By incorporating factual solidarity, the present account similarly argues that a member state's support of cohesion can also result from a desire to serve its self-interest.[109] A variety of situations may occur in which a state's self-interest is bound up with that of the collective. This variety is of such magnitude that it cannot be fully grasped by theoretical models on an *a priori* basis. Two situations, however, should be singled out as they are particularly telling of this kind of solidarity between states: *interdependence* and *common destiny*.

The idea that interdependence between states, especially in the context of the European Union, can lead to solidary behaviour is not new. On the

105 Parsons, *Politics and Social Structure* (n 3) 301-302.

106 Parsons, *Politics and Social Structure* (n 3) 301 (mentioning NATO, which of course includes, but is not limited to, European states).

107 See text to n 218 (ch 1).

108 See text to n 95 (ch 1).

109 Habermas (n 98) 23 argues in this regard: '[A]ppeals to solidarity refer to an interest in the integrity of a shared form of life *that includes one's own well-being*' (emphasis added, footnote omitted). Bayertz (n 4) 18 also reasons that 'in many solidary performances there are overtones of an expectation of potential mutuality and the hope of simultaneously serving one's own interests'. See also Esin Kücük, 'Solidarity in EU Law: An Elusive Political Statement or a Legal Principle with Substance' (2016) 23 MJ 965, 967.

contrary, it can be traced back to one of Europe's founding fathers, Robert Schuman. When he announced his plan to pool the production of coal and steel of France and Germany through the creation of the European Coal and Steel Community on 9 May 1950, he famously declared:

> 'Europe will not be made all at once, or according to a single plan. It will be built through concrete achievements which first create a *de facto* solidarity.' (*L'Europe ne se fera pas d'un coup, ni dans un construction d'ensemble: elle se fera par des réalisations concrètes créant d'abord une solidarité de fait*).[110]

This statement of Schuman indicates that factual solidarity, based on the actual interdependence of member states, forms an important basis for cohesion.[111] Indeed, pooling the production of coal and steel made a Franco-German war much more difficult, even though Schuman himself realised such interdependence would eventually not suffice to sustain cohesion.[112]

The importance of actual interdependence for bringing about cohesion has not stayed confined to the Schuman Declaration, but has come to feature prominently in several theories of European integration which have clarified its meaning and content. One such theory is the *liberal intergovernmentalism* of Andrew Moravcsik.[113] He identifies economic interdependence as one of the main drivers for policy coordination among member states.[114] When the attainment of a member state's policy aims is conditional on the actions of other states, 'policy externalities' may develop, which means that the policies of one member state lead to 'costs and benefits' for actors situated outside its own borders.[115] Especially in situations where such externalities are 'negative' and the policies of one member state have a disadvantageous impact on the realisation of policy aims of one or more other states, coordination becomes urgent.[116]

In the case of common destiny, solidary behaviour results from the fact that a state's 'survival' or 'welfare' is tied up with that of the collective.[117]

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110 Schuman Declaration, Paris, 9 May 1950.

111 See also WT Eijsbouts and D Nederlof, 'Rethinking Solidarity in the EU, From Fact to Social Contract' (2011) 7 EuConst 169, 170.

112 Eijsbouts and Nederlof (n 111) 170.

113 Andrew Moravcsik, 'Preferences and Power in the European Community: A Liberal Intergovernmentalist Approach'(1993) 31 JCMS 473.

114 Moravcsik (n 113) 485-486.

115 Moravcsik (n 113) 485. See also Andrea Sangiovanni, 'Solidarity in the European Union' (2013) 33 Oxf J Leg Stud 213, 223-232 who defends a model of solidarity between member states focusing on 'the fair return' they 'owe one another' based on 'the level at which each state would insure against the potential losses' resulting from European integration 'had they known the distribution of risks but not their place in that distribution' (see text at 229-230).

116 Moravcsik (n 113) 485.

117 Alexander Wendt, *Social Theory of International Politics* (CUP 1999) 349. Note that Wendt himself employs the notion of 'common fate'. This study prefers common *destiny*.

Common destiny and interdependence are often treated as one and the same, yet there is a notable difference between the two. Interdependence presupposes a situation of 'interaction' in which the actions of states have a bearing on each other's results.[118] No such interaction, however, is required in the case of common destiny. A common destiny arises as a result of a 'third party' by which certain states perceive of themselves as a collective.[119] Such a third party can be another state, as in the situation of Nazi-Germany whose military aggression made other states on the European continent share a common destiny during the second World War.[120] Yet, it can also be a more abstract entity, like an environmental disaster or financial markets.[121] In fact, as chapter 5 will show, the factual solidarity that developed during the debt crisis among the member states of the currency union to a great extent resulted from financial market turbulence which made them share in a common destiny.[122]

Two remarks should be made about the account of normative and factual solidarity that is presented here. First of all, it does not pretend to give a complete explanation of the ways in which structure and member states interact. Its mission is more modest, focusing on a particular part of this structure, that of joint commitments and the political obligations flowing from them, and showing how they *condition* the acts of member states. These commitments and obligations, however, do not *determine* their acts, given that member states possess the capacity to reflect on them and take into account other demands of the situation, including their own interests. Normative and factual solidarity together, then, provide different insights into why member states act in the interest of the collective: either because they are normatively obligated to do so or because their own interest is bound up with it.

Secondly, and following from the above, the account does not aspire to capture all the reasons that member states may have for acting in support of cohesion. By focusing on normative and factual solidarity it does, however, single out two especially important ones which, moreover, may very well inspire one and the same action. When a member state acts in support of cohesion its actions can be infused by a mix of normative and factual solidarity. It is in such cases that the importance and quality of factual solidarity becomes apparent. If a member state were always confronted with the Parsonian dilemma of choosing between its own interests or those of the collective,

118 Wendt, *Social Theory of International Politics* (n 117) 349.
119 Wendt, *Social Theory of International Politics* (n 117) 349.
120 Wendt, *Social Theory of International Politics* (n 117) 349.
121 Wendt, *Social Theory of International Politics* (n 117) 349: 'Having a common fate can sometimes be good….but in international politics it is often bad, typically being constituted by an external threat to the group. The threat may be social, like that which Nazi Germany posed to other European states, or material, like the threat of ozone depletion or nuclear war'.
122 See text to n 10 and n 297 (ch 5).

showing solidarity would become unduly difficult, requiring a member state to choose on a continuous basis. Mostly, however, there is no such dilemma. Nonetheless, when a state's (perceived) self-interest does not provide a compelling reason for action in support of cohesion or, even more so, when it calls for action contrary to such cohesion, the strength of normative solidarity becomes apparent. Being confronted with the dilemma of individual or collective orientation, it is especially in such situations that a member state's political obligation makes it reflect on its normative position and decide whether or not to take responsibility for the collective. Or to speak in the words of Rousseau, it is in such situations in particular that a state is required to consult its reason before listening to its inclinations.[123]

The second spectrum is subsidiary in nature and subordinate to the first. Its added value lies in the fact that it specifies what *kind* of solidary actions member states display when they act in support of cohesion. The spectrum's ends are taken up by *negative* and *positive* solidarity respectively. Negative solidarity occurs when the acts displayed by a state in the interest of the collective mainly relate to itself. Such solidary acts are negative in nature as they are focused on a state's own condition, thereby aiming to support the interest of the collective. In the case of positive solidarity, on the contrary, a state's acts directly relate to other states. When a state displays such solidarity, its acts directly benefit one or more others for the sake of the collective. Contrary to normative and factual solidarity, which may inspire one and the same action, negative and positive solidarity are mutually exclusive. A solidary action is *either* negative *or* positive in nature. It is possible, however, that a member state carries out *several* solidary actions, negative and positive, in support of cohesion. A member state may, for example, display positive solidarity by granting financial assistance to another state, whilst at the same time showing negative solidarity by implementing austerity measures.[124] Moreover, the two kinds of solidarity represent ideal types. Not every act in support of cohesion lends itself for clear categorisation as either positive or negative. As subsequent chapters will show, however, the two types do clarify what kinds of acts states originally had to pursue in support of their currency union and what has changed in this regard since the crisis.[125]

123 See text to n 158 (ch 1) (discussing Rousseau's statement that the 'general will' makes man 'consult his reason before listening to his inclinations').

124 For an analysis of the link between the two kinds of solidarity during the crisis see text to n 89ff (ch 5).

125 See especially chs 3 and 5.

4 Commitment and Union law

A final issue that needs to be addressed is the relationship between joint commitment and Union law. Above, this chapter explained how the conclusion of a treaty forms one way of creating a joint commitment.[126] As a result, treaty conclusion has an intriguing, dual function. On the one hand, it gives rise to a legal regime regulating a certain topic or area between the contracting parties. But on the other hand, it also creates a joint commitment between these parties in virtue of which they have a political obligation to uphold, or one could say 'obey', the treaty. When the six founding member states concluded and ratified the ECSC Treaty in 1951-52 they not only created a legal regime regulating the pooling of coal and steel, they also jointly committed themselves to uphold it. Likewise, by concluding and ratifying the Treaty of Maastricht in 1992-93 member states did not simply establish a legal system for their currency union that institutionalises a stability paradigm. They also incurred a political obligation to uphold this system.[127] The Union Treaties, then, are much more than simply a set of laws. They form the object of a fundamental joint commitment, a 'Founding Contract', between the member states.

This coincidence between treaty conclusion and the formation of joint commitments may lead one to think that for member states of the Union, being subject to political obligation is reducible to a duty to obey the law. This, in turn, may cause one to conclude that the issue of political obligation is not a very pressing one for these states, as it coincides with the legal obligations that Union law places on them. Such a conclusion, however, is misplaced for two reasons in particular.[128] The first has to do with the *object* of their joint commitment. The obligation to uphold the Treaties entails more than a duty to respect the individual rules set out in them. As Article 1 TEU makes clear, through the Treaties the member states *establish* the Union. Rules of primary and secondary Union law play an essential role in regulating this Union, but they should not be equated with it. In other words, states are not only committed to Union law, they are committed to the Union itself, including its currency union. They are therefore under a political obligation to uphold the Union, not just the laws governing it.[129]

The fact that the object of the Founding Contract covers more than just the law is instrumental for an adequate understanding of why the member states preserved their unity during the crisis and how this put strain on the

126 See text to n 80 (ch 2).

127 For a detailed discussion on the character and nature of this stability union see ch 3.

128 See also Horton (n 6) 14 (stressing the fact that political obligation encompasses more than just an obligation to obey the law). See on this point also n 6 (ch 2).

129 This conceptual distinction between the law and its object is diminished by Union law itself, not only by Art 1 which states that the member states establish the Union but also for example by Art 3 TEU which sets out the tasks of the Union, among which is the establishment of an 'economic and monetary union whose currency is the euro'.

single currency's legal set-up. As this study will show later on, since states are committed to the Union they are under a political obligation to protect it, even if that means implementing actions that push, or even exceed, the boundaries of what law permits.[130] Such actions carry great normative weight, but not necessarily with a legal origin, at least at first sight, which creates huge difficulty for constitutional courts, national and European, that have to assess their permissibility.

The second reason concerns the *capacity* in which member states act and the *occasions* on which they can establish joint commitments. First the capacity in which they act. When ministers or national leaders meet in the Council or the European Council, states act in their *executive* capacity.[131] The same goes for other executive fora such as the Eurogroup or the Euro Summit. The Eurogroup is an informal body consisting of the ministers of finance of the states in the currency union.[132] Protocol 14 to the Union Treaties indicates that the Commission also takes part in its meetings and that the Bank is invited to participate.[133] The Euro Summit, which was created at the instigation of former French President Sarkozy during the financial crisis in 2008 and which has subsequently received legal recognition in the Treaty on Stability, Coordination and Governance, provides for a similar arrangement at the highest political level.[134] In principle,[135] the euro area heads of state or government take part in the summit, together with the president of the Com-

130 See especially ch 5.

131 WT Eijsbouts and J-H Reestman, 'In Search of the Union Method' (2015) 11 EuConst 425, 429. See also Joseph HH Weiler, 'The Transformation of Europe' (1991) 100 Yale L J 2403, 2430.

132 The Eurogroup was established by the European Council in December 1997. See European Council, Presidency Conclusions, Luxembourg, 12-13 December 1997, para 44. It met for the first time on 4 June 1998 in Luxembourg. For an extensive analysis of the Eurogroup's (informal) working practices see Uwe Puetter, *The Eurogroup: How a secretive circle of finance ministers shape European economic governance* (Manchester University Press 2006). For recent judicial confirmation of the Eurogroup's informal nature see Joined Cases C-105/15 P to C-109/15 P *Mallis and others* [2016] ECLI:EU:C:2016:702, paras 46-47, 49, 61.

133 Art 1 of Protocol No 14 on the Eurogroup.

134 Art 12 TSCG.

135 Art 12(3) TSCG makes clear that Contracting Parties that have ratified the TSCG but have not (yet) adopted the single currency shall participate in 'discussions of Euro Summit meetings concerning competitiveness….the modification of the global architecture of the euro area and the fundamental rules that will apply to them in the future' as well as issues concerning the implementation of the TSCG. Summits involving all Contracting Parties shall take place when appropriate and at least once a year. See Art 12(3) TSCG; Council of the European Union, Rules for the Organisation of the Proceedings of the Euro Summits, Brussels, 14 March 2013, Point 5(3) ('Rules for the Organisation of Euro Summits').

mission and the president of the summit itself. The president of the Bank is also invited to take part in the meeting.[136]

However, member states can also act in their *full* capacity, for example when they amend the Union Treaties. As Article 48 TEU indicates, regardless of whether use is made of the ordinary revision procedure laid down in its first to fifth paragraphs or the simplified procedure in the sixth, amendment requires ratification or approval by states in accordance with national constitutional requirements.[137] Consequently, it is not just the executives that are acting, but states as full entities. States equally act in their full capacity when they conclude and ratify a separate international treaty.

Due to the fact that *occasions* for the conclusion of joint commitments extend well beyond those of Treaty amendment, states may incur political obligations, in their executive capacity or in full, that are not accompanied by a change of Union law. Take the European Council. In principle, it takes its decisions by consensus.[138] When it issues conclusions or adopts statements on a future line of action, these will give rise to political obligations as political leaders have expressed their readiness to engage in a joint commitment. The Euro Summit too, may be a site of creation of such obligations given that any statement it wishes to make needs to be similarly based on consensus among its members.[139] In both cases, member states, acting in their executive capacity, can incur political obligations that are not reflected in, or even conflicting with, Union law. When states conclude and ratify an international treaty or otherwise establish a separate legal regime outside the Union Treaties, they can even be bound in full by such obligations as they express their readiness to engage in a joint commitment in their entirety.

It should now be clear why the political obligation that flows from the most fundamental joint commitment between the member states, their Founding Contract, is not reducible to a duty to obey the law. This obligation requires more than simply obeying the specific rules set out in the Treaties and it can be changed without a corresponding amendment of Union law. In fact, it is precisely moments other than treaty amendment that have been crucial for

136 Art 12(1) TSCG. Art 12(5) TSCG makes clear that the president of the European Parliament may only be invited to be heard. Point 4(3) Rules for the Organisation of Euro Summits determines that the president of the Eurogroup may be invited to attend.

137 Art 48(4) TEU stipulates that in case of the ordinary revision procedure the envisaged amendments that have been determined by a conference of representatives of the governments of the member states only 'enter into force after being ratified by all the Member States in accordance with their respective constitutional requirements'. Under the simplified revision procedure, laid down in Art 48(6) TEU, approval must be given in relation to the decision of the European Council amending all or part of the provisions of Part III of the TFEU.

138 Art 15(4) TEU.

139 Point 6(3) Rules for the Organisation of Euro Summits.

the solidarity that states displayed during the crisis, thereby creating great tension between their *legal* and *political* obligations.

5 Conclusion

A thorough account of the solidarity that exists between the member states in the Union is crucial for understanding why, and in what way, they maintained their unity during the crisis and how this has sparked a transformation of the euro. This chapter has therefore conceptualised this solidarity in three steps. First of all, it has shown that states can incur political obligations through their participation in joint commitments. By jointly committing themselves states form a plural subject, which means that they intend to perform certain acts or achieve certain goals as a body. Consequently, each state has an obligation to act in conformity with the commitment as it owes such behaviour to the others in their capacity as members of the plural subject. In the same vein, each state also has the right to demand conformity with the commitment of others and rebuke them if they fail to deliver.

Hereafter, the issue of solidarity between states was examined. Two spectrums served as guides disentangling its different strands. One relates to the reasons for acting in the interest of the collective, the other deals with the kind of solidary behaviour displayed. The poles of the first spectrum are taken up by *normative* and *factual* solidarity. Normative solidarity relates to the joint commitments of states. When a state displays normative solidarity it acts in line with the obligations that flow from such commitments. Factual solidarity occurs when a state supports the collective because its own interest is served by it. Normative and factual solidarity may very well coincide. In fact, the real strength and significance of normative solidarity only becomes apparent in the absence of factual solidarity, forcing a member state to decide between acting on its obligations, thereby taking responsibility for the collective, or serving its own interest. The poles of the second spectrum are *negative* and *positive* solidarity. Negative solidarity occurs when the acts displayed by a state in the interest of the whole relate to itself. Positive solidarity, on the other hand, occurs when a state acts in the interest of the collective by directly benefitting another state. Negative and positive solidarity are mutually exclusive, meaning that a solidary act is either negative or positive in nature. It is possible, however, for a member state to combine several solidary actions, negative and positive, when supporting the collective.

The last step of the conceptualisation concerned the relation between joint commitment and Union law. As the conclusion of a treaty or agreement forms a species of creating joint commitments, member states not only established a stability minded legal regime for their single currency when they signed and ratified the Treaty of Maastricht. They also incurred a political obligation to uphold it. It is not a given, however, that the creation of, or change in,

political obligations always coincides with a change in Union law. They may arise out of European Council meetings or fora that have received no formal recognition in Union law at all, like the Euro Summit. They may even be created through the establishment of new legal regimes, such as when member states conclude a separate international treaty. Although each of these occasions are very different in nature, they all share in their capacity to generate political obligations requiring member states to display solidarity, but not necessarily in a way that conforms to Union law. In fact, as chapters 5 to 7 will show, this is exactly what has happened during the crisis.

Let us now turn to the single currency's original legal framework and see what kind of currency union it is that the member states originally committed themselves to.

Part II

The original stability conception

3 Committing to stability

1 INTRODUCTION

In November 1995 the German Finance Minister Theo Waigel tabled a proposal for a *Stabilitätspakt für Europa*. In its preamble he argued:

> 'The monetary union must be committed to stability from the beginning. All participants in the final stage have the same interest in this. They form a community of solidarity in the sense that the stability of the European currency will be reliably and permanently secured through strict budgetary discipline in all the participating countries.'[1]

Waigel's words captured the very essence of how the members of the currency union had to relate to one another, except for the fact that this was not an ambition to be realised with his pact but a political and legal reality due to the entry into force of the Treaty of Maastricht two years earlier, on 1 November 1993. By signing and ratifying this Treaty the member states had changed their Founding Contract and had jointly committed themselves to a currency union geared towards price stability. As a result, the solidarity they were bound to display was largely negative in kind; the actions each state had to perform in the interest of the collective mainly focused on its own condition, especially in the area of fiscal policy where each had to maintain budgetary discipline. For Waigel, however, these arrangements did not go far enough and that is why he pleaded for a stability pact only two years after the Treaty had entered into force.

▪ This chapter contains and/or builds on previously published work by the author. See especially Vestert Borger, 'How the Debt Crisis Exposes the Development of Solidarity in the Euro Area' (2013) 9 EuConst 7; Stefaan Van den Bogaert and Vestert Borger, 'Twenty Years After Maastricht: The Coming of Age of the EMU?' in Maartje de Visser and Anne Pieter van der Mei (eds), *The Treaty on European Union 1993-2013: Reflections from Maastricht* (Intersentia 2013) 451; Stefaan Van den Bogaert and Vestert Borger, 'Differentiated integration in EMU' in Bruno De Witte, Andrea Ott and Ellen Vos (eds), *Between Flexibility and Disintegration: The Trajectory of Differentiation in EU Law* (Edward Elgar 2017) 209.

1 Theo Waigel, *Stabilitätspakt für Europa: Finanzpolitik in der dritten Stufe der WWU* (Bundesministeriums der Finanzen, 10 November 1995), translation obtained from <www.cvce.eu> accessed 13 March 2017. See also Jean-Victor Louis, 'Managing Public Finances. Lessons and Perspectives for the EU and the Euro Area' (Vortrag and der Humboldt-Universität zu Berlin, 15 December 2011) 7-8.

This chapter examines the single currency's original stability set-up. Thorough knowledge about this set-up is crucial to understand *how* the debt crisis could strike at the heart of the currency union when it erupted late in 2009 and *why* this necessitated a transformation of the euro. The chapter starts with a concise discussion of the history of European monetary integration. Clearly, this study is not the first to give such a description. In fact, they abound.[2] Yet, treatment of this history is justified as it not only helps to explain when and why the member states succeeded in creating a single currency, but also the rationale behind its legal set-up.

The discussion draws on the works of various disciplines, including those of integration theorists. It refrains, however, from defending a particular theory or model.[3] Its ambition is more modest as it simply differentiates between two sorts of motives – one economic, the other political – and shows how both have been important drivers of monetary integration. Each of them inspired Europe's first attempt to create a currency union, started by its political leaders in The Hague in 1969, but each was lacking in urgency to have it succeed. Both, however, suddenly gained in importance during the 1980s, even to such an extent that the European Council dared to undertake a second attempt at its meeting in Hannover in June 1988. And this time both motives were sufficiently pressing, as the member states agreed on the creation of a single currency by 1999 at the latest when they signed the Treaty of Maastricht on 7 February 1992.

Economically, this move was inspired by rising capital mobility and the importance of exchange rate stability for the internal market, the combination of which made it increasingly difficult for states to pursue a monetary policy of their own. In fact, most of them had already lost much of their autonomy under the European Monetary System in which they had to closely follow the policy of the *Bundesbank* in order to have monetary stability. But political considerations were crucial too. The fall of the Berlin Wall in November 1989 provided critical incentives, in particular to Germany and France, to speed up plans for a currency union that had already been set in motion.

2 Some very thorough analyses, from various disciplines and viewpoints, are provided by Tommaso Padoa-Schioppa, *The Road to Monetary Union in Europe: The Emperor, the Kings, and the Genies* (OUP 1994); Daniel Gros and Niels Thygesen, *European Monetary Integration: From the European Monetary System to Economic and Monetary Union* (2nd edn, Longman 1999); André Szász, *The Road to European Monetary Union* (Macmillan Press 1999); Kenneth Dyson and Kevin Featherstone, *The Road to Maastricht: Negotiating Economic and Monetary Union* (OUP 2003).

3 For an overview of the different theoretical explanations of why Europe managed to attain economic and monetary union see Tal Sadeh and Amy Verdun, 'Explaining Europe's Monetary Union: A Survey of the Literature' (2009) 11 International Studies Review 277.

Attention then shifts to the legal set-up of the single currency, in particular its *internal policy* dimension.[4] The economic and political forces behind the currency union's creation have also exercised great influence on its set-up. Cooperation in the European Monetary System stimulated a convergence of economic preferences among states, characterised by a shift away from 'Keynesian' to 'monetarist' thinking and a corresponding increase in importance of price stability as an objective. Moreover, price stability was greatly valued by Germany, which wanted to ensure that a single currency would be 'at least as stable as the D-Mark'.[5] Given its anchor position in the European Monetary System, the German government was able to strongly push for this during the treaty negotiations on monetary union. And afterwards it sought further stability guarantees at the level of secondary law.

As a result of these dynamics, the single currency's original set-up institutionalised a 'stability' or 'sound money' paradigm. Characteristic of this paradigm was that it granted overriding importance to price stability as a policy goal and argued for a privileged position of the central bank in achieving this. Its influence was most notably evident at the level of aims and principles and in the constitutional position of the European Central Bank. But it also shaped the single currency's economic foundations, in particular the Union's limited competences in this area and its focus on fiscal prudence. It even informed the rules governing accession.

Throughout its discussion of this original set-up the chapter refers to the provisions that are currently laid down in the Union Treaties, unless consideration of the former EC Treaty is explicitly warranted.[6] It discusses secondary law in its pre-crisis form.

2 Calling for monetary union

2.1 The Hague, 1-2 December 1969

As early as 1950, several years before the creation of the Coal and Steel Community, Jacques Rueff, French economist and former judge at the European

4 For analyses of the legal framework governing the external aspects of monetary union see eg René Smits, *The European Central Bank: Institutional Aspects* (Kluwer Law International 1997) 365-484; Chiara Zilioli and Martin Selmayr, 'The External Relations of the Euro Area: Legal Aspects' (1999) 36 CML Rev 273.

5 See in this regard text to n 156 (ch 3).

6 For a discussion of the changes introduced by the Lisbon Treaty in the area of economic and monetary policy see René Smits, 'The European Constitution and EMU: An Appraisal' (2005) 42 CML Rev 425 (analysing the provisions in the Constitution for Europe that have largely been reproduced by the Lisbon Treaty); Fabian Amtenbrink and Johan W van de Gronden, 'Economisch recht en het Verdrag van Lissabon II: Europese Economische en Monetaire Unie' (2008) 56 SEW 389.

Court of Justice, declared: '*L'Europe se fera par la monnaie ou ne se fera pas*' (Europe will be created through the currency, or it will not be created).[7] With the benefit of hindsight one can say these words bore a prophetic character. The desire to unite Europe monetarily has inspired the integration process since its inception. Admittedly, the original EEC Treaty contained only modest provisions on economic and monetary cooperation, mainly focusing on the coordination of national economic policies and obliging member states to treat their exchange rate policies 'as a matter of common interest'.[8] Yet, this modesty can be explained by the fact that during the early years of European integration, monetary cooperation was not primarily a European, but a global affair.[9] In 1944 the allied states, notably the United States and Great Britain, had established the Bretton Woods system with the aim to achieve monetary stability as soon as the Second World War came to an end. The system was inspired by a desire to return to the stable monetary relations that had characterised the international order in the 19th century when the Gold Standard was effective.[10] It formed a 'semi-gold standard',[11] administered by the International Monetary Fund, with the dollar operating as an 'anchor currency' being tied to gold at $35 an ounce.[12] The other currencies were pegged to the dollar and the parities around which they could 'pivot' within margins of one percent were 'fixed' but 'adjustable'.[13]

The Bretton Woods system disguised the importance of money for European integration as long as it operated quite successfully, but as soon as the first cracks in the system emerged in the 1960s,[14] European initiatives at intensifying monetary cooperation appeared. They were modest at first, focusing on the establishment of policy bodies like the Committee of Central Bank

7 Jacques Rueff, 'L'Europe se fera par la monnaie ou ne se fera pas' (1950) 4 Synthèse 267 (as cited in Christopher S Chivvis, *The Monetary Conservative: Jacques Rueff and Twentieth-century Free Market Thought* (Northern Illinois University Press 2010) 142, 209 (fn 40)).

8 Arts 6, 103-109 and 145 EEC.

9 Loukas Tsoukalis, *The Politics and Economics of European Monetary Integration* (George Allen & Unwin 1977) 52; Smits, *The European Central Bank* (n 4) 10-11; Michele Chang, *Monetary Integration in the European Union* (Palgrave Macmillan 2009) 15; Rosa M Lastra and Jean-Victor Louis, 'European Economic and Monetary Union: History, Trends, and Prospects' (2013) 32 YEL 57, 63.

10 Chang (n 9) 15-16.

11 Smits, *The European Central Bank* (n 4) 11.

12 Harold James, *International Monetary Cooperation Since Bretton Woods* (IMF and OUP 1996) 66. See also Chang (n 9) 16.

13 Chang (n 9) 16-17. See also Szász, *The Road* (n 2) 16. For an overview of the legal regime governing the system see Joseph Gold, *Legal and Institutional Aspects of the International Monetary System: Selected Essays* (IMF 1979).

14 For an elaborate discussion of the events that contributed to the system's demise, notably increased capital mobility, increasing rigidity of the exchange rates and a 'loose', inward looking US monetary policy see James (n 12) 205-227.

Governors,[15] and closer cooperation and consultation in the economic and monetary sphere.[16] But the more the Bretton Woods engine sputtered, the more European cooperation intensified. By the time the system collapsed in August 1971 when President Nixon let the world know he was 'closing the gold window', meaning that the United States was no longer prepared to exchange dollars for gold,[17] Europe had already voiced its desire to achieve monetary union.

This desire was expressed by the heads of state and government at a summit in The Hague in December 1969. When studying the declaration they adopted at this summit, it is striking how closely European integration and money are related. First the leaders stress their belief that a 'Europe composed of states which.…are united in their essential interests' and 'assured in its internal cohesion' is vital for peace and prosperity.[18] Then they call for a plan to achieve economic and monetary union in stages.[19]

Why were they prepared to take this bold move? First of all, there were economic motives. The gradual establishment of the internal market was causing greater trade interdependence among their national economies, which made them vulnerable to exchange rate fluctuations. When the Bretton Woods system began to show signs of decline, this interdependence provided the member states with a strong incentive to strengthen their own efforts to create monetary stability.[20] International monetary disturbances also created problems for the Community's agricultural policy.[21] This policy was based on Community-wide prices for a range of agricultural products. Exchange rate fluctuations negatively affected its operation; whenever a state's currency

15 Council Decision 64/300/EEC of 8 May 1964 on cooperation between the central banks of the Member States of the European Economic Community [1964] OJ 77/1206.

16 See, for example, Council Decision 64/301/EEC of 8 May 1964 on cooperation between Member States in the field of international monetary relations [1964] OJ 77/1207; Declaration 64/306/EEC of 8 May 1964 of the representatives of the Governments of the Member States of the European Economic Community, meeting within the Council, on the prior consultations between the Member States in the event of changes in the exchange-rate parities of their currencies [1964] OJ 78/1226. For an overview of the major decisions and events in the run up to the creation of monetary union see Commission, 'Towards economic and monetary union (EMU): A chronology of major decisions, recommendations or declarations in this field' (European Economy Occasional Papers No 13, 2005).

17 James (n 12) 218-219. See also Chang (n 9) 24.

18 Final communiqué of the meeting of Heads of State or Government, The Hague, 1-2 December 1969, para 4.

19 Final communiqué of the meeting of Heads of State or Government, The Hague, 1-2 December 1969, para 8.

20 Tsoukalis (n 9) 58; Szász, *The Road* (n 2) 20; Chang (n 9) 21-22.

21 Tsoukalis (n 9) 59-60; Szász, *The Road* (n 2) 8-9; Chang (n 9) 22.

depreciated or appreciated, the common price system caused national prices to fluctuate.[22]

But just as important were political motives. During the 1960s the economy of the Federal Republic of Germany had become increasingly powerful. This risked upsetting 'the balance of power' with France that had provided the basis for European stability and integration ever since the war had ended.[23] France feared that this stability as well as its own position on the continent would be threatened by Germany's economic strength. A monetary union could encapsulate this strength and ensure the state's continued commitment to European integration. Instead of a European economy dominated by the D-Mark, Germany would participate in a monetary union and thereby give up its strong currency in favour of a European alternative.[24]

For Germany itself, monetary union constituted a means to achieve its new '*Ostpolitik*'.[25] After the Federal Republic had conducted a policy of neglect concerning its eastern counterpart – the German Democratic Republic – during the 1950s and 1960s it adopted a new approach after Willy Brandt became chancellor in 1969.[26] Intensifying the ties with the East was perceived as an essential step towards the eventual reunification of Germany.[27] In the West this policy change created fears of a return by Germany to its pre-war tendency to move back and forth between East and West, depending on what served its interests best.[28] For Germany, then, monetary union formed an opportunity to reassure its partners that it would not exchange reunification for a lessening of European integration; it would become so strongly embedded in the Community that giving Europe the cold shoulder would no longer be an option.[29]

The plan announced in The Hague was prepared by a committee headed by the Prime Minister of Luxembourg, Pierre Werner.[30] Published in October 1970 and known as the 'Werner Report',[31] it set out a strategy to achieve

22 Smits, *The European Central Bank* (n 4) 14. Smits mentions that next to agricultural policy, other Community measures and plans based on a common value were also negatively affected by exchange rate fluctuations. Examples he gives are capitalisation standards for public limited companies, fines and other levies of the Commission in relation to competition policy and the unit of account for the Community budget.

23 Szász, *The Road* (n 2) 20-25, 29.

24 Szász, *The Road* (n 2) 28-29; David Marsh, *The Euro: The Politics of the New Global Currency* (YUP 2009) 50-51.

25 Szász, *The Road* (n 2) 25-26.

26 Szász, *The Road* (n 2) 25-26.

27 Szász, *The Road* (n 2) 26.

28 Szász, *The Road* (n 2) 26-27; Marsh (n 24) 52.

29 Szász, *The Road* (n 2) 28-29.

30 The decision to appoint Pierre Werner as the committee's president was taken by the Council on 6 March 1970. See Council Decision 70/192/EEC of 6 March 1970 on the procedure for economic and monetary cooperation [1970] OJ L 59/44.

31 Werner Group, *Report to the Council and the Commission on the realization by stages of Economic and Monetary Union in the Community* (Luxembourg, 8 October 1970) (Werner Report).

economic and monetary union by 1980. Only a few months later, in March 1971, the Council and the representatives of the governments of the member states adopted a Resolution in which they expressed their political will to achieve this goal within a decade.[32]

Both the Werner Report and the Resolution envisaged the achievement of monetary union in three stages, putting most emphasis on the first and final stages. During the first, preparatory stage, beginning on 1 January 1971 and lasting three years, the focus should be on narrowing currency fluctuation margins, streamlining economic policy through the setting of broad guidelines, coordinating fiscal policy and preparing Treaty amendments.[33] In the second stage this policy should be continued, especially by liberalising capital markets, eliminating exchange rate fluctuations and an increasingly tight coordination of economic and fiscal polies 'by ever closer regard for the common interest'.[34] In the final stage, for which no starting date was mentioned, currencies should be fully convertible, parity rates irrevocably fixed and national economic and fiscal policies strongly coordinated or harmonised.[35] Moreover, responsibility for monetary policy should be transferred to the Community, whereas in the area of economic policy a 'centre of decision' had to be established with the power to steer national fiscal policy 'to the extent necessary for the proper functioning' of the monetary union.[36] The Werner Report made explicit that in the final stage 'national monetary symbols' could either be maintained or exchanged in favour of a single currency. It preferred the latter, since it would underline the 'irreversibility of the venture'.[37]

In the years that followed several initiatives were taken to further the goal of monetary union.[38] The most notable one related to the reduction of currency fluctuation margins.[39] After the United States had decided to close the gold window in August 1971, new rates for currencies in the Bretton Woods system were (temporarily) agreed on and fluctuation margins against the dollar

32 Resolution of the Council and of the Representatives of the governments of the Member States of 22 March 1971 on the attainment by stages of economic and monetary union in the Community [1971] OJ C 28/1, para I (1971 EMU Resolution).
33 Werner Report (n 31) 15-24; 1971 EMU Resolution, para III.
34 Werner Report (n 31) 24-25, 28.
35 Werner Report (n 31) 9-13; 1971 EMU Resolution, para I.
36 Werner Report (n 31) 11-13.
37 Werner Report (n 31) 10.
38 Besides this exchange rate arrangement, several Community legislative instruments aimed at intensifying economic and monetary policy were adopted. Moreover, the European Monetary Cooperation Fund was established. For analysis see Smits, *The European Central Bank* (n 4) 16-19; Gros and Thygesen (n 2) 20-23.
39 Note that in their Resolution of March 1971 political leaders had already decided to hold exchange rate fluctuations within margins narrower than those in place for the US dollar. See 1971 EMU Resolution, para III(6). See also Werner Report (n 31) 22.

were set at 2.25% on the basis of the Smithsonian Agreement.[40] Community currencies could now fluctuate against each other within margins double the size of that vis-à-vis the dollar, a level considered too high for the common agricultural policy.[41] In March 1972 the Council and the representatives of the governments of the member states therefore decided to narrow fluctuation margins between their currencies to ±2.25 percent.[42] Soon Denmark, the United Kingdom and Ireland (as member of the sterling bloc), which were about to accede to the Community on 1 January 1973, also entered the arrangement,[43] which was called the 'snake in the tunnel' as the narrow fluctuation band of participating currencies 'writhed like a like a snake through the wider band, or tunnel, against the dollar'.[44]

Being part of the first 'stage' towards monetary union, the snake was only intended as a preparatory step towards the full elimination of fluctuation margins.[45] But things would not get that far. Currency realignments and states withdrawing and re-joining were the rule rather than the exception under the arrangement.[46] The first oil crisis in 1973 affected some participating states more than others and had 'asymmetric' effects on their economies.[47] Moreover, the states failed to agree on a common strategy to deal with the economic hardship.[48] Their inability to gear economic policies to one another and the tendency to focus monetary policy on domestic interests only prevented the snake from delivering monetary stability.[49]

From the nine states that had initially joined the snake only five were left in it by January 1974.[50] Instead of providing monetary stability for the whole Community, the snake had developed into a 'mark zone' in which only those states able and willing to closely observe German monetary policy could

40 Tsoukalis (n 9) 117, 120; Chang (n 9) 24.
41 Tsoukalis (n 9) 120; Chang (n 9) 24.
42 Resolution of the Council and of the Representatives of the Governments of the Member States of 21 March 1972 on the application of the Resolution of 22 March 1971 on the attainment by stages of economic and monetary union in the Community [1972] OJ C 38/3, para III (1972 EMU Resolution).
43 Norway and Sweden, which were not (yet) members of the Community, would also become associated to the arrangement in May 1972 and March 1973 respectively. See also Gros and Thygesen (n 2) 16-17.
44 Szász, *The Road* (n 2) 36. After it was decided to let the dollar float on 19 March 1973 the snake was out of the 'tunnel'.
45 See also 1972 EMU Resolution, para III.
46 For an overview of withdrawals and exchange rate adjustments see Gros and Thygesen (n 2) 17.
47 Barry Eichengreen, *Globalizing Capital: A History of the International Monetary System* (Princeton University Press 1996) 157-159.
48 Eichengreen (n 47) 159.
49 Tsoukalis (n 9) 130-131; Eichengreen (n 47) 159.
50 Germany, the Netherlands, Belgium, Luxembourg and Denmark. See also Tsoukalis (n 9) 130; Gros and Thygesen (n 2) 17.

participate.[51] When the Commission commissioned a group of experts headed by its former Vice-President Robert Marjolin to assess the possibility of attaining monetary union by 1980, they responded in their report:

> 'Europe is no nearer to EMU than in 1969. In fact if there has been any movement it has been backward. The Europe of the Sixties represented a relatively harmonious economic and monetary entity which was undone in the course of recent years; national economic and monetary policies have never in 25 years been more discordant, more divergent, than they are today.'[52]

With the benefit of hindsight this view seems overly pessimistic,[53] especially given the fact that only a few years later, in 1978, monetary integration would receive a new impetus with the establishment of the European Monetary System (EMS). But ambitions had certainly been scaled down. When it called for the establishment of this system in Bremen on 6 and 7 July 1978, the European Council no longer spoke of the ultimate objective of monetary union. Its purpose was now more modest: a 'zone of monetary stability'.[54]

Central to the Monetary System, of which the key features were laid down in a European Council Resolution adopted in Brussels on 5 December 1978,[55] was the European Exchange Rate Mechanism (ERM). This mechanism essentially formed a prolongation of the snake as states were still required to keep their currencies within fluctuation margins of 2.25%,[56] but it was attempted to inject more 'symmetry' in the system through some technical reforms in order to distribute adjustment efforts more evenly among states with 'strong' and 'weak' currencies.[57]

Did the system succeed in creating a zone of monetary stability?[58] After a rocky start lasting until 1983, during which states were still recovering from the miserable economic conditions of the 1970s, the system entered a more tranquil period in which it helped to coordinate national monetary policies,

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51 Chang (n 9) 25. See also Tsoukalis (n 9) 130.

52 Commission, *Report of the study group "Economic and Monetary Union 1980"* (8 March 1975) 1.

53 See also Gros and Thygesen (n 2) 20.

54 European Council, Conclusions, Bremen, 6 -7 July 1978, 3.

55 Resolution of the European Council of 5 December 1978 on the establishment of the European Monetary System (EMS) and related matters, annexed to European Council Conclusions, Brussels, 5 December 1978 (1978 EMS Resolution). In addition to this Resolution, EMS arrangements were laid down in Community legislation and central bank agreements. For detailed overviews of these arrangements see Jean-Victor Louis, 'Het Europees Monetair Stelsel' (1979) SEW 441; René Smits, 'Het Europees Monetair Stelsel' (1979) 28 Ars Aequi 303; Jean-Jacques Rey, 'The European Monetary System' (1980) 17 CML Rev 7.

56 1978 EMS Resolution, para 3.1. Italy, whose currency floated before the introduction of the EMS, opted for margins of 6%.

57 Chang (n 9) 26-28. See also Gros and Thygesen (n 2) 44-48.

58 For an overview of the several phases in the functioning of the system see Gros and Thygesen (n 2) 65-105.

especially by keeping exchange rates in line with the D-Mark.[59] In particular from 1987 onwards the system's bands 'hardened', meaning that 'markets ... essentially treated the exchange rates as if they were fixed'.[60] But things changed over the course of 1992 when the system came to experience the most serious crisis of its existence. Ironically, this crisis in part resulted from the fact that the Community had in the meanwhile embarked on a second attempt to achieve monetary union and markets doubted whether this time it would actually be successful.

2.2 Hannover, 27-28 June 1988

Similar to the first attempt, a call at the highest political level formed the basis for the undertaking. After a series of memoranda had been circulating in 1988 between French, Italian and German (finance) ministers in which they had expressed the need to revitalise economic and monetary cooperation,[61] the European Council decided at its meeting in Hannover on 27 and 28 June of that year to set up a committee that should study and propose concrete stages leading towards economic and monetary union.[62] The committee was chaired by Commission President Jacques Delors and consisted, besides him, of national central bank governors, the Commission's vice-president and three independent experts.

The Delors Report bore great resemblance to its forerunner, the Werner Report. It too envisaged that economic and monetary union should be achieved in three stages. And it too stated that the process should culminate in the introduction of a single currency, controlled by a 'European System of Central Banks'.[63] The greatest difference with its predecessor was that it did not envisage the creation of a centralised institution for economic policy.[64] It put much emphasis on the principle of subsidiarity and stressed that in the area of economic policy the functions to be exercised at Community level should

59 Gros and Thygesen (n 2) 83-84; Chang (n 9) 29-30.

60 Chang (n 9) 30-31. The only realignment concerned the lira and related to its entrance to the 'normal' fluctuation bands of 2.25%. Part of the success of the system during this period can be attributed to the Basel-Nyborg agreement which reformed it in several respects. Of special interest are those reforms aimed at fencing off speculators, in particular through making better use margins of fluctuation and interest rates. See Smits, *The European Central Bank* (n 4) 26. For a detailed discussion see Gros and Thygesen (n 2) 88-93, 104-105.

61 Gros and Thygesen (n 2) 396-401; Szász, *The Road* (n 2) 101-105; Chang (n 9) 33-35.

62 European Council, Conclusions, Hannover, 27-28 June 1988, 7.

63 Committee for the study of economic and monetary union, *Report on economic and monetary union in the European Community* (17 April 1989) paras 23, 31-32 (Delors Report).

64 Delors Report (n 63) para 33. See also Gros and Thygesen (n 2) 402-403.

be 'as limited as possible'.[65] Efforts at that level should concentrate on the coordination of national policies within agreed frameworks.[66]

On 26 and 27 June 1989 the European Council approved of the report at its meeting in Madrid.[67] At the same time it set the starting date for the first stage towards monetary union at 1 July 1990.[68] Then, with the dissolution of the Eastern bloc, political events unfolded at a fast pace. On 8 and 9 December 1989, in Strasbourg, the European Council decided to convene an intergovernmental conference on economic and monetary union.[69] A few months later, on 25 and 26 June 1990 in Dublin, it did the same for political union.[70] Both conferences opened in the midst of December of that year in Rome. Their results were incorporated in the Treaty on European Union that was signed in Maastricht on 7 February 1992 and entered into force on 1 November 1993.[71] Two months later, with the necessary Treaty adjustments in place, the second stage of economic and monetary union was put into motion. The launch of the third stage would follow on 1 January 1999 with the introduction of the euro.[72] Europe had achieved monetary union within less than a decade.

What explains the achievement of monetary union second time round? An increase in its economic rationale? That had certainly been an important factor. When the European Council charged Jaques Delors with the study on monetary union, European integration was experiencing a revival due to the Single European Act.[73] It had injected new life into the internal market by endowing its completion by the end of 1992 with constitutional status in Article 8a of the EEC Treaty.[74] At the same time it had provided the Community with its first, be it modest, monetary capacity in Article 102A.[75] It stressed that in striving for convergence of their economic and monetary policies, states had to 'take account of the experience acquired in cooperation within the framework of the European Monetary System…'. It also made clear, however, that

65 Delors Report (n 63) para 20.
66 Delors Report (n 63) paras 19-20, 33.
67 European Council, Conclusions, Madrid, 26-27 June 1989, 10.
68 European Council, Conclusions, Madrid, 26-27 June 1989, 10.
69 European Council, Conclusions, Strasbourg, 8-9 December 1989, 8.
70 European Council, Conclusions, Dublin, 25-26 June 1990, 6. Note, however, that at a special meeting on 18 April 1990 the European Council had already discussed the possibility of a conference on political union. See European Council, Conclusions, Dublin, 18 April 1990, 6.
71 Treaty on European Union, signed at Maastricht on 7 February 1992 [1992] OJ C 191/1.
72 On this date the euro was only launched as an accounting currency for cashless payments and accounting reasons. On 1 January 2001 it was also introduced in physical form (ie in the form of notes and coins).
73 Single European Act, signed at Luxembourg on 17 February 1986 and at The Hague on 28 February 1987 [1986] OJ L 169/1.
74 The definition is now laid down in Article 26(2) TFEU. The deadline of 31 December 1992 has been repealed by the Lisbon Treaty.
75 For analysis see Jean-Victor Louis, '"Monetary Capacity" in the Single European Act' (1988) 25 CML Rev 9.

any institutional changes in the economic and monetary field would require a treaty amendment.

The concurrence of these two objectives in the Single European Act – the completion of the internal market and economic and monetary cooperation – was no coincidence. The Commission, in particular its President Delors, had pushed for it in the run up to the signing of the Act, arguing that the two are inextricably linked.[76] Once the Act had entered into force, the Commission used its authority to stress their mutual dependence even more. Illustrative is its *One Market, One Money* report of 1990 in which the Commission assesses the benefits and costs of monetary union.[77] On the one hand, it argues that the benefits of the internal market can only be fully reaped if accompanied by a single currency, eliminating exchange rate uncertainty and transaction costs.[78] On the other hand, it echoes the economist Tommaso Padoa-Schioppa by pointing to the incompatibility of full capital mobility, fixed exchange rates and national monetary policy autonomy.[79] They cannot coexist and in any monetary arrangement at least one of them has to give way. Given the liberalisation of capital movements following the Act, the next logical step would be to transfer monetary policy competences to the European level.[80]

That this inconsistency argument was more than simply a rhetorical tool of the Commission to further the cause of monetary union became painfully apparent during the crisis of the European Monetary System in 1992. After several years of exchange rate stability in which markets had treated exchange rates as 'fixed',[81] seemingly anticipating a smooth transition to monetary

76 Nicolas Jabko, 'In the name of the Market: how the European Commission paved the way for monetary union' (1999) 6 Journal of European Public Policy 475, 479-481; Szász, *The Road* (n 2) 89-92.

77 Commission, *One market, one money: An evaluation of the potential benefits and costs of forming an economic and monetary union* (October 1990) (One Market, One Money Report).

78 See eg One Market, One Money Report (n 77) 20: 'EMU will result in an amplification of the type of economic benefits that follow from the 1992 programme. Indeed only a single currency allows the full potential benefits of a single market to be achieved'.

79 One Market, One Money Report (n 77) 34-35. Note that Padoa-Schioppa himself, who would later serve on the ECB's Executive Board, used to speak about an 'inconsistent quartet', adding 'free trade' to the analysis. See Padoa-Schioppa (n 2) 110-111, 121-124.

80 This logic also resonated among lawyers. See eg Pieter Ver Loren Van Themaat, 'Some Preliminary Observations on the Intergovernmental Conferences: The Relations Between the Concepts of a Common Market, A Monetary Union, An Economic Union, A Political Union and Sovereignty' (1991) 28 CML Rev 291, 294: '[T]he establishment of an internal market without internal frontiers, as required explicitly by the Single European Act (the new Article 8a of the Treaty) was already implied in the notion of the common market in Article 2 of the Treaty and it is on the other hand only one aspect of this notion ... it is submitted that the notion already implies the abolition of "monetary frontiers"….To that extent a monetary union is the logical consequence of the concept of the common market in Article 2 of the Treaty'.

81 See also text to n 60 (ch 3).

union, things changed dramatically after the Danes rejected the Treaty of Maastricht in a referendum on 2 June 1992.[82] With the fate of the Treaty hanging in the balance, markets started to reassess the exchange rate arrangement. How determined were states to defend it now that dark clouds were gathering over the prospect of monetary union? Speculators saw their chance and put increasing pressure on the British pound and the Italian lira, both of which were considered to be overvalued.[83]

With speculation on the rise, the inconsistency between capital mobility, fixed exchange rates and national monetary policies raised its head. Participating states failed to agree on a common strategy for defending exchange rates.[84] Germany was struggling with the economic difficulties resulting from German reunification. In order to fight rocketing inflation the *Bundesbank* was raising interest rates far into the summer of 1992. Most other participants, however, found themselves in a recession and were suffering from the high interest rates needed to hold on to their exchange rates with the D-Mark.[85] Tensions reached a peak at a meeting of finance ministers and central bank governors in Bath on 4-6 September 1992.[86] Several participants, in particular the British, demanded that Germany lowered its interest rates. But German representatives refused, arguing that a 'general realignment' of exchanges rates was called for instead.[87] When the disagreement that prevailed during the meeting reached the public, markets reacted without remorse. Little more than a week later, on 16 September 1992, better known as 'Black Wednesday', the pound left the system. The Italian lira followed a day later.[88]

The departure of these currencies formed the start of a period in which the European Monetary System experienced severe instability and frequent realignments which only came to an end after the ministers of finance and central bank governors decided on 2 August 1993 to broaden fluctuation margins to 15%.[89] Interestingly, although this period of instability was

82 Barry Eichengreen and Charles Wyplosz, 'The Unstable EMS' (1993) Brookings Papers on Economic Activity 51, 82ff; Chang (n 9) 50-51.

83 The British pound had only entered the ERM, with fluctuation margins of 6%, in October 1990 after not having participated in exchange rate arrangements since its departure from the snake in 1973. See also Szász, *The Road* (n 2) 176.

84 For elaborate discussions of events during the run-up to 'Black Wednesday' see Mark D Harmon and Dorothee Heisenberg, 'Explaining the European currency crisis of September 1992' (1993) 29 German Politics and Society 19, 24-32; Gros and Thygesen (n 2) 93-96; Szász, *The Road* (n 2) 172-180; Chang (n 9) 50-53; Marsh (n 24) 150-161.

85 Harmon and Heisenberg (n 84) 25-26; Gros and Thygesen (n 2) 93-94.

86 Harmon and Heisenberg (n 84) 28-29; Gros and Thygesen (n 2) 95; Szász, *The Road* (n 2) 177-178; Chang (n 9) 51; Marsh (n 24) 153-154.

87 Harmon and Heisenberg (n 84) 28-29.

88 Harmon and Heisenberg (n 84) 19, 31-32.

89 Szász, *The Road* (n 2) 191-192. For an overview of realignments see Gros and Thygesen (n 2) 95-101. Only for the D-Mark and the Dutch guilder were the margins of 2.25% kept in place on the basis of a bilateral agreement. See also Smits, *The European Central Bank* (n 4) 21, 125.

triggered by doubts among market participants whether monetary union would ever see the light of day, it had exactly the opposite effect. Otmar Issing, board member of the *Bundesbank* at the time, explains it very clearly:

> 'The experience of this period confirms the theory of the so-called "uneasy triangle", according to which only two of the three goals of stable exchange rates, stable prices (or monetary policy autonomy) and free movement of capital can ever be attained at the same time. Since restrictions on capital movements are incompatible with common market principles – disregarding other major objections such as the practicability of capital controls – the only choice remaining is between the other two objectives. The option of flexible exchange rates was never seriously entertained in the context of European integration ... Thus, out of the set of three objectives, it was basically "only" monetary policy that remained on the table.'[90]

In other words, as there was no possibility to go back in time and undo the internal market, and given the unattractiveness of floating exchange rates, the best option was to take a great leap forward: a single currency.

But even this strengthening of its economic rationale cannot fully account for the achievement of monetary union. It cannot account for the acceleration of events towards the conclusion of the Treaty of Maastricht after the European Council had decided to move to monetary union in Madrid in June 1989, all of which took place before the exchange rate crisis of 1992. Take the Delors Report. It stresses the link between the completion of the internal market and monetary union, and even argues that in many respects the latter forms a 'natural consequence' of the former.[91] Yet, few members of the Delors Committee had ever dreamt of the speed with which the Treaty would be concluded when they presented their report in April 1989. *Bundesbank* President Otto Pöhl recalls:

> 'The Delors Report was a confused piece of work. There were some wild ideas in it. When it was formulated, I did not believe that monetary union with a European Central Bank could come about in the foreseeable future. I thought it might come in the next hundred years.'[92]

Admittedly, Pöhl belonged to the most hawkish members of the committee. As president of the *Bundesbank* he was wary of any initiative aiming for monetary union, concerned as he was that a European single currency would not be able to deliver on price stability the same way as the D-Mark.[93] But this only makes the question more pressing: what can explain the rapid con-

90 Otmar Issing, *The Birth of the Euro* (CUP 2008) 7-8.
91 Delors Report (n 63) para 14.
92 Quoted in Marsh (n 24) 123.
93 Szász, *The Road* (n 2) 112-113.

clusion of the Treaty, given that Germany, from a monetary perspective, stood to lose a lot and gain little?

Answering this question requires a return to the realm of high politics. Ever since the first call for monetary union in 1969,[94] the Franco-German axis had informed European monetary cooperation, even more modest initiatives like the Monetary System.[95] Yet it gained centre stage at the end of 1989 when Europe was shaken to its foundations by the fall of the Berlin Wall and the looming prospect of German unification. All of a sudden, both France and Germany were more interested in a single currency than ever before.

To be fair, France had been pleading for a single currency long before the Wall came down on 9 November 1989, displeased as it was with the European Exchange Rate Mechanism in which it had to bear most of 'the burden of adjustment' in order to maintain stability with its German neighbour whose D-Mark operated as the 'anchor currency'.[96] Instead of having its monetary policy under the factual control of the *Bundesbank*, it preferred a currency union in which all participating states had 'a seat at the monetary table'.[97] In the words of President Mitterrand:

> 'Today the strongest currency in Europe is West Germany's….should we live in a mark zone where only the Germans would express themselves? I would prefer an assembly, a meeting, a permanent conference of the different authorities where France could have its say on all aspects of economic policy.'[98]

But now on top of this long-cherished desire, came the urgency of 'the German question'.[99] Concerned about the position of a unified Germany at the very centre of Europe, France perceived a single currency as a means of keeping its neighbour strongly tied to Western Europe.[100] Or to resort once more to Mitterrand, speaking to students in Leipzig in December 1989:

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94 See text to n 18 (ch 3).

95 Szász, for example, explains how the EMS originated from the joint effort of German Chancellor Helmut Schmidt and French President Giscard d'Estaing, stating: '[P]olitical considerations were the basis for the monetary initiatives in 1978, as had been the case in 1969. The reasons for establishing the European Monetary System went far beyond the merits of an exchange rate arrangement, both for Helmut Schmidt and for Valéry Giscard d'Estaing'. See Szász, *The Road* (n 2) 52.

96 Dyson and Featherstone (n 2) 25-26. See also Wayne Sandholtz, 'Choosing union: monetary politics and Maastricht' (1993) 47 International Organization 1, 27-29; Szász, *The Road* (n 2) 98-99.

97 Sandholtz (n 96) 29-30. See also Dyson and Featherstone (n 2) 222-223.

98 Quoted in Reuters, 27 June 1989 (as cited in Szász, *The Road* (n 2) 152).

99 Szász, *The Road* (n 2) 141.

100 Sandholtz (n 96) 32-33; Szász, *The Road* (n 2) 142-143.

> 'I thus assert that the reunification of Germany is also the concern of your neighbours who do not have to substitute for the German will, but who need to ensure European stability. It is almost a contradiction. Two different analytic elements, that could be thesis and antithesis, waiting for a synthesis. I think such is possible, that is to say: one has to proceed simultaneously with German and European unification.'[101]

The issue of unification had even more profound effects in Germany itself. At the meeting of the European Council in Madrid in June 1989 Chancellor Kohl approved of the Delors Report and consented to 1 July 1990 as the starting date for the first stage of monetary union, but he refrained from giving his blessing to a rapid convening of an intergovernmental conference to prepare the necessary Treaty amendments for the second and third stages.[102] Personally, Kohl, and even more so his Foreign Affairs Minister Genscher, thought permissively about a single currency, as they regarded it as an indispensable key to intensifying Germany's ties with the East whilst securing political stability in Europe.[103] Yet, they were held back from acting accordingly by Germany's financial establishment, in particular the *Bundesbank* and the economics and finance ministries, which perceived monetary union to be a distant goal, only within reach after considerable convergence of the national economies had taken place.[104] In addition, they had to take into account German public opinion which, although positive about European integration in general, placed great pride in the D-Mark.[105] When asked about his readiness to set a final date for the intergovernmental conference during a bilateral with Mitterrand at the European Council meeting in Madrid, Kohl therefore allegedly told the latter: 'Abandoning the D-Mark is a great sacrifice for the Germans. Opinion is not yet ready!'[106]

But Kohl's position changed over the second half of 1989 when German reunification loomed on the short term horizon with increasing speed. Particularly after the fall of the Wall, Kohl approached monetary union with urgency in the realisation that its geopolitical dimension was now more relevant than ever.[107] Keen on assuaging Mitterrand's fears about

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101 François Mitterand, *De l'Allemagne, de la France* (Editions Odile Jacob 1996) 211.

102 Szász, *The Road* (n 2) 143; Dyson and Featherstone (n 2) 312, 353-354; Marsh (n 24) 130.

103 Szász, *The Road* (n 2) 93-94, 104-106; Dyson and Featherstone (n 2) 307-313, 326-332.

104 Szász, *The Road* (n 2) 105; Dyson and Featherstone (n 2) 274-282, 284-285, 309, 311-312.

105 Szász, *The Road* (n 2) 215; Marsh (n 24) 138.

106 Quoted in Hubert Védrine, *Les mondes de François Mitterand* (Fayard 1996) 420 (as cited in Marsh (n 24) 130).

107 Szász, *The Road* (n 2) 137ff**;** Dyson and Featherstone (n 2) 363-366. See also Femke van Esch, 'Why Germany Wanted EMU: The Role of Helmut Kohl's Belief System and the Fall of the Berlin Wall' (2012) 21 German Politics 21, 44: '[T]he 1989 revolution in Eastern Europe strengthened Kohl's pre-existing pro-European convictions, politicizing the issue of European monetary union and inciting him to act on these beliefs ... the fall of the Berlin Wall instigated a crucial shift in the German domestic balance of power by giving the chancellor

reunification, he sent him several letters in late November in which he indicated his willingness to agree on an early date for the intergovernmental conference at the upcoming December summit of the European Council in Strasbourg.[108] At the same time he made clear that it was of prime importance that a single currency was not pursued in isolation, but that it was accompanied by political union. And so it came to be. At its December meeting in Strasbourg, the European Council decided to hold an intergovernmental conference on economic and monetary union, starting before the end of 1990.[109] Several months later, in June 1990, it did the same for political union at its meeting in Dublin.[110] Little more than a year later, on 7 February 1992, the Treaty of Maastricht was signed.

German reunification, then, turned out to significantly speed up the achievement of monetary union. This view is also taken by Michel Rocard, the French prime minister between 1988 and 1991. Looking back at the run-up to the Treaty of Maastricht, he explains:

> 'There was a balance between unification of Germany and the establishment of European monetary union. Botch processes accelerated after the fall of the Berlin Wall. Kohl and Mitterrand were already engaged in both efforts. Mitterrand had to accept reunification more quickly than he thought likely, in the same way that Kohl had to accept monetary union more quickly than he had intended.'[111]

Just as the move towards monetary union has both an economic and a political dimension to it, so too does its legal set-up. Creation and legal substance are even related. Let us therefore turn to this set-up and see how and where these dimensions become apparent.

3 THE STABILITY PERSPECTIVE

3.1 Explaining the original set-up

Accounts differ about which factors have inspired the move towards the single currency and how this has influenced its legal set-up. Take former Dutch Central Bank Director André Szász. He attributes much importance to the

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the necessary domestic discourse and legitimacy to overrule the German financial elite on several crucial elements in the EMU negotiations'.

108 Dyson and Featherstone (n 2) 365-366. See also Szász, *The Road* (n 2) 105-106.

109 See text to n 69 (ch 3).

110 See text to n 70 (ch 3).

111 Quoted in Marsh (n 24) 137.

currency union's political dimension,[112] viewing its establishment and legal set-up as two sides of a compromise. The single currency itself, according to Szász, is a 'French *desire* and a German *concession*'.[113] For France it formed a means to gain influence in the monetary domain, putting an end to the situation in which it had to gear its policy to a great extent to that of the *Bundesbank*. Given the single currency's geopolitical importance, Germany was prepared to go along with French desires. Yet, the reverse is true when it comes to the currency's set-up. Because of its 'deep-seated fear of inflation', Szász argues, Germany's preparedness to sacrifice its D-Mark was tied to the condition that its European replacement would be at least as strong and solid.[114] As a result, France had to accept that the law on economic and monetary union would bear a strong 'stability' hallmark.[115]

To explain why Germany managed to exert such influence on the shape of the single currency's set-up one can point to its strong negotiating position.[116] As the 'anchor' of the European Monetary System, Germany enjoyed most policy autonomy, allowing it to take stock of domestic demands when setting monetary policy to a greater degree than other participants.[117] By consenting to a single currency, Germany would forego this position and have to live with a central bank gearing its policy to European-wide conditions instead.[118] Germany also had to deal with scepticism in financial circles and among the public at large.[119] Abandoning the D-Mark, the epitomisation of Germany's economic success following the War, in exchange for a European alternative with no inflation credentials whatsoever was a delicate issue.[120] Given these sacrifices, Germany could force its partners at the negotiating table to concede on crucial points. Andrew Moravscik, who puts much emphasis on 'intergovernmental bargaining theory' in explaining the single currency's set-up, even goes as far as saying that 'anything less than a "German" EMU

112 See eg Szász, *The Road* (n 2) 219: 'The main motives for establishing the Economic and Monetary Union are political rather than economic'.

113 André Szász, 'Een Duits dilemma: de euro van geloofwaardigheids- naar vertrouwenscrisis' (2012) 66 Internationale Spectator 137, 139 (translation by the author, emphasis added). See also Szász, *The Road* (n 2) 214-215, 217-219, 222.

114 Szász, *The Road* (n 2) 215.

115 Szász, 'Een Duits dilemma' (n 113) 137.

116 See in this regard Andrew Moravcsik, *The Choice for Europe: Social Purpose and State Power From Messina to Maastricht* (Cornell University Press 1999) 440-447, 461-467.

117 Chang (n 9) 67-68.

118 See also Moravcsik (n 116) 466: 'The German government was tightly constrained, such that the asymmetrical EMS….was an acceptable alternative'.

119 Moravcsik (n 116) 394-395, 466.

120 Dyson and Featherstone (n 2) 254: '[G]erman negotiators were being asked to concede the most for EMU: the surrender of the D-Mark, the foremost symbol of Germany's postwar economic achievement…'.

would simply be vetoed at home, whereas greater compromise was possible in neighbouring countries'.[121]

Others attach less importance to politics and bargaining and instead stress changes in the international economy and the influence this had on the type of economic and monetary policy that states considered desirable. Illustrative is Kathleen McNamara. Central to her explanation of European monetary integration are increasing cross-border movements of capital and converging policy 'ideas' among states.[122] The evolving structure of the global economy during the 1980s and 1990s, characterised by growing capital mobility, created an environment in which monetarist 'policy preferences' could take hold 'among European elites', even in states with the traditional habit of more expansionary policies.[123] This change in mind-set cleared the way for increasing monetary cooperation, eventually culminating in the Treaty of Maastricht which, according to McNamara, sets out a 'low-inflation, German-model style EMU'.[124]

Accounts like those of Szász and McNamara about the creation of monetary union differ, attributing varying importance to political trade-offs, economic conditions and converging policy ideas. The truth is that neither of them can completely explain the creation of the monetary union as each of them singles out certain aspects that have been important for its establishment, but leaves out others.[125] Where they converge, however, is on the shape of its legal set-up which both regard as containing a stability-oriented policy framework. Indeed, integration theorists and political economists agree that the Union Treaties institutionalise a 'sound money' or 'stability' paradigm.[126] This paradigm attributes overriding importance to price stability as a policy goal and argues for a privileged position for the central bank to achieve it.

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121 Moravcsik (n 116) 441. This does not mean, however, that Moravcsik would agree with Szász's analysis that the main motives behind the establishment of the monetary union were (geo)political. In his view German 'preference formation' in relation to monetary union was mostly grounded in economics, with geopolitical 'ideology' being of subsidiary importance. See Moravsckik (n 116) 386-389, 396-404. For a critique of this emphasis on preference formation based on 'structural economic interests' see Dyson and Featherstone (n 2) 770-774.

122 For a discussion of the argument in a nutshell see Kathleen R McNamara, *The Currency of Ideas: Monetary Politics in the European Union* (Cornell University Press 1998) 3-8.

123 McNamara, *The Currency of Ideas* (n 122) 6.

124 McNamara, *The Currency of Ideas* (n 122) 170-171.

125 Needless to say that together they cannot fully account for the monetary union's creation either.

126 See eg Martin Marcussen, 'The Dynamics of EMU Ideas' (1999) 34 Cooperation and Conflict 383, 402; Kenneth Dyson, *The Politics of the Euro-Zone: Stability or Breakdown?* (OUP 2000) 27; Martin Heipertz and Amy Verdun, *The Politics of the Stability and Growth Pact* (CUP 2010) 91-93. Legal academics too have recognized the influence of the stability paradigm on the legal set-up of the economic and monetary union. See most notably Matthias J Herdegen, 'Price Stability and Budgetary Restraints in the Economic and Monetary Union: The Law as Guardian of Economic Wisdom' (1998) 35 CML Rev 9.

The remainder of this chapter goes on to explore the substance of this stability perspective further. It claims that this perspective informs crucial elements of the single currency's original legal set-up. Without trying to account for all the reasons that have led to this particular set-up, the chapter shows that to some extent at least it is grounded in a preference for monetarism, implicitly shared by many policy makers and politicians at the time of its creation. At the same time, it certainly also reflects Germany's strong negotiating position. Where the stability perspective first of all becomes visible is at the level of goals and principles.

3.2 Price stability as the overriding aim

A convergence in economic policy beliefs is key to an understanding of the economic and monetary union's primary aim: price stability. This convergence means a shift away from the policy paradigm of 'Keynesianism' towards that of 'monetarism'. Each employs a very different conception of the economy and the extent to which it can be steered by the government.

During the first decades following the Second World War, Keynesianism dominated much of macro-economic policy-making in Europe.[127] 'Keynesians', Peter Hall explains, 'regard the private economy as unstable and in need of government intervention'.[128] The government has to actively pursue economic growth and combat unemployment, in particular by stimulating demand through 'expansionary' use of monetary and fiscal tools.[129] After the oil crisis in 1973, however, Keynesianism lost much of its appeal when it became clear that states had failed to reach their employment and growth targets.[130] On the contrary: many of them were facing 'stagflation', meaning that they were struggling with a recession and inflation at the same time.[131]

The failure of Keynesian responses to the economic problems of the 1970s made policy makers receptive to a different school of thought: monetarism.[132] Contrary to Keynesians, Hall makes clear, monetarists regard 'the private economy as basically stable and government intervention as likely to do more harm than good'.[133] Expansionary monetary policies are unsuited for com-

127 McNamara, *The Currency of Ideas* (n 122) 84-87.

128 Peter A Hall, 'From Keynesianism to monetarism: Institutional analysis and the Brisish economic policy in the 1970s' in Sven Steinmo, Kathleen Thelen and Frank Longstreth (eds), *Structuring Politics: Historical Institutionalism in Comparative Analysis* (CUP 1992) 92.

129 Paul De Grauwe, *Economics of Monetary Union* (10th edn, OUP 2014) 150. See also Hall (n 128) 92.

130 McNamara, *The Currency of Ideas* (n 122) 65, 146.

131 McNamara, *The Currency of Ideas* (n 122) 65, 146.

132 This view can ultimately be traced back to the ideas of Milton Friedman. See eg Milton Friedman, 'The Role of Monetary Policy' (1968) 58 The American Economic Review 1.

133 Hall (n 128) 92. See also McNamara, *The Currency of Ideas* (n 122) 144-146.

bating unemployment as there is no 'permanent trade-off' with inflation.[134] They may affect unemployment in the short-run, but they cannot structurally push it beneath its 'natural rate'.[135] One of the main reasons for this inability to improve employment in the long-run lies in the problem of 'time-inconsistency'.[136] Assuming that the public is 'rational', it will anticipate the government's tendency to create 'surprise inflation' when they have to determine prices or negotiate salaries.[137] This interaction between the government and the public, both acting on their rational expectations, creates an 'inflationary bias' in which monetary policy leads to higher inflation but without the desired effect on employment.[138]

What monetary policy should aim for instead, and above anything else, is price stability. Keeping prices stable offers the best prospects of preventing inflation and creating the requisite conditions for sustainable economic growth.[139] To the extent that the government does want to do something about unemployment, it should concentrate efforts on 'structural policies', for example reforms of the labour laws or tax system.[140]

During the 1980s and 1990s the monetarist view gained in popularity, even in states with a traditional habit of expansionary policies. The European Monetary System was instrumental to this change. By 'tying their hands' to Germany – that is: by closely following the policy of the *Bundesbank* – central banks of participating states were able to strengthen their credibility and bring inflation down to acceptable levels.[141] A good example of the disciplining effect of the system is the policy 'U-turn' of France at the beginning of the 1980s.[142] As the first socialist president of France in more than two decades, and with the Communists participating in his government, Mitterrand tried to steer the French economy by applying the Keynesian medicine when he

134 McNamara, *The Currency of Ideas* (n 122) 146.

135 McNamara, *The Currency of Ideas* (n 122) 67, 146. See also De Grauwe (n 129) 150.

136 De Grauwe (n 129) 40-45, 150. For a classic analysis of the policy problem of 'time-inconsistency' see Finn E Kydland and Edward C Prescott, 'Rules Rather Than Discretion: The Inconsistency of Optimal Plans' (1977) 85 Journal of Political Economy 473; Robert J Barro and David B Gordon, 'A Positive Theory of Monetary Policy in a Natural Rate Model' (1983) 91 Journal of Political Economy 589.

137 William Bernhard, J Lawrence Broz and William R Clark, 'The Political Economy of Monetary Institutions' (2002) 56 International Organization 693, 705. See also Mcnamara, *The Currency of Ideas* (n 122) 146-147.

138 Bernhard, Broz and Clark (n 137) 705. See also De Grauwe (n 129) 150.

139 McNamara, *The Currency of Ideas* (n 122) 67, 145; De Grauwe (n 129) 150.

140 De Grauwe (n 129) 150. See also McNamara, *The Currency of Ideas* (n 122) 147.

141 Chang (n 9) 29-30, 42. For an extensive analysis of the disciplining effect of the EMS on central bank credibility see Francesco Giavazzi and Marco Pagano, 'The Advantage of Tying One's Hands: EMS Discipline and Central Bank Credibility' (1988) 32 European Economic Review 1055.

142 Chang (n 9) 28. See also Mcnamara, *The Currency of Ideas* (n 122) 135-139.

came to office in 1981.[143] The attempt was short-lived as it did not improve the economy, but triggered severe exchange rate problems and high inflation. Only two years later, in 1983, the French government therefore changed course and started to implement a '*franc fort* policy' by trying to align its monetary policy to that of Germany.[144]

Besides its disciplining effect, the European Monetary System also more generally served as a platform for the spread of monetarist views, in particular through the example set by Germany in conducting a monetary policy of restraint. 'When most of Europe was struggling with stagflation after the first oil crisis', McNamara argues, 'West Germany stood out as successful in managing its economy, particularly in terms of inflation and employment'.[145] 'German officials were not hesitant to make known their views on the importance of price stability', she continues, 'proselytizing the merits of restrictive monetary policy to their neighbours'.[146]

It would be wrong, however, to think that all members of the Community equally favoured price stability and that in making it the currency union's overriding rationale Germany's function was confined to that of a role model preaching the monetary gospel. Together with other stability-minded states like The Netherlands, it simply also negotiated hard to achieve this goal. As the state where the stability culture was most strongly entrenched, making sure that the future currency union would be oriented towards price stability was of great importance to Germany. This was particularly true for its financial elites, represented most forcefully by the *Bundesbank*, whose thinking was significantly influenced by 'ordoliberalism'.[147]

Developed as an alternative to the defects of the Weimar Republic, in particular the severe economic and political instability caused by hyperinflation, ordoliberalism sought to create an economic system that would guard society against both '*laissez-faire* liberalism' and 'collectivist' rule.[148] To this end, it advocated a powerful state capable of securing and regulating a healthy market economy.[149] One of its key responsibilities was to put in place a policy

143 Chang (n 9) 28; Mcnamara, *The Currency of Ideas* (n 122) 135-139.

144 Chang (n 9) 28. See also Mcnamara, *The Currency of Ideas* (n 122) 137-139.

145 McNamara, *The Currency of Ideas* (n 122) 69.

146 McNamara, *The Currency of Ideas* (n 122) 69 (as well as 152-158). Dyson and Featherstone (n 2) 752 equally argue that due to Germany's economic success 'What followed in the EMU negotiations was imitation of the EC economy judged to have been most successful in managing monetary policy – Germany'.

147 Dyson and Featherstone (n 2) 278-279.

148 Werner Bonefeld, 'Freedom and the Strong State: On German Ordoliberalism' (2012) 17 New Political Economy 633, 634-635, 639. See also Dyson and Featherstone (n 2) 276-277.

149 Bonefeld (n 148) 641: '"[O]rdoliberalism" asserts the authority of the state as the political master of the free economy. Freedom is freedom within the framework of order, and order is a matter of political authority. Only on the basis of order can freedom flourish and can a free people be trusted to adjust to the price mechanism willingly and self-responsibly'.

set-up to achieve such an economy, in particular by having a well-functioning 'price mechanism'.[150] Ensuring monetary stability was therefore one of ordo-liberalism's central preoccupations.[151]

Negotiations over the set-up of the currency union not only took place during the intergovernmental conference on economic and monetary union – much of it happened earlier, and indirectly, in the Delors Committee.[152] Admittedly, central bankers belonged to the circle of officials and experts where the influence of monetarist ideas was particularly strong.[153] But their report was not only a result of stability-mindedness. Within the committee a very different dynamic was at work as well. Its president, Jacques Delors, knew that any report the committee was going to produce would be most influential if it had the unanimous approval of its members.[154] And in order to obtain unanimity he had to persuade the central bank president of the most critical state, Otto Pöhl, to consent.[155] Soon he realised that this would only be possible if the report stressed the importance of price stability. Kenneth Dyson and Kevin Featherstone put it as follows:

> '[T]he Delors Committee was a rapid learning experience about what was politically realistic as the basis for unanimity ... he [Delors, ed] was quick to learn that an independent ECB pledged to price stability was a price to be paid for agreement on EMU to anchor the most important principle for the Germans – that the single currency must be "at least as stable as the D-Mark".'[156]

The Delors Report indeed pays great tribute to price stability, even to such an extent that after its publication several members of the committee stated in the press that it contained 'a lot of German thinking' and that Governor Pöhl 'had good reason to look happy'.[157] This inclination to price stability first of all shows up at the level of objectives and principles. The report mentions price stability as one of the guiding principles of economic and monetary policy and as the primary objective of monetary policy.[158]

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150 Bonefeld (n 148) 638: 'The free market allows social cooperation between autonomous individuals by means of a "signalling system", the price mechanism. It thus requires monetary stability as a "calculating machine"….that informs consumers and producers of the degree of scarcity in the whole economy'.

151 Dyson and Featherstone (n 2) 276; Bonefeld (n 148) 638.

152 See Moravcsik (n 116) 435-446, 464-466.

153 Amy Verdun, 'The role of the Delors Committee in the creation of EMU: an epistemic community?'(1999) 6 Journal of European Public Policy 308, 321.

154 Jabko (n 76) 481; Szász, *The Road* (n 2) 112-113, 118.

155 Charles Grant, *Delors: Inside the House that Jacques Built* (Nicholas Brealey Publishing 1994) 122-123; Jabko (n 76) 482; Moravcsik (n 116) 435; Szász, *The Road* (n 2) 114.

156 Dyson and Featherstone (n 2) 718.

157 Quoted in 'Bankers agree on EC route to unity', *Financial Times*, 13 April 1989 (as cited in Jabko (n 76) fn 28).

158 Delors Report (n 63) paras 16, 32.

Due to the fact that the Delors Report carried the unanimous approval of all committee members it greatly influenced the treaty negotiations that followed. Many even say it formed a 'blueprint' for the treaty provisions on economic and monetary policy.[159] And indeed, as far as goals and principles are concerned, these provisions are similarly driven by a concern for price stability. Besides the fact that price stability serves as a general aim of the Union,[160] Article 119(3) TFEU mentions it as the first guiding principle of economic and monetary policy. The other principles – sound public finances and monetary conditions and a sustainable balance of payments – fit the monetarist school of thought with its aversion to fiscal laxity.[161] More important even is that Article 119(2) TFEU declares price stability to be the primary objective of monetary policy. Support of general economic policies through monetary means is of secondary importance, possible only in as far as it does not conflict with price stability.

However, the importance of the stability paradigm reaches far beyond the realm of objectives and principles. It also exerts a profound influence on the Union's monetary policy set-up, in particular on the constitutional position of the European Central Bank.

4 The constitutional position of the European Central Bank

4.1 The stability argument for independence

Given the overriding aim of price stability, it is hardly surprising how Article 127 TFEU shapes the mandate of the European Central Bank. As an almost natural extension of Article 119(2) TFEU, its first paragraph determines that the primary objective of the European System of Central Banks – consisting of the European Central Bank and the national central banks –[162] is to maintain price stability. Only without prejudice to this goal can the system support the general economic policies in the Union in order to achieve the latter's objectives set out in Article 3 TEU.[163] More interesting than the system's mandate, is the capacity in which it pursues price stability. This capacity is one of great independence. Again, the influence of monetarism and German demands have been key in bringing it about.[164]

159 Jabko (n 76) 482; Verdun (n 153) 309.
160 See Art 3(3) TEU.
161 Dyson (n 126) 29-30.
162 Arts 282(1) TFEU and 1 of the Statute on the ESCB and ECB laid down in Protocol No 4 annexed to the Union Treaties (Central Bank Statute).
163 See also Art 282(2) TFEU and Art 2 Central Bank Statute.
164 See also Smits, *The European Central Bank* (n 4) 159.

The negative experience with high inflation during the 1970s not only contributed to the importance of price stability as a monetary policy goal. It also created momentum for central bank independence. In fact, the two are strongly linked, the idea being that price stability benefits from central bank independence. The argument supporting this idea is, in principle, quite straightforward and focuses on the possible risks of having democratically elected governments in control of monetary policy. Two such risks deserve to be mentioned specifically, each of them focusing on the negative inflationary effects of using monetary policy to push unemployment below its natural rate.

The first has to do with monetary policy being determined by 'office-motivated' governments.[165] Eager to cling on to their position, elected politicians are predominantly motivated to bring home the next election.[166] They are therefore inclined to boost the economy in the run-up to the election in order to achieve growth and reduce unemployment, for example through excessively low interest rates.[167] The second risk concerns 'partisan' politicians.[168] Unlike office-motivated politicians, partisan ones will not necessarily stick to a monetary policy that offers them the best prospects of winning elections. What they aim for instead, is a policy that is most in line with their political beliefs.[169] As a result, socialist or left-wing politicians will be inclined to pursue a more expansionist monetary agenda that is beneficial for growth and employment for a little while but also carries greater inflationary risk.[170] In combination with the time-inconsistency argument discussed above,[171] both risks may materialise and lead to an inflation bias with higher inflation but no long-term effects on employment.[172]

A possible solution to these democratic pitfalls lies in the transfer of monetary policy competences out of the hands of elected politicians into those of 'technocratic' central bankers who can 'commit credibly' to modest inflation targets.[173] During the 1980s and early 1990s this strategy was supported by a considerable amount of empirical studies arguing that the greater a central bank's independence, the lower the rate of inflation.[174] Whether and to what

165 Alberto Alesina, 'Macroeconomics and Politics' (1988) 3 *NBER Macroeconomics Annual* 13, 14. See also Kathleen R McNamara, 'Rational Fictions: Central Bank Independence and the Social Logic of Delegation' (2002) 25 West European Politics 47, 51.

166 Alesina (n 165) 14; McNamara, 'Rational Fictions' (n 165) 51.

167 Alesina (n 165) 15; McNamara, 'Rational Fictions' (n 165) 51.

168 Alesina (n 165) 15. See also McNamara, 'Rational Fictions' (n 165) 51-52.

169 Alesina (n 165) 15; McNamara, 'Rational Fictions' (n 165) 51-52.

170 Alesina (n 165) 15-16; McNamara, 'Rational Fictions' (n 165) 51-52.

171 See text to n 136 (ch 3).

172 Mcnamara, 'Rational Fictions' (n 165) 52.

173 Mcnamara, 'Rational Fictions' (n 165) 52.

174 See eg Vittorio Grilli, Donato Masciandaro and Guido Tabellini, 'Political and Monetary Institutions and Public Financial Policies in the Industrial Countries' (1991) 13 Economic Policy 341; Alberto Alesina and Lawrence H Summers, 'Central Bank Independence and Macroeconomic Performance: Some Comparative Evidence' (1993) 25 Journal of Money,

extent such studies indeed prove that central bank independence leads to better inflation results is open to debate.[175] Critics question the causal connection between the two, in particular by pointing out that such studies fail to take into account the stance of society at large concerning inflation.[176] What matters, however, is that from the 1980s onwards independence was widely *perceived* as necessary for price stability and that this has influenced the constitutional position of the European Central Bank.[177] A great deal of this influence was exercised by the most arduous advocates of independence: central bankers themselves. Not only did they sit on the Delors Committee, which argued strongly in favour of independence,[178] they also made themselves heard via the Committee of Central Bank Governors which was in charge of preparing the Bank's Statute.[179]

Besides the shift from Keynesianism to monetarism, German negotiating demands have been vital in shaping the Bank's independent position.[180] Given its essential concern to make sure that the future single currency would have a stability record that would be at least as solid as that of its D-Mark,[181] Germany tried to 'model' the European Central Bank after the independent *Bundesbank*.[182] Its financial elites attached even more importance to central

Credit and Banking 151; Thomas Havrilesky and James Granato, 'Determinants of inflationary performance: Corporatist structures vs. central bank autonomy' (1993) 76 Public Choice 249. For a discussion see also Sylvester CW Eijffinger and Jacob de Haan, 'The Political Economy of Central Bank Independence' (Special Papers in International Economics, Princeton University 1996) 7-12.

175 McNamara, 'Rational Fictions' (n 165) 58-59.

176 See Bernd Hayo, 'Inflation culture, central bank independence and price stability' (1998) 14 European Journal of Political Economy 241. See also Peter A Hall and Robert J Franzese, Jr, 'Mixed Signals: Central Bank Independence, Coordinated Wage Bargaining, and European Monetary Union' (1998) 52 International Organization 505 (arguing that the proposition that central bank independence leads to low inflation only holds in states with coordinated wage-bargaining systems); McNamara, 'Rational Fictions' (n 165) 58-59.

177 For an analysis of the popularity and acceptance of central bank independence see McNamara, 'Rational Fictions' (n 165) 59-66; James Forder, 'Why is Central Bank Independence So Widely Approved?' (2005) 39 Journal of Economic Issues 843.

178 Delors Report (n 63) para 32.

179 See also Matthias Kaelberer, *Money and Power in Europe: The Political Economy of European Monetary Cooperation* (State University of New York Press 2001) 184.

180 Moravscik (n 116) 441-442, 444-445.

181 See text to n 114, 156 (ch 3).

182 Jakob de Haan and Laurence Gormley state in this regard that 'the Statutes of the ECB are largely modelled after the law governing the Bundesbank'. See Jakob de Haan and Laurence W Gormley, 'The Democratic Deficit of the European Central Bank' (1996) 21 EL Rev 95, 95. For the argument that the institutional position of the ECB is actually very different from that of the *Bundesbank* due to the legal character of the provisions governing its independence see Marijn van der Sluis, 'Maastricht Revisited: Economic Constitutionalism, the ECB and the Bundesbank' in Maurice Adams, Federico Fabbrini and Pierre Larouche (eds), *The Constitutionalization of European Budgetary Constraints* (Hart Publishing 2014) 105.

bank independence in a monetary union than in a purely national context. Speaking shortly before the start of the intergovernmental conference on monetary union, *Bundesbank* President Pöhl explained why:

> 'Historical experience shows that monetary stability can best be expected of a system which is independent of political interference. This applies to the EC to an even greater extent than to nation-states because in a confederation such as the EC there is always a tendency to orientate oneself towards averages and compromises, but that is the worst possible compass for monetary policy. Only an independent institution is in a position to resist the recurring wishes of politicians to prescribe monetary policy targets which are often inconsistent with the objective of stability.'[183]

In other words, the *Bundesbank* estimated the risks associated with having politicians in control of monetary policy to be greater in the case of a shared currency, making the need for an independent central bank even more pressing.

4.2 Legal safeguards for independence

Article 282(3) TFEU is the first provision to answer the desire for central bank independence. It determines that the European Central Bank 'shall be independent in the exercise of its powers and in the management of its finances'.[184] But legal safeguards for independence are more plentiful and specific than this general clause. Scattered around in the TFEU and the Statute of the Bank (hereafter 'Statute'), they aim to protect independence in several ways: 'institutionally', 'organizationally', 'functionally' and 'financially'.[185]

Institutional independence aims to shield a central bank from, generally speaking, the government's executive and legislative branches.[186] Several

183 Karl Otto Pöhl, 'Towards Monetary Union in Europe' (Speech at the General Meeting of the Mont Pelerin Society, 3 September 1990) in James M Buchanan, *Europe's Constitutional Future* (Institute of Economic Affairs 1990) 38 (as cited in Rosa M Lastra, 'The Independence of the European System of Central Banks' (1992) 33 Harvard Int'l LJ 475 (fn 9).

184 Prior to the entry into force of the Lisbon Treaty, the EC Treaty did not employ the notion 'independence' in relation to the ECB. It did so only in relation to national central banks in Article 116(5) EC. See also Fabian Amtenbrink, Leendert A Geelhoed and Suzanne Kingston, 'Economic, Monetary and Social Policy' in PJG Kapteyn and others (eds), *The Law of the European Union and the European Communities* (Kluwer Law International 2008) 951-952.

185 A similar subdivision, be it sometimes differently worded, is used by many legal academics. See eg Smits, *The European Central Bank* (n 4) 155-157; Amtenbrink, Geelhoed and Kingston (n 184) 953. It is also used by the ECB in its convergence reports which are further discussed below (see text to n 438 (ch3)).

186 Smits, *The European Central Bank* (n 4) 155; Amtenbrink, Geelhoed and Kingston (n 184) 953.

treaty provisions aim to protect this facet of the Bank's independence, both in law and in fact. Legally, its separation from other branches of government finds its expression in Articles 282(3) TFEU and Article 9.1 of the Statute. Together, these provisions ensure that the Bank has separate legal personality and enjoys in each member state 'the most extensive legal capacity accorded ... under its national law'. But the Bank's institutional independence extends beyond its legal status as Articles 130 TFEU and 7 of the Statute stipulate that it 'shall not seek or take instructions' from Union institutions and bodies or national governments.[187] The same also applies the other way around since these entities must not seek to influence members of the Bank. The aim of this prohibition is very clear and was aptly put by the Court in the *OLAF* case as seeking 'to shield the ECB from all political pressure in order to enable it effectively to pursue the objectives attributed to its tasks'.[188] Protecting the Bank against such pressure is also one of the primary aims of the prohibition on monetary financing in Article 123 TFEU, which will be further discussed below in relation to fiscal policy.[189]

Personal independence concerns the composition of the Bank's decision-making bodies and the conditions governing the employment of their members.[190] Concerning appointment, Articles 283(2) TFEU and 11.2 of the Statute determine that members of the Executive Board, which is in charge of implementing the monetary policy decided on by the Governing Council,[191] must be appointed by the European Council from among 'persons of recognized

187 Both provisions also apply to national central banks.

188 Case C-11/00 *Commission v ECB* [2003] EU:C:2003:395, para 134 (*OLAF*). The fact that the ECB enjoys great independence does not mean, however, that it is completely separated from the Union or exempted from each and every rule of (secondary) Union law. In *OLAF* the Court has made clear that provided, first, that the Union has a competence to legislate and, second, that such legislation does not affect the ECB's independence, the latter cannot escape its application (para 135ff). It has thereby also brought some clarification to the debate on the consequences of the ECB's independence for its legal position in the (then) Community legal order. Some, notably Chiara Zilioli and Martin Selmayr, had argued that due to its independence and separate legal personality the ECB formed a 'Community within the Community', an 'independent specialized organization of Community law'. Others disagreed with this view, arguing that despite its far-reaching independence the ECB is the central bank of the (now) Union. In its judgment, the Court leans towards the latter view. For an overview of the debate see Zilioli and Selmayr, 'The External Relations of the Euro Area' (n 4) 282-286; Chiara Zilioli and Martin Selmayr, 'The European Central Bank: An Independent Specialized Organization of Community Law' (2000) 37 CML Rev 591; Ramon Torrent, 'Whom is the ECB the Central Bank of?: Reaction to Zilioli and Selmayr' (1999) 36 CML Rev 1229; Fabian Amtenbrink and Jakob de Haan, 'The European Central Bank: An Independent Specialized Organization of Community Law: A Comment' (2002) 39 CML Rev 65.

189 See text to n 274 (ch 3).

190 Amtenbrink, Geelhoed and Kingston (n 184) 954. For an extensive overview of the different dimensions of personal, or organisational, independence see Lastra (n 183) 482-488.

191 Art 12.1 Central Bank Statute. To the extent possible, the ECB must have recourse to the national central banks for the implementation of its policies.

standing and professional experience in monetary or banking matters'. The provision aims to prevent appointments made purely for political reasons.[192] The term of office of Executive Board members is set at the relatively long period of 8 years.[193] Appointment is non-renewable so as to make sure that members do not set monetary policy with the possibility of reappointment playing in the back of their minds.[194] The situation is somewhat different for national central bank governors who, together with the Executive Board members, sit on the Bank's Governing Council which has to formulate monetary policy.[195] Their term of office cannot be shorter than five years and is renewable.[196]

The possibility to dismiss members of the Executive Board is limited. Only if a member no longer meets the requirements for the duties accompanying his position, or has engaged in serious misconduct, is compulsory retirement possible. A decision to this end must be taken by the Court on application by the Governing Council or the Executive Board.[197] Whilst being in office, members of the Executive Board are not allowed to engage in any other occupation, paid or not, except for those instances in which prior approval has been given by the Governing Council.[198]

192 Smits, *The European Central Bank* (n 4) 162.

193 Arts 282(3) TFEU and 11.2 Central Bank Statute.

194 Lastra (n 183) 484-486; Amtenbrink, Geelhoed and Kingston (n 184) 955.

195 Art 12.1 Central Bank Statute. It should be noted that the Statute does not say anything about the independence of members of the governing bodies of national central banks other than governors. This is somewhat strange as decisions may have to be taken by national central bank boards as 'a collegiate body'. See Smits, *The European Central Bank* (n 4) 166.

196 Art 14.2 Central Statute. Given that the Statute is silent about reappointment, it follows that reappointment of central bank governors is possible. See also Smits, *The European Central Bank* (n 4) 165.

197 Art 11.4 Central Bank Statute. Similar grounds of dismissal apply to national central bank governors. Their dismissal, which is a national measure, can be appealed by the governor in question or the Governing Council before the Court on grounds of infringement of the Union Treaties or any rule of law relating to their application. See Art. 14.2 Central Bank Statute.

198 Art 11.1 Central Bank Statute. A similar rule for national central bank governors is lacking. Moreover, Union law is silent about the possibility for both Executive Board members and national governors to take up employment once their appointment has expired. Art 37.1 Central Bank Statute only requires board members of the ECB and national central banks 'not to disclose information of the kind covered by the obligation of professional secrecy'. See also Smits, *The European Central Bank* (n 4) 164, 166; Amtenbrink, Geelhoed and Kingston (n 184) 955-956. The Governing Council's Code of Conduct does determine that during the first year after their term of office has ended, its members should 'avoid any conflict of interests that could arise from any new private or professional activities'. See European Central Bank, Code of Conduct for the Members of the Governing Council [2002] OJ C 123/9, point 6. See also Amtenbrink, Geelhoed and Kingston (n 184) 956.

Independence also shows up in the implementation of the tasks entrusted to the System of Central Banks.[199] The most important task concerns the formulation and implementation of monetary policy, which is in the hands of the Eurosystem – consisting of the European Central Bank and the national central banks in the currency union – as long as not all states have adopted the single currency.[200] In carrying out this task the Bank enjoys a substantial degree of 'functional' independence, allowing it to decide on its own how to discharge its monetary responsibilities.[201] This functional independence can be further subdivided into two more specific kinds: 'goal' independence and 'instrumental' independence.[202] The first relates to the aims pursued, the second concerns the means employed to attain these aims.

Goal independence resides in the fact that nowhere do the Treaties or the Statute define price stability. Articles 127(1) and 282(2) TFEU, as well as Article 2 of the Statute, turn it into the primary aim of monetary policy,[203] yet they fail to define the notion. It is therefore up to the Bank to put flesh on it.[204] At the start of the currency union it defined price stability as 'a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the euro area of below 2%' over the medium term.[205] In response to fears that this could lead to a deflationary strategy, it subsequently redefined its target as a year-on-year increase in the index 'below, but close to, 2%'.[206]

When it comes to independence in the use of monetary policy instruments, laid down in Articles 17 to 21 of the Statute, a distinction should be made between 'direct' and 'indirect' instruments.[207] Direct instruments are those that impose obligations on a central bank's counterparts in order to influence

199 The European System of Central Banks has to carry out several tasks which can be subdivided into 'basic' and 'non-basic'. The basic tasks are laid down in Arts 127(2) TFEU and 3.1 Central Bank Statute and concern monetary policy, foreign exchange policy, the management of official foreign reserves and the promotion of a smooth payment system. The non-basic tasks are spread over the TFEU and the Statute. See also Lastra and Louis (n 9) 134. An especially interesting non-basic task concerns prudential supervision and the stability of the financial system, which is regulated in Arts 127(5)-(6) TFEU and 3.3 and 25 Central Bank Statute. On this task see text to n 289 (ch 4).

200 Arts 282(1) TFEU and 1 Central Bank Statute.

201 Amtenbrink, Geelhoed and Kingston (n 184) 954.

202 Lastra (n 183) 491.

203 Strictly speaking, these provisions make clear that price stability is not just the primary aim of monetary policy but of all tasks entrusted to the European System of Central Banks.

204 In contrast to eg the Reserve Bank of New Zealand. This central bank also has as its primary aim to pursue price stability, but it has to agree with the government on a goal for inflation. In the UK too quantification of price stability is left to the government. See Fabian Amtenbrink, 'On the Legitimacy and Democratic Accountability of the European Central Bank: Legal Arrangements and Practical Experiences' in Anthony Arnull and Daniel Wincott (eds), *Accountability and Legitimacy in the European Union* (OUP 2002) 148-149.

205 See eg European Central Bank, 'Monthly Bulletin' (ECB January 1999) 46.

206 European Central Bank, 'The Monetary Policy of the ECB' (ECB 2004) 50-51. See also Amtenbrink, Geelhoed and Kingston (n 184) 965.

207 Amtenbrink, Geelhoed and Kingston (n 184) 965.

market circumstances.[208] Indirect instruments also have this aim, but they do not pursue it through the imposition of obligations. Instead, such instruments are based on the voluntary participation of counterparts.[209] An example of a direct instrument can be found in Article 19 of the Statute and relates to minimum reserves. Generally speaking, such reserves aim to control 'monetary expansion' by requiring credit institutions to hold in reserve with the central bank certain amounts of money proportionate to the deposits they manage.[210] Open market operations, principally governed by Article 18 of the Statute, are examples of indirect instruments. They serve to 'steer' interest rates and control liquidity conditions and take place most often on the basis of 'repurchase agreements' or 'collateralized loans'.[211]

The European Central Bank enjoys most independence in the use of indirect instruments. Article 18.2 of the Statute allows it to determine on its own the 'general principles for open market and credit operations carried out by itself or the national central banks…'.[212] Its independence is more limited in relation to the direct instrument of minimum reserves. In line with the obligatory nature of this instrument, certain decisions over its use are left to the Council. Article 19.2 of the Statute determines that this institution has to 'define the basis for minimum reserves and the maximum permissible ratios between those reserves and their basis, as well as the appropriate sanctions in cases of non-compliance'.[213] Within these limits, the Bank's Governing Council can adopt regulations concerning the calculation and determination of reserves.[214]

A final way in which the independence of the Bank shows up concerns its finances. Here, too, external influence is limited. The Bank's budget is kept apart from that of the Union and it finances its activities through several

208 Smits, *The European Central Bank* (n 4) 226.

209 Smits, *The European Central Bank* (n 4) 226.

210 Smits, *The European Central Bank* (n 4) 224, 277ff. For a discussion of the ECB's use of minimum reserve requirements see European Central Bank, 'The implementation of monetary policy in the euro area' (ECB 2011) 11-12, 82-89.

211 European Central Bank, 'The implementation of monetary policy in the euro area' (n 210) 10-11, 19-26.

212 See in this regard Guideline (EU) 2015/510 of the European Central Bank of 19 December 2014 on the implementation of the Eurosystem monetary policy framework (ECB/2014/60) [2015] OJ L 91/3, as last amended by Guideline (EU) 2016/2298 of the European Central Bank of 2 November 2016 [2016] OJ L 344/102.

213 The Council has to take these decisions in accordance with the procedure set out in Arts 129(4) TFEU and 41 Central Bank Statute. It has used its competence in Art 19.1 Central Bank Statute to adopt Council Regulation 2531/98 of 23 November 1998 concerning the application of minimum reserves by the European Central Bank [1998] OJ L 318/1, as last amended by Council Regulation 134/2002 of 22 January 2002 [2002] OJ L 24/1.

214 Art 19.1 Central Bank Statute. The Governing Council has made use of this power by adopting Regulation 1745/2003 of 12 September 2003 on the application of minimum reserves (ECB/2003/9) [2003] OJ L 250/10, as last amended by Regulation 1358/2011 of 14 December 2011 (ECB/2011/26) [2011] OJ L 338/51.

specific funding channels.[215] It has its own capital, provided by the national central banks which are its sole shareholders,[216] may acquire income from the management of foreign reserves and can receive 'seigniorage' (proceeds from the creation of money).[217] The need to ensure financial independence also forms the reason for the European Court of Auditors' limited possibilities to examine the accounts of the European Central Bank. It can assess the 'operational efficiency' of the Bank's management, yet is excluded from pronouncing on its monetary strategy.[218]

The independence enjoyed by the European Central Bank – institutionally, personally, functionally and financially – is further reinforced by the fact that its safeguards are all laid down in the TFEU and the Statute and can therefore only be changed through treaty amendment.[219] Surprisingly, however, its independence was not strongly contested in the treaty negotiations on economic and monetary union. Ever since the publication of the Delors Report price stability, and with it central bank independence, were seen as important foundations for the future currency union. Even France, whose central bank had traditionally been under government control,[220] did not seriously question the need for independence as it realised that the chance of having a single currency would be close to zero if it did not cede ground on this point. What it aimed for instead was curbing the power of the future bank through political safeguards in the area of economic policy.[221]

Telling for this change in negotiating strategy are the recollections of former *Banque de France* Governor Jacques de Larosière concerning a discussion he had on the Delors Report with Pierre Bérégovoy, French finance minister at the time. De Larosière tells how he had been summoned by the minister to justify the far-reaching independence envisaged for the future central bank,

215 See also Smits, *The European Central Bank* (n 4) 167-168; Amtenbrink, Geelhoed and Kingston (n 184) 956.

216 Arts 28 and 29 Central Bank Statute. Art 47 Central Bank Statute determines that national central banks of states which do not (yet) belong to the currency union do not have to pay up their subscribed capital unless the General Council decides that 'a minimal percentage has to be paid up in order to cover the operational costs of the ECB'. These national central banks therefore do not share in the ECB's net profits or in the monetary income of the System of Central Banks. See Arts 32.5 and 33.1 Central Bank Statute.

217 Amtenbrink, Geelhoed and Kingston (n 184) 956. See also Smits, *The European Central Bank* (n 4) 167.

218 Art 27.2 Central Bank Statute. See also Amtenbrink, Geelhoed and Kingston (n 184) 956.

219 See also Smits, *The European Central Bank* (n 4) 168-169.

220 As Fabian Amtenbrink puts it: 'France also embodies a tradition of government-guided monetary policy with the Banque de France representing something similar to an administrative arm of the executive'. See Fabian Amtenbrink, 'The Democratic Accountability of Central Banks: The European Central Bank in the Light of its Peers' (DPhil thesis, University of Groningen 1998) 69.

221 Dyson and Featherstone (n 2) 181-182, 193-194, 211, 222-223.

and that he explained to him that this was actually not such a bad idea.[222] He then describes how the minister responded:

> 'M. Bérégovoy turned to his advisers and said, "The Governor is right." He stressed that, instead of criticizing the Delors Report, the Trésor should be working to put together a political counterweight to the European central bank. He said, "There's going to be a super-monetary power. We need a *gouvernement économique* [economic government] to balance that." I said to Bérégovoy, "What you have just said is wisdom itself".'[223]

Let us see whether and to what extent Union law provides for such an economic government.

5 Economic policy: fiscal prudence as a safeguard for stability

5.1 Hopes and fears for a *gouvernement économique*

Those discussing the single currency's economic foundation, lawyers and economists alike, often do so by contrasting it to its monetary foundation. And for good reason as the difference between the two is striking. Whereas the Union has been granted the exclusive competence over monetary policy in the euro area,[224] no such transfer has taken place in the economic realm. Article 5(1) TFEU merely determines that the member states 'shall coordinate their economic policies within the Union'. Article 119(1) TFEU further specifies that the activities of the Union and the states shall comprise the adoption of an economic policy that is based on 'the close coordination' of national economic policies. What explains this 'asymmetry' between the Union's economic and monetary competences?[225] And how does Union law give shape to the coordination of economic policy? Again, the answer lies to a considerable extent in the desire to safeguard price stability.

As with much of the single currency's legal framework, the contours of the economic policy arrangements were already laid down in the Delors Report. Contrary to its predecessor, the Werner Report, it envisaged far less centralisation of competences in this field.[226] This was in part due to the fact that the report already anticipated that states were unwilling to cede much of their

222 Marsh (n 24) 127-128.
223 Quoted in Marsh (n 24) 128.
224 Art 3(1)(c) TFEU.
225 On this asymmetry see eg Alicia Hinarejos, *The Euro Area Crisis in Constitutional Perspective* (OUP 2015) 3ff.
226 See also text to n 63 (ch 3).

competence in this sensitive field.[227] Yet, it was also in line with the departure from Keynesian thinking that had occurred in the intervening period and the accompanying decline in popularity of viewing the government, as Daniel Gros and Niels Thygesen say, 'as a sort of "benevolent" social planner who would ensure that demand was always at the right level'.[228] At the same time, and in contrast to its recommendations for monetary policy, the report did not set out a detailed view of what this less centralised economic policy framework should look like. It confined itself to stating that:

> 'In the economic field a wide range of decisions would remain the preserve of national and regional authorities. However, given their potential impact on the overall domestic and external economic situation of the Community and their implications for the conduct of a common monetary policy, such decisions would have to be placed within an agreed macroeconomic framework and be subject to binding rules and procedures.'[229]

This formulation left so much undecided that states could still take up very different positions during the treaty negotiations.

France saw the recommendation as a confirmation of its desired *gouvernement économique*, a term used to indicate the necessity of a 'counterweight',[230] or '*contre pouvoir*',[231] to an independent central bank. As France realised at an early stage in the negotiations that such an independent central bank was the price to pay if it wanted to have a single currency, it shifted attention to the establishment of a 'political pole', an economic government, capable of balancing the 'monetary pole'.[232] In a statement issued in December 1990 at the start of the intergovernmental conference, Finance Minister Bérégovoy described the French position as follows:

> 'It is also necessary to ensure that, in the Economic and Monetary Union, the "monetary pole" advances in parallel with the "economic pole"; the independence of the monetary institution can only be conceived within the interdependence with a strong "Economic Government". This Economic Government must be fully demo-

227 Fabian Amtenbrink and Jakob de Haan, 'Economic Governance in the European Union: Fiscal Policy Discipline versus Flexibility' (2003) 40 CML Rev 1075, 1078; Lastra and Louis (n 9) 61.

228 Gros and Thygesen (n 2) 324. See also Szász, *The Road* (n 2) 158-159; Dyson (n 126) 32.

229 Delors Report (n 63) para 19.

230 David J Howarth, 'Making and breaking the rules: French policy on EU "gouvernement économique"' (2007) 14 Journal of European Public Policy 1061, 1075.

231 Dyson and Featherstone (n 2) 182, 229-230.

232 Dyson and Featherstone (n 2) 181-182.

> cratic and its decisions must be directly binding on the member states, who will continue to execute the main elements of economic policy.'[233]

In a draft treaty that it presented shortly thereafter, in January 1991, the French government further defined its vision of *gouvernement économique*.[234] It attributed central importance to the European Council, which should ensure an adequate 'policy mix' between monetary, fiscal and other macro-economic policies by setting broad policy guidelines.[235] *Within* these guidelines the Council would be in charge of coordinating national economic policies, whilst the central bank would determine the appropriate monetary policy stance.[236]

Germany was adamantly against incorporating anything like a *gouvernement économique* into the Treaty. It regarded the prior, *ex-ante* coordination of economic and monetary policy under the guise of ensuring an appropriate policy mix as a threat to central bank independence.[237] Moreover, it sought to limit the involvement of the European Council, which it regarded as 'too political' in nature and prone to give in to short-term economic demands.[238] Instead, it favoured the Council of Ministers in its ECOFIN composition.[239]

The treaty provisions governing the coordination of national economic policies – Articles 120 and 121 TFEU – to a considerable extent favour the German view.[240] They are placed in the economic policy chapter, as a result of which they do not extend to monetary policy which is regulated in a separate chapter.[241] Moreover, the arrangements fall short of a real economic government. Article 121(1) TFEU merely determines that the member states 'shall regard

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233 Communication publiée à l'issue du Conseil des Ministres du 5 décembre 1990, 'Les progrès vers L'Union Économique et Monétaire' (as cited in Szász, *The Road* (n 2) 157).

234 French Government, *Draft Treaty on economic and monetary union* (Agence Europe No 1686, 31 January 1991) (French EMU-Draft Treaty). See also Dyson and Featherstone (n 2) 229-230; Howarth (n 230) 1066-1067.

235 Art 4-1(1) French EMU-Draft Treaty stated: 'On the basis of a report by the Council, the Commission and the ESCB, the European Council shall determine the broad guidelines for Economic and Monetary Union. It shall guarantee its satisfactory operation'. On the notion of 'policy mix' see Dyson and Featherstone (n 2) 181, 229-230; Dyson (n 126) 13; Howarth (n 230) 1066-1070.

236 Arts 1-1, 1-2, 1-3 and chapter 2 French EMU-Draft Treaty. See also Howarth (n 230) 1067. Note, moreover, that Arts 1-2 and 1-3 made clear that the coordination of economic policies by the Council had to be based on additional, superior economic guidelines set by the European Council. See in this regard n 243 (ch 3).

237 Szász, *The Road* (n 2) 158; Dyson (n 126) 13, 36.

238 Dyson and Featherstone (n 2) 411.

239 Arts 102A and 105 German government, *Overall proposal by the Federal Republic of Germany for the intergovernmental conference* (Agence Europe No 1700, 20 March 1991) (German EMU-Draft Treaty). It should be noted that, whereas the draft was only published by Agence Europe in March 1991, it had already been presented to the intergovernmental conference late February. See Dyson and Featherstone (n 2) 412.

240 Dyson (n 126) 36; Dyson and Featherstone (n 2) 788.

241 See Arts 127-133 TFEU (Ch 2).

their economic policies as a matter of common concern and shall coordinate them within the Council…'.

Articles 120 and 121(2) TFEU make clear that broad policy guidelines serve as anchor points for this coordination. The European Council is involved in the formulation of these guidelines, which cover the economic situation of the Union as a whole as well as that of specific member states,[242] but less prominently than the French had hoped for.[243] The Council, acting on the basis of a proposal by the Commission, formulates a draft for these broad guidelines and reports its finding to the European Council. The latter subsequently discusses a conclusion on the guidelines on the basis of the Council's report. Yet it is the Council, acting on the basis of this conclusion, which formally adopts recommendations setting out the guidelines.

These recommendations in turn play a prominent role in the multilateral surveillance procedure that is regulated in Articles 121(3)-(5) TFEU. The Council monitors, on the basis of Commission reports, economic developments in the Union and the member states, and examines the consistency of their policies with the broad policy guidelines. When it appears that a state's policies are not in line with these guidelines, or risk upsetting the functioning of the economic and monetary union in another way, the Commission may address a warning to the state concerned.[244] Moreover, in such a situation the Council, on a recommendation of the Commission, may address recommendations to the state. It can also, on the basis of a Commission proposal, decide to make these recommendations public.[245]

It is thus no exaggeration to say that the primacy of price stability not only shines through in the goals and principles of the currency union and its monetary set-up, but that it has also greatly influenced its economic foundation. A shift away from Keynesian to monetarist thinking, as well as a fear among stability-minded states for political threats to central bank independence, have been key in attributing the Union with only little capacity to actively shape economic policy. But this is not the only way in which stability concerns have influenced the single currency's economic base. They also provide the rationale behind the strife of Union law to bring about fiscal prudence through the imposition of discipline.

242 Amtenbrink, Geelhoed and Kingston (n 184) 915-916.

243 See Art 1-2 French EMU-Draft Treaty: 'The European Council shall, on the basis of a report by the Council, define the broad guidelines of Community economic policy'.

244 The possibility for the Commission to issue warnings only features in Art 121(4) TFEU (ex Art 103(4) EC) since the entry into force of the Lisbon Treaty.

245 Art 121(4) TFEU determines that actions of the Council on the basis of this provision are taken by qualified majority vote, without however taking into account the vote of the member state concerned. Prior to the entry into force of the Lisbon Treaty, the former Art 103(4) EC did not provide for this exclusion.

5.2 Primary law and the logic of discipline

5.2.1 The logic of discipline

The decision to grant the Union only modest economic policy competences and the pursuit of fiscal prudence are not only driven by the same need to safeguard price stability. They are also interrelated. Due to the fact that the member states remain the most important players in the realm of economic policy, ways need to be sought to prevent, and deal with, any negative consequences that may result from their fiscal imprudence. This had already been realised by the drafters of the Delors Report, who formulated their concern as follows:

> 'However, an economic and monetary union could only operate on the basis of mutually consistent and sound behaviour by governments and other economic agents in all member countries. In particular, uncoordinated and divergent national budgetary policies would undermine monetary stability and generate imbalances in the real and financial sectors of the Community.'[246]

Several negative consequences that may flow from fiscal negligence can be identified.[247] The first deals with the threat of rising interest rates.[248] Sizeable deficits can affect the 'overall savings-investment balance', which in turn may push up interest rates in the currency union.[249] These higher interest rates may have the effect of 'crowding out' other debtors, public and private, as it becomes more expensive for them to obtain financing.[250] Nevertheless, crowding out effects do not provide the strongest justification for putting limits on national budgets since they operate through the market. As Gros and Thygesen explain: 'There is no reason on economic efficiency grounds to impose ceilings on deficits just because other market participants dislike increases in the market price for savings'.[251]

Things are different for costs of fiscal laxity that are not confined to the market mechanism and therefore constitute truly 'negative externalities'.[252] One such externality occurs when a rise in public expenditure financed by market borrowings leads to an increase in the money supply.[253] As a result

246 Delors Report (n 63) para 30.
247 Whether and to what extent the risk that national governments display fiscal imprudence in a monetary union is greater than in national monetary regimes is open to debate. See De Grauwe (n 129) 218-222.
248 Gros and Thygesen (n 2) 326-327.
249 Gros and Thygesen (n 2) 326. See also De Grauwe (n 129) 215-216.
250 Smits, *The European Central Bank* (n 4) 74.
251 Gros and Thygesen (n 2) 326.
252 Heipertz and Verdun (n 126) 71-74.
253 Heipertz and Verdun (n 126) 72.

of this increase, and in order to counter any inflation risk, the Bank may consider it necessary to raise interest rates, which in turn may constrain economic activity.[254] Moreover, the rise in interest rates could drive up the euro relative to other currencies and negatively affect the trade balance.[255]

A third, and the most worrisome negative consequence, concerns the European Central Bank itself and in particular its ability to independently discharge its mandate to achieve price stability. It thereby touches upon the most important feature of the stability paradigm.[256] States that pursue expansionary fiscal policies and increasingly turn to the capital markets to finance them, could pressure the Bank to ease its interest rates in order to facilitate market access.[257] They could even induce it to 'finance' their debts by granting credit facilities or buying up their bonds.[258] A critic may argue that such pressurising is impossible given that, as shown above, Union law contains safeguards for the Bank's independence.[259] However, the truth is that such legal safeguards do not provide the final word if push comes to shove. If a state's deficit or debt becomes so large that it gets into a funding crisis, with possible spill-over effects to the banking sector, the Bank may have no other option but to intervene.[260] In fact, as chapter 6 will show, during the crisis it was precisely this dilemma that the Bank faced.[261]

The last negative consequence, that of risks for central bank independence and price stability, also shows that the struggle for fiscal prudence should not only be framed in negative terms. In other words, it is not only because of the Union's limited competences in the economic realm that Union law promotes sound fiscal policies. The monetarist school of thought with its preference for price stability gained in popularity in many parts of the world during the 1980s and 1990s and formed part of a broader neo-liberal swing towards 'financial orthodoxy'.[262] The pursuit of fiscal prudence formed a key feature of this development and was not limited to Europe.[263] On the contrary, states like Canada, the United States and New Zealand also implemented reforms granting (*de facto*) greater powers to their treasuries or finance ministries, or

254 Heipertz and Verdun (n 126) 72.
255 Heipertz and Verdun (n 126) 72.
256 Heipertz and Verdun (n 126) 74-75.
257 Heipertz and Verdun (n 126) 74; Gros and Thygesen (n 2) 327; De Grauwe (n 129) 216.
258 Heipertz and Verdun (n 126) 74-75.
259 See text to n 184 (ch 3).
260 Gros and Thygesen (n 2) 327.
261 See generally ch 6.
262 Philip G Cerny, *Rethinking World Politics: A Theory of Transnational Neopluralism* (OUP 2010) 142-144.
263 Cerny (n 262) 143-144.

putting in place fiscal rules limiting the government's budgetary room for manoeuvre.[264]

According to Alasdair Roberts, the desire for fiscal prudence was part of a broader search for a mode of government suited to the age of globalisation.[265] The answer was found in a 'design philosophy' he terms the 'logic of discipline'.[266] This logic, according to Roberts, consists of two elements. The first stresses the necessity of reform in areas that are key to financial markets.[267] Faced with the negative consequences of 'conventional methods of democratic governance' that lead to 'short-sighted' and 'unstable' policies, it makes 'a call for reforms that will promote policies that are farsighted, consistent over time, and crafted to serve the general interest'.[268] The second component concerns the shape that the reform should take.[269] In general terms, the reform should lead to a 'depoliticisation' of the area of governance concerned, the idea being that the shift away from 'everyday politics' makes it easier to implement policies that support the long-term general interest.[270] In the case of fiscal prudence, Roberts argues, the necessity of reform resulted from the high inflation and unemployment rates that many western states were facing throughout the 1970s.[271] The shape of change presented itself in reforms that sought to curb the 'fiscal drift' of governments by curtailing their discretion in financial housekeeping.[272]

This logic of discipline may be criticised for depicting the turn to fiscal prudence too negatively, or for being too general in nature to thoroughly compare and examine the ways in which different states have sought to control their budgets during the last decades. Nonetheless, it provides a valuable tool for understanding the instruments that Union law uses to keep national fiscal policies in check. Indeed, the logic of discipline is visible in two instruments. One makes use of what could be called *market discipline*, the other resorts to *public discipline*.[273]

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264 See in this regard Alasdair Roberts, *The Logic of Discipline: Global Capitalism and the Architecture of Government* (OUP 2010) 47-64.
265 Roberts (n 264) 4.
266 Roberts (n 264) 4.
267 Roberts (n 264) 4-5, 11-12.
268 Roberts (n 264) 4-5.
269 Roberts (n 264) 5.
270 Roberts (n 264) 5.
271 Roberts (n 264) 26-28, 47-48.
272 Roberts (n 264) 48, 57ff.
273 See also Stefaan Van den Bogaert and Vestert Borger, 'Twenty Years After Maastricht: The Coming of Age of the EMU?' in Maartje de Visser and Anne Pieter van der Mei (eds), *The Treaty on European Union 1993-2013: Reflections from Maastricht* (Intersentia 2013) 454.

5.2.2 *Market discipline*

The instrument of market discipline is embodied in three prohibitions laid down in Articles 123-125 TFEU. Together these three prohibitions try to ensure that member states are, as René Smits calls it, subject 'to the full rigour of the market'.[274] Each of them cuts off certain financing mechanisms and thereby aims to ensure that states are solely responsible for their fiscal behaviour and cannot rely on the financial help of third parties. This should lead markets to judge the capacity of states to honour their financial commitments on similar terms as they would apply to other borrowers and charge higher risk premiums if they have doubts about it, causing interest rates to rise.[275] This, in turn, should induce a state to adjust its policies, putting it back on the track of fiscal prudence.

The first prohibition, the one in Article 123(1) TFEU, contains a ban on monetary financing. It is repeated in Article 21(1) of the Statute and cuts off two financing mechanisms. First of all, it prohibits the granting of credit facilities by the European Central Bank and national central banks to a state's central government, other authorities and public bodies or public undertakings. Second, it rules out that the European Central Bank and national central banks buy up their debt instruments directly. Similar prohibitions apply in relation to Union institutions, bodies, offices or agencies. Together these two prohibitions not only aim to ensure that states have to obtain financing on the markets under normal conditions, but also to avoid situations in which the Bank's independence as well as its main responsibility – the achievement of price stability – is put under pressure due to the financing of government budgets (or those of other public entities covered by them).[276] Article 123(2) TFEU, again repeated in Article 21(3) of the Statute, makes clear that the prohibitions do not apply to publicly-owned credit institutions, thereby ensuring that they are not treated disadvantageously by the Bank compared to their private counterparts.[277]

Article 125(2) TFEU allows for the specification of definitions of the prohibition on monetary financing by the Council. The latter has made use of this possibility by adopting Regulation 3603/93.[278] It provides definitions of terms such as 'overdraft facilities', 'other type of credit facilities', 'debt

274 Smits, *The European Central Bank* (n 4) 75.

275 Smits, *The European Central Bank* (n 4) 75-77; Amtenbrink, Geelhoed and Kingston (n 184) 907-908, 910-911.

276 Smits, *The European Central Bank* (n 4) 74, 290-291.

277 Smits, *The European Central Bank* (n 4) 75.

278 Council Regulation (EC) 3603/93 of 13 December 1993 specifying definitions for the application of the prohibitions referred to in Articles 104 and 104b(1) of the Treaty [1993] OJ L 332/1 (Reg 3603/93). At the time of its adoption the relevant legal basis for this regulation was Art 104 EC Treaty.

instruments' and 'public sector'.[279] At the same time it makes clear that certain activities do not fall under the scope of the prohibition, given that they are not regarded as conflicting with its purpose.[280] Several of these exempted activities, like the granting of intra-day credits to the public sector, the collection of cheques for this sector and involvement in the issue of coins,[281] can be seen as specific elaborations of Article 21(2) of the Statute which permits the European Central Bank and national central banks to act as 'fiscal agents' for the public entities covered by the ban.[282]

What is most interesting about Regulation 3603/93, however, cannot be found in its operative part, but in its preamble. Contrary to direct purchases of public debt instruments on the primary market, purchases on the secondary market, where debt instruments are traded after they have initially been issued by the state on the primary one, are not mentioned in Article 123(1) TFEU. This makes sense as they can be an effective monetary policy tool.[283] Nonetheless, the 7th recital of the preamble makes clear that secondary market purchases 'must not be used to circumvent the objective of that Article'. As will become clear in subsequent chapters, the question of whether certain actions taken by the Bank on the secondary market in defence of the single currency could be seen as circumventions of the ban on monetary financing would take centre stage during the crisis.[284]

Article 124 TFEU contains the second prohibition related to market discipline. It provides that 'any measure, not based on prudential considerations, establishing privileged access' by central governments and public bodies to financial institutions shall be prohibited. The same goes for privileged access by Union institutions and entities. The rationale behind the ban is clear: the state (or any other public entity covered by the ban) should not be able to obtain financing through 'forced savings' imposed on financial institutions.[285] A classic example constitutes an obligation for a bank to invest some of its capital in government debt instruments.[286] Such a measure puts the state in a beneficial position compared to private actors who are unable to resort to such coercive means.

As with the prohibition on monetary financing, the specifics concerning the ban on privileged access are laid down in secondary law based on Article

279 See Arts 1(1), 1(2) and 3 Reg 3603/93.
280 Smits, *The European Central Bank* (n 4) 293.
281 See Arts 4, 5 and 6 Reg 3603/93.
282 See also Recital 11 Reg 3603/93; Smits, *The European Central Bank* (n 4) 295-296.
283 Smits, *The European Central Bank* (n 4) 289-290.
284 See especially text to n 333 (ch 4) and chs 6-7.
285 Smits, *The European Central Bank* (n 4) 75.
286 Smits, *The European Central Bank* (n 4) 75.

125(2) TFEU.[287] Regulation 3604/93 defines a measure establishing privileged access as being any measure that either 'obliges financial institutions to acquire or hold liabilities' of public sector entities, or confers on them specific 'tax advantages' or other advantages that 'do not comply with the principles of a market economy' in order to encourage them to acquire or hold such liabilities.[288] The Regulation also gives definitions of 'prudential considerations', 'public undertaking' and 'financial institutions'.[289]

The centrepiece of the instrument of market discipline is the 'no-bailout' clause in Article 125(1) TFEU. It aims to ensure that the disciplining effect of the bans on monetary financing and privileged access are not counteracted by financing by the Union or other member states.[290] To this end it determines that neither the Union nor a member state shall be 'liable for' or 'assume' the commitments of another member state. An exception is made for 'mutual financial guarantees for the joint execution of a specific project'.

Unlike the prohibitions on monetary financing and privileged access, the ban on bail-out lacks detailed specifications in secondary law. Although Regulation 3603/93 also applies to Article 125(1) TFEU, its relevance for this provision is limited as it only specifies the notions of 'public sector' and 'public undertaking'.[291] This does not mean that Union law does not provide any clarifications concerning the ban. It certainly does, but not in secondary law. One has to turn to primary law instead to find information about scope and meaning of the ban, in particular Article 122(2) TFEU. This provision, included at the insistence of the Commission as well as several states which feared a ruthless application of the no-bailout clause,[292] allows the Union to grant financial assistance to a member state in case the latter is 'in difficulties or is seriously threatened with severe difficulties caused by natural disasters or

287 Council Regulation (EC) 3604/93 of 13 December 1993 specifying definitions for the application of the prohibition of privileged access referred to in Article 104a of the Treaty [1993] OJ L 332/4 (Reg 3604/93). At the time of its adoption the legal basis for this Reg was Art 104a EC Treaty.

288 Art 1(1) Reg 3604/93.

289 Arts 2-4 Reg 3604/93.

290 Amtenbrink, Geelhoed and Kingston (n 184) 908-909.

291 See Arts 3 and 8 Reg 3603/93.

292 See also Jörn Pipkorn, 'Legal Arrangements in the Treaty of Maastricht for the Effectiveness of the Economic and Monetary Union' (1994) 31 CML Rev 263, 273-274; Ulrich Häde, 'Haushaltsdisziplin und Solidarität im Zeichen der Finanzkrise' (2009) 20 EuZW 399, 402-403; Jean-Victor Louis, 'Guest Editorial: The No-Bailout Clause and Rescue Packages' (2010) 47 CML Rev 971, 982. The assistance clause is, however, worded more cautiously than the Commission had initially envisaged in its draft treaty of December 1990, especially by requiring that assistance can only be granted in case of difficulties caused by 'exceptional occurrences beyond its control'. See also Dyson and Featherstone (n 2) 732 and text to n 143 (ch 7). Note, moreover, that assistance in case of difficulties caused by 'exceptional occurrences' could at first only be granted on the basis of unanimity in the Council. Since the entry into force of the Treaty of Nice only a qualified majority is required.

exceptional occurrences beyond its control'. As chapters 5 and 7 will show, the question of how to read the relationship between the ban on bail-out and this assistance clause, and what this says about any limits applying to the ban and the instrument of market discipline became the subject of intense debate during the crisis.[293]

5.2.3 Public discipline

This short discussion of Articles 122(2) and 125(1) TFEU already shows that the issue of fiscal prudence was also the subject of debate between stability-minded states and those preferring a more lenient approach during the negotiations on the Treaty of Maastricht. Yet, this debate was much more fierce and visible as far as the instrument of public discipline was concerned. The Delors Committee had already argued in its report that it was unwise to put all trust in the disciplining force of the markets.[294] It advised that in addition there should be an element of public discipline in the form of 'upper limits on budget deficits of individual member countries'.[295] It refrained, however, from giving more detailed guidance on the nature and substance of these limits, or on the desirability of sanctioning states that violate them. As a result, the issue of public discipline, in particular that of quantitative limits and sanctions, received considerable attention during the treaty negotiations.

How different the views on these issues were among the participants to the intergovernmental conference becomes clearly apparent from several draft treaties that circulated shortly before or during the conference. The Commission's draft, published on 10 December 1990,[296] did not (yet) mention quantitative upper limits on deficits,[297] let alone any sanctions for violating

293 See especially text to n 147 (ch 5) and text to n 141 (ch 7).

294 For a more elaborate discussion of the committee's view in this regard see text to n 26 (ch 4).

295 Delors Report (n 63) para 33.

296 See Commission, *Draft Treaty amending the Treaty establishing the European Economic Community with a view to achieving economic and monetary union* (Bulletin of the European Communities, supplement 2/91) (Commission EMU-Draft Treaty). It should be noted that at an earlier stage the Commission had already issued a communication on economic and monetary union. See Commission, 'Communication of 21 August 1990 on economic and monetary union' SEC (90)1659 final (Bulletin of the European Communities 1991, supplement 2/91). The decision to table a real draft proposal was only made shortly before the opening of the conference. See Dyson and Featherstone (n 2) 725-727.

297 In its commentary on the separate provisions of the draft, the Commission did recognise that it would be 'necessary to have one or more benchmarks' for establishing the excessiveness of a deficit, and that it would come up with proposals in this regard. See Commission, *Commentary to the Draft Treaty on Economic and Monetary Union* (Bulletin of the European Communities, supplement 2/91) 54. The reference values were eventually devised by the Monetary Committee. See n 309 (ch 3).

them.[298] It confined itself to stating that 'excessive budget deficits shall be avoided' and that the Council could adopt 'appropriate measures' to that end.[299] The French draft of January 1991 paid more attention to public discipline. Not only did it state that excessive deficits had to be avoided,[300] it also provided for the possibility of sanctions in case Council recommendations on the reduction of excessive deficits were not implemented.[301] Yet, the envisaged sanctions were different to those that would eventually end up in the Treaty,[302] focusing on reducing financial benefits paid out of the Community budget for the state concerned, restricting or suspending transactions in its public debt instruments by the Bank and instructing the national supervisory authorities to take all necessary steps to safeguard the stability of the financial system. Moreover, it did not mention quantitative limits to budget deficits.[303]

The German draft, published late February 1991, spoke out most clearly in favour of public discipline. It required states to 'carry out a budgetary policy that helps to guarantee price stability as a result of exercising strict discipline with regard to spending and limiting the deficit'.[304] Moreover, it stressed the necessity of having quantitative limits on deficits in place – although not yet mentioning any specific numbers – the violation of which would give rise to the presumption of an excessive deficit.[305] If deficits were indeed found excessive, the Council had to 'set a mandatory ceiling for the deficit' of the state concerned and recommend measures to comply with it.[306] The envisaged sanctions for states failing to respect their ceiling were severe, ranging from the suspension of aid paid out of Community funds to 'other appropriate' sanctions.[307] These other appropriate sanctions, as became clear during the

298 In the explanatory memorandum to the draft, the Commission recognised that there was not yet agreement on the bindingness of the principle to avoid excessive deficits. It stated that 'sanctions might be envisaged', but made clear that it 'would prefer a system of incentives' in the context of the multilateral surveillance procedure. See Commission, *Commentary to the EMU-Draft Treaty* (n 297) 36.

299 Art 104a(2) Commission EMU-Draft Treaty.

300 Art 1-4(2) French EMU-Draft Treaty.

301 Arts 1-3(3) and 1-4(3) French EMU-Draft Treaty.

302 Dyson and Featherstone (n 2) 240 state, however, that France was strongly in favour of fines in the case of excessive deficits. According to Andrew Moravscik (n 116) 445, on the contrary, France was not that convinced of the necessity of fines, yet did not 'overtly oppose' them.

303 According to Kenneth Dyson and Kevin Featherstone (n 2) 240, the absence of quantitative limits in the French draft treaty did not reflect opposition to such limits, but had to do with the fact that France was awaiting work in the Monetary Committee on this issue. For the committee's work see n 309 (ch 3).

304 Art 105B(1) German EMU-Draft Treaty.

305 Arts 105B(1)-(2) German EMU-Draft Treaty.

306 Art 105B(2) German EMU-Draft Treaty.

307 Art 105B(3) German EMU-Draft Treaty.

treaty negotiations, could be as far-reaching as expulsion out of the currency union.[308]

The instrument of public discipline that was eventually incorporated in Article 126 TFEU inevitably forms a compromise between these views. Nonetheless, the final result to a considerable extent leans towards that of Germany. The first paragraph of Article 126(1) TFEU stipulates that the member states 'shall avoid excessive government deficits'. Article 126(2) TFEU, in line with the German view, then links this obligation to specific, quantitative limits by stating that both a government's deficit and debt are examined in relation to certain reference values set out in Protocol No 12 annexed to the Union Treaties. Article 1 of this Protocol sets the reference value for the deficit at 3% of GDP and that for debt at 60% of GDP.[309]

This is not to say, however, that the German view on quantitative limits had managed to become incorporated in the Treaty totally unscathed. The reference values are not absolute as Article 126(2) TFEU provides that in certain situations an excess over (one of) the reference values is permissible. A deficit exceeding the ratio of 3% to GDP will not be regarded as excessive if it 'has declined substantially and continuously and reached a level that comes close to the reference value', or if 'the excess is only exceptional and temporary and the ratio remains close to the reference value'. Similarly, a debt exceeding the reference value of 60% of GDP will not be seen as excessive if the ratio 'is sufficiently diminishing and approaching the reference value at a satisfactory pace'.

Compliance with these budgetary criteria takes place on the basis of the so-called 'excessive deficit procedure'. It starts with the Commission monitoring budgetary developments in the member states in light of the reference values. Article 126(3) TFEU states that the Commission shall prepare a report if it finds that a state does not comply with these values, thereby taking into account whether its deficit exceeds investment expenditure as well as other factors, in particular its medium-term economic and budgetary position. The Commission can also prepare this report if a state does comply with the budgetary criteria, but it nonetheless considers that there is a risk of an excessive deficit.

Article 126(5) TFEU subsequently makes clear that if the Commission takes the view that an excessive deficit exists or may occur, and after having

308 Moravscik (n 116) 445-446.

309 These numbers were proposed by the Monetary Committee (the precursor of the current Economic and Financial Committee) that had to devise the budgetary dimension to the Treaty provisions on economic and monetary union. See Monetary Committee of the European Communities, *Report by the Alternates on the Excessive Deficit Procedure* (Brussels 12 April 1991) para 4. See also Mathieu Segers and Femke van Esch, 'Behind the Veil of Budgetary Discipline: The Political Logic of the Budgetary Rules in the EMU and the SGP' (2007) 45 JCMS 1089, 1100. On the consistency between the references values of 3% and 60% see Gros and Thygesen (n 2) 339-340.

obtained the opinion of the Economic and Financial Committee,[310] it shall address an opinion to the relevant state and inform the Council. The latter then has to decide in line with Article 126(6) TFEU, and on a proposal from the Commission, whether an excessive deficit actually exists. If the Council considers this to be the case, Article 126(7) TFEU obliges it to adopt, without undue delay and on a recommendation of the Commission, recommendations on how to bring the excessive deficit to an end. In case the state concerned has taken no effective action within the period set by the Council in its recommendation, Article 126(8) TFEU provides that the latter may decide to make its recommendations public.

If a state persists in refusing to act upon the Council's recommendations, Article 126(9) TFEU stipulates that the latter may decide to give notice to the state to take, within a specified period, measures to remedy the situation. As long as the state fails to take these measures the Council may decide to apply sanctions on the basis of Article 126(11) TFEU. Although not as severe as Germany had hoped for, they can be tough. Whereas one may question the severity of publishing additional information before issuing bonds or inviting the European Investment Bank to reconsider its lending policy, such doubts disappear when the sanctions concern non-interest bearing deposits or even outright fines. To the extent that excessive deficits have, in the view of the Council, been corrected, Article 126(12) TFEU obliges the latter to abrogate some or all of its recommendations and sanctions taken over the course of the procedure.[311]

Even though to a considerable extent Germany managed to mould the instrument of public discipline in line with its own views, it was not satisfied with the final result. Especially within financial circles there was concern that Article 126 TFEU did not provide enough safeguards for fiscal discipline once the single currency was introduced.[312] One could see how the prospect of membership of the currency union could induce states to fiscal prudence prior to entry. Yet, the exceptions to the quantitative limits and the degree of discretion attributed to the Council in deciding whether or not to impose sanctions raised doubts about the ability of Union law to bring about such prudence once states would have managed to get 'in'.[313] Only a few years after the conclusion

310 See Art 126(4) TFEU. The Economic and Financial Committee replaced the Monetary Committee with the start of the third stage of the economic and monetary union on 1 January 1999. Art 134 TFEU regulates its position and functioning.

311 Art 126(13) TFEU makes clear that the Council takes decisions on the basis of Arts 126(6)-(9) and 126(11) TFEU by qualified majority vote and without taking into account the vote of the member state concerned. Prior to the entry into force of the Lisbon Treaty the exclusion of the member state concerned was not provided for decisions taken on the basis of Art 126(6) TFEU (ex Art 104(6) EC).

312 Segers and Van Esch (n 309) 1101; Heipertz and Verdun (n 126) 45.

313 Heipertz and Verdun (n 126) 45-46. See also Seegers and Van Esch (n 309) 1100-1101.

of the Treaty of Maastricht, and still before the launch of the single currency, the German government therefore argued again, and more loudly, for public discipline.

5.3 Secondary law and the logic of discipline

5.3.1 Waigel's proposal for a Stability Pact

For the *Bundesbank*, the fiscal arrangements in the Treaty of Maastricht were no more than an intermediary result, at best.[314] Telling is the following statement by the bank in its monthly report of February 1992 in which it comments on the result achieved by Europe's political leaders at Maastricht:

> 'As part of its advisory function, the Bundesbank pointed out at an early stage that the implications of monetary policy pursued in a monetary union at Community level – in particular the implications for the value of money – will be crucially influenced by the economic and fiscal policies of ... the participating countries ... The Maastricht decisions do not yet reveal an agreement on the future structure of the envisaged political union and on the required parallelism with monetary union.'[315]

The *Bundesbank's* concern that the treaty arrangements on political and economic, in particular fiscal, integration were lagging behind those for monetary policy fuelled public scepticism over the future single currency. Especially over the course of 1995, when the initial boost caused by reunification was over and Germany's economy and fiscal position had weakened, public opinion about monetary union turned increasingly negative.[316] The opposition in the *Bundestag* soon tried to cash in on the situation by presenting themselves as 'stability-hardliners', criticising the Kohl-government for the weak fiscal arrangements arrived at in Maastricht.[317] Illustrative are the remarks of SPD leader Scharping which he made during the debate on the 1996 budget:

> 'Maastricht, of which one could say it is the important breakthrough in direction towards a common economic and monetary union, requires strengthening. It requires strengthening in the form of a better coordination of budgetary and fiscal policy, it needs a better, more lasting assurance of the stability criteria compared

314 See also Dyson and Featherstone (n 2) 450-451; Seegers and Van Esch (n 309) 1101; Heipertz and Verdun (n 126) 45-46.
315 Deutsche Bundesbank, 'Monthly Report' (Bundesbank February 1992) 51. See also Dyson and Featherstone (n 2) 450; Seegers and Van Esch (n 309) 1101.
316 Heipertz and Verdun (n 126) 50.
317 Heipertz and Verdun (n 126) 50.

> to what is currently foreseen by the Treaty. This is also required as not to overburden the European Central Bank.'[318]

With criticism on the rise and the launch of the single currency approaching, the Kohl government had to regain the initiative on monetary union. It tried to do so through its Finance Minister Theo Waigel, who presented a proposal for a *Stabilitätspakt für Europa* (Stability Pact for Europe) on 10 November 1995.[319]

Aiming at the reinforcement of the fiscal commitments of member states participating in the currency union, the proposal's most important suggestions for improving public discipline were the following.[320] First of all, it argued that the deficit limit of 3% of GDP should be respected even if the economy were to take a turn for the worse. States should therefore aim for a deficit of 1% of GDP over the medium term under 'normal economic conditions', making it possible to respect the upper limit of 3% if the economic environment deteriorated. Exceeding this ultimate limit would only be possible 'in extremely exceptional cases', and only with the consent of at least a qualified majority of the participating states.[321] Second, the proposal envisaged that sanctions would be automatically imposed upon transgression of the 3% limit, without any intervention of the Council being required.[322] These sanctions would have to take the form of 'stability deposits' amounting to 0.25% of GDP 'for each full or partial percentage point' crossing the limit.[323] If the limit was still transgressed after two years, the deposit would become a fine.[324] Third, the supervision and coordination of the pact's 'binding commitments' should be placed in the hands of a '*Stabilitätsrat*' (Stability Council).[325]

From the start it was clear that Germany's proposal for a stability pact, or at least elements of it, could not be implemented without amending the Treaties. In particular the automatic imposition of sanctions was problematic, given that Article 126(11) TFEU specifically envisages that the Council takes a decision to this end.[326] Although its proposal did not specifically say so, it was therefore understood that Germany was aiming for a separate international treaty

318 Deutscher Bundestag, 13. Wahlperiode, 67. Sitzung, Bonn, 8 November 1995, 5775 (translation, with some modifications, resembles the one of Heipertz and Verdun (n 126) 50-51).
319 Waigel (n 1).
320 See also Hugo J Hahn, 'The Stability Pact for European Monetary Union: Compliance With Deficit Limit as a Constant Legal Duty' (1998) 35 CML Rev 77, 80; Seegers and Van Esch (n 309) 1101-1102.
321 Waigel (n 1) 3.
322 Hahn (n 320) 80-81; Seegers and Van Esch (n 309) 1101-1102.
323 Waigel (n 1) 3.
324 Waigel (n 1) 3.
325 Waigel (n 1) 3.
326 Hahn (n 320) 81-83.

implementing the pact.[327] However, most other member states were against a new, separate international treaty, instead favouring the tightening of fiscal commitments on the basis of the current Treaties.[328] They were supported by the Commission in this regard, which feared that the creation of a stability council on the basis of a separate treaty would undermine its own position and prerogatives in the field of fiscal policy.[329]

Quite soon, therefore, the German government realised that it had to let go of its insistence on a separate treaty if it wanted to achieve any tightening of fiscal policy.[330] It consequently had to accept giving up the idea of automatic sanctions.[331] In return, however, it obtained the green light from other states to mould the second-best option, that of secondary law, in the spirit of its stability pact.[332] And indeed the final result, approved by the European Council at its summit in Amsterdam on 16-17 June 1997 and cosmetically termed the 'Stability *and* Growth Pact' in order to allow the French government to show at home that it had not given in to fiscal discipline at the cost of growth,[333] pays tribute to the German proposal in several respects.

5.3.2 The Stability and Growth Pact

The Stability and Growth Pact (hereafter 'Pact'), in its pre-crisis form,[334] consisted of two Council Regulations, a European Council Resolution, as well as a report of the (ECOFIN) Council.[335] The latter did not form part of the Pact

327 Hahn (n 320) 81; Seegers and Van Esch (n 309) 1102.
328 Heipertz and Verdun (n 126) 32.
329 Seegers and Van Esch (n 309) 1102.
330 Heipertz and Verdun (n 126) 32.
331 Seegers and Van Esch (n 309) 1102.
332 Heipertz and Verdun (n 126) 32.
333 European Council, Conclusions, Amsterdam, 16-17 June 1997. See also Hahn (n 320) 87; Heipertz and Verdun (n 126) 31, 34, 36, 56-60. As Heipertz and Verdun explain, at the instigation of the French, and in an attempt to further balance the picture, the European Council also adopted a Resolution on Growth and Employment. Moreover, France obtained the final consent of Chancellor Kohl to include a Title on Employment in the Treaty of Amsterdam, the final draft of which was approved by the heads of state at that summit as well.
334 For a discussion of the amendments of the Pact as a result of the crisis see text to n 167 (ch 4).
335 Council Regulation (EC) 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies [1997] OJ L 209/1, as amended by Council Regulation (EC) 1055/2005 of 27 June 2005 [2005] OJ L 174/1 (Reg 1466/97, as amended by Reg 1055/2005); Council Regulation (EC) 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure [1997] OJ L 209/6, as amended by Council Regulation (EC) 1056/2005 of 27 June 2005 [2005] OJ L 174/5 (Reg 1467/97, as amended by Reg 1056/2005); Resolution of the European Council on the Stability and Growth Pact, Amsterdam, 17 June 1997 [1997] OJ C 236/1 (European Council Resolution on the Stability and Growth Pact); Council Report

from the start,[336] but was added to it when it was amended in 2005.[337] In the next chapter the reasons for this amendment will be discussed. For now, it suffices to examine the most important features of the Pact as it stood after its amendment in 2005.

Of the four documents making up the Pact, the two Council Regulations are by far the most important. The first Regulation, numbered 1466/97, is based on Article 121(6) TFEU (ex Art 99(5) EC) which allows Parliament and Council to adopt detailed rules for the multilateral surveillance procedure in Articles 121(3) and (4) TFEU. As explained above,[338] this procedure serves as a general coordination mechanism for the economic policies of the member states. Indeed, as Fabian Amtenbrink explains, 'the concept of economic policy must….be more widely interpreted' than as mere fiscal policy, as 'the "quality" and the competitive strength of the national economic policies and of the Community economy as a whole is only partly determined by the budgetary and monetary conditions…'.[339] However, and in line with the initial German proposal for a stability pact, the Regulation was heavily geared towards fiscal policy, attributing only secondary importance to other economic issues.

This focus on fiscal policy already became apparent from the Regulation's title which first mentions the 'strengthening of budgetary positions' and only thereafter talks about 'the surveillance and coordination of economic policies'. The primacy of fiscal policy was similarly discernible in Article 1 which set out the purpose of the Regulation. By defining and detailing the multilateral surveillance procedure, the Regulation aimed to 'prevent, at an early stage, the occurrence of excessive general government deficits', only thereafter stating that it also more generally aimed 'to promote the surveillance and coordination of economic policies'. No wonder, therefore, that the Regulation was, and still is, usually referred to as the 'preventive arm' of the Pact.[340]

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to the European Council, *Improving the implementation of the Stability and Growth Pact*, Brussels, 21 March 2005, 7423/05.

336 For an extensive analysis of the Pact in its original form see Fabian Amtenbrink, Jakob de Haan and Olaf CHM Sleijpen, 'The Stability and Growth Pact: Placebo or Panacea (I) (1997) 9 EBLR 202; Fabian Amtenbrink, Jakob de Haan and Olaf CHM Sleijpen, 'The Stability and Growth Pact: Placebo or Panacea (II) (1997) 10 EBLR 233.

337 See Recital 2 Council Regulation (EC) 1055/2005 of 27 June 2005 amending Regulation (EC) 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies [2005] OJ L 174/1. See also Jean-Victor Louis, 'The Review of the Stability and Growth Pact' (2006) 43 CML Rev 85, 90.

338 See text to n 240 (ch 3).

339 Amtenbrink, Geelhoed and Kingston (n 184) 914.

340 See eg Louis, 'The Review of the Stability and Growth Pact' (n 337) 92; Chang (n 9) 124.

At the basis of the Regulation's efforts to prevent excessive deficits were 'stability programmes' which each member state had to submit annually.[341] Central to these programmes, which according to the Regulation provided 'an essential basis for price stability and for sustainable growth conducive to employment creation',[342] were 'medium-term budgetary objectives'. Each state had such an objective for its budgetary stance, which could 'diverge from the requirement of a close to balance or in surplus position'.[343] For states participating in the currency union or in the second Exchange Rate Mechanism (ERM2)[344] the objective had to range 'between -1% of GDP and balance or surplus, in cyclically adjusted terms, net of one-off and temporary measures'.[345] By requiring states to pursue medium-term objectives, the Regulation answered Germany's demand for having in place a 'safety margin' as regards the deficit limit of 3% of GDP, whilst allowing states to face cyclical developments.[346]

The stability programme had to provide information about the medium-term budgetary objective and the 'adjustment path' the state intended to pursue towards this objective.[347] In addition, it had to set out 'the main assumptions about expected economic developments' and provide detailed assessments of the measures taken to achieve the objective.[348] Moreover, the programme had to contain 'an analysis of how changes in the main economic assumptions' would impact the state's fiscal position,[349] and provide the reasons for any deviations from the adjustment path towards the medium-term objective.[350]

The Council, based on assessments of the Commission and the Economic and Financial Committee, had to examine the plans presented by the member states in their programmes.[351] Of particular importance was the fact that it had to verify whether states pursued an 'annual improvement' towards their medium-term objective of at least 0.5% of GDP, thereby taking into account

341 Arts 3(1) and 4(1) Reg 1466/97, as amended by Reg 1055/2005. Member states outside the currency union do not have to submit 'stability', but 'convergence' programmes. See text to n 462 (ch 3).

342 Art 3(1) Reg 1466/97, as amended by Reg 1055/2005. See also Recitals 1 and 8.

343 Art 2a Reg 1466/97, as amended by Reg 1055/2005.

344 For information about ERM II see text to n 428 (ch 3).

345 Art 2a Reg 1466/97, as amended by Reg 1055/2005. Prior to its amendment in 2005, Reg 1466/97 did not provide for differentiated medium term objectives for each specific state, instead containing a single objective for all states of close to balance or surplus. See in this regard Fabian Amtenbrink and Jakob de Haan, 'Reforming the Stability and Growth Pact' (2006) 31 EL Rev 402, 408; Louis, 'The Review of the Stability and Growth Pact' (n 337) 92-93.

346 See Recital 4 and Art 2a Reg 1466/97, as amended by Reg 1055/2005, which specifically use the term 'safety margin'.

347 Art 3(2)(a) Reg 1466/97, as amended by Reg 1055/2005.

348 Arts 3(2)(b)-(c) Reg 1466/97, as amended by Reg 1055/2005.

349 Art 3(2)(d) Reg 1466/97, as amended by Reg 1055/2005.

350 Art 3(2)(e) Reg 1466/97, as amended by Reg 1055/2005.

351 Art 5(1) Reg 1466/97, as amended by Reg 1055/2005.

that adjustment efforts could be more ambitious in 'good times' and less in the event of an economic downturn.[352] Illustrative of the Regulation's predominant focus on fiscal policy and discipline is that only after having set out these fiscal parameters, it stated that the Council should also verify whether the stability programmes facilitated the coordination of economic policies, and whether these policies were consistent with the broad guidelines adopted on the basis of Article 121(2) TFEU.[353]

Within three months after submission of the programme the Council, on the recommendation of the Commission, had to issue an opinion on it and, if necessary, invite the state concerned to make adjustments.[354] The Council would subsequently monitor the implementation of the programme.[355] In the case of any divergences, it had to issue, in line with Article 121(4) TFEU, a recommendation to the state 'with a view to giving early warning' of a possible excessive deficit.[356] If the divergences subsequently persisted the Council, again in line with Article 121(4) TFEU, had to make a recommendation to the state 'to take prompt corrective measures'.[357]

The second Regulation, numbered 1467/97 and commonly referred to as the 'corrective' or 'punitive' arm of the Pact,[358] is based on Article 126(14) TFEU (ex Art 104 EC) and aims to speed up and clarify the implementation of the excessive deficit procedure. In its pre-crisis form, it did so in three ways essentially.

The first was by clarifying the notions 'exceptional' and 'temporary' in Article 126(2)(a) TFEU, allowing member states to get off the hook if they had deficits exceeding the limit of 3% of GDP.[359] Prior to the Pact's amendment in 2005 the notion 'exceptional' was defined more strictly, and therefore more in line with Germany's proposal for a stability pact which had argued that exceeding the 3% limit should only be possible in 'extremely exceptional' situations. In its original, unamended form, Regulation 1467/97 provided that such an exceptional situation was present in the event of a 'severe economic downturn', which it subsequently defined as 'an annual fall of real GDP of at

352 Prior to its amendment in 2005, Reg 1466/97 did not contain this adjustment benchmark of 0.5% of GDP. See also Amtenbrink and De Haan, 'Reforming the Stability and Growth Pact' (n 345) 408.

353 Art 5(1) Reg 1466/97, as amended by Reg 1055/2005.

354 Art 5(2) Reg 1466/97, as amended by Reg 1055/2005.

355 Art 6(1) Reg 1466/97, as amended by Reg 1055/2005.

356 Art 6(2) Reg 1466/97, as amended by Reg 1055/2005.

357 Art 6(3) Reg 1466/97, as amended by Reg 1055/2005.

358 See eg Chang (n 9) 124.

359 The other exception mentioned by Art 126(2)(a) TFEU, which allows a state to run a deficit exceeding the 3% limit if the deficit 'has declined substantially and continuously and reached a level that comes close to the reference value', received less attention in Reg 1467/97, as amended by Reg 1056/2005. The formula featured in Art 2(7) in relation to excessive deficits reflecting the implementation of pension reforms.

least 2%'.[360] However, when taking a decision under Article 126(6) TFEU on the existence of an excessive deficit the Council could take into account observations of a state showing that its downturn was exceptional even though the fall was less than 2%.[361] In a Resolution adopted by the European Council in Amsterdam on 17 June 1997, the states nonetheless committed themselves to not make use of this possibility if the fall was less than 0.75% of GDP.[362]

Since its amendment in 2005, Regulation 1467/97 defined the notion of 'exceptional' more leniently as being present if the excess over the 3% limit resulted from 'a negative annual GDP volume growth rate or from an accumulated loss of output during a protracted period of very low annual GDP volume growth relative to its potential'.[363] Moreover, both the Commission when drawing up its report on the basis of Article 126(3) TFEU as well as the Council when taking a decision on the existence of an excessive deficit under Article 126(6) TFEU, had to take into account a host of considerations that could be relevant for assessing the nature and quality of the excess over the 3% limit, such as 'contributions fostering international solidarity', expenses related to 'the unification of Europe', policies stimulating research and development, and the implementation of pension reforms.[364]

The second way in which Regulation 1467/97 clarified the excessive deficit procedure was by attaching specific time limits to each of the steps the Commission and Council could or must take under Article 126 TFEU.[365] Of particular interest was the maximum period that could transpire between the Council taking a decision on the existence of an excessive deficit on the basis of Article 126(6) TFEU and the actual imposition of sanctions by this institution on the basis of Article 126(11) TFEU. After the amendment of 2005, this period stood at 16 months.[366] Obviously, when a state was acting upon Council recommendations or notices given on the basis of Articles 126(7) or (9) TFEU, the excessive deficit procedure was held in abeyance.[367] Yet, the Commission and Council would carefully monitor whether a state was actually implement-

360 Arts 2(1) and 2(2) Reg 1466/97 (unamended).

361 Art 2(3) Reg 1467/97 (unamended).

362 European Council Resolution on the Stability and Growth Pact, point 7 of the part addressed to the member states. The number 0.75% formed a compromise between Germany (arguing for 1%) and France (arguing for 0.5%), arrived at during the European Council summit in Dublin on 13-14 December 1996. See Heipertz and Verdun (n 126) 31, 35.

363 Art 2(2) Reg 1467/97, as amended by Reg 1056/2005. See also Amtenbrink and de Haan, 'Reforming the Stability and Growth Pact' (n 345) 408-409; Louis, 'The Review of the Stability and Growth Pact' (n 337) 95-98.

364 See Arts 2(3)-2(5) Reg 1467/97, as amended by Reg 1056/2005.

365 See Arts 3-8 Reg 1467/97, as amended by Reg 1056/2005.

366 Art 7 Reg 1467/97, as amended by Reg 1056/2005. Prior to its amendment of 2005, the Reg set this period at 10 months. See also Louis, 'The Review of the Stability and Growth Pact' (n 337) 99.

367 Arts 9(1)-(2) Reg 1467/97, as amended by Reg 1056/2005.

ing a Council recommendation or notice and whether the actions taken by it were adequate to ensure correction of the excessive deficit within the set time limits.[368] If, after having given notice to take measures for correcting the deficit on the basis of Article 126(9) TFEU, the Council considered that the state in question was not implementing the measures, or only inadequately, it had to impose sanctions on the basis of Article 126(11) TFEU.[369] The same course of action had to be taken in case the deficit had not been corrected within the deadline set by the Council in its notice.[370]

The issue of sanctions also leads to the third way in which Regulation 1467/97 clarified the excessive deficit procedure. It limited the Council's discretion in choosing between the possible sanctions listed in Article 126(11) TFEU by requiring it, 'as a rule', to resort to non-interest bearing deposits.[371] If the deposit was imposed for an excess over the government *deficit* reference value, it needed to comprise a 'fixed component' of 0.2% of GDP and a 'variable component' equalling one tenth of the difference between the deficit in the preceding year and the 3% limit.[372] The total amount of a single deposit could not, however, exceed 0.5% of GDP.[373] It had to be converted into a fine if after two years the excessive deficit, according to the Council, had not been corrected.[374] The Regulation here clearly echoed Germany's proposal for a stability pact with its preference for 'stability deposits' that should be turned into a fine after two years.

Although even the sanction mechanism therefore paid tribute to German wishes, it did not fulfil the desire for automatic sanctions. Given the unwillingness of other states to conclude a separate treaty and, more importantly, the impossibility to establish automaticity on the basis of the current Treaties, Germany had to concede this point. But this did not prevent it from trying to create as much automaticity as possible through the back door, in the European Council Resolution adopted in Amsterdam in June 1997. One of its most essential features is the commitment of the Council '*always to impose sanctions*' if a state would not take the action necessary to end an excessive deficit in line with its recommendations.[375] As the next chapter will show,[376] however, this 'quasi-automaticity' in the sanctioning mechanism has proved

368 Arts 9(3) and 10(1)-(2) Reg 1467/97, as amended by Reg 1056/2005.
369 Art 10(2) Reg 1467/97, as amended by Reg 1056/2005.
370 Art 10(3) Reg 1467/97, as amended by Reg 1056/2005.
371 Art 11 Reg 1467/97, as amended by Reg 1056/2005.
372 Art 12(1) Reg 1467/97, as amended by Reg 1056/2005.
373 Art 12(3) Reg 1467/97, as amended by Reg 1056/2005.
374 Art 13 Reg 1467/97, as amended by Reg 1056/2005.
375 European Council Resolution on the Stability and Growth Pact, point 3 of the part addressed to the Council (emphasis added).
376 See text to n 76ff (ch 4).

to be one of the Pact's major weaknesses.[377] In fact, the Council has never had to face the dilemma of living up to its political commitment in the Resolution as it already proved unable to enforce public discipline at earlier stages of the excessive deficit procedure.

6 Accession to the currency union

6.1 Negotiating accession: stability versus inclusiveness

A member state cannot decide on its own when to join the currency union. Union law subjects accession to conditions, the fulfilment of which is dependent on the judgment of Union institutions. Putting limits on entry can make sense from an economic point of view. Not every area is optimal for a single currency. A currency union composed of greatly diverging economies can make it very hard, if not impossible, for a central bank to implement a single monetary policy. One would therefore expect the conditions that Union law attaches to entry to focus on issues that feature prominently in the theory of 'optimum currency areas', which aims to ascertain under what conditions it is favourable to share a currency,[378] for example labour mobility.[379] The reality is, however, that the accession arrangements are not primarily concerned with such issues. What they are concerned with first and foremost is safeguarding price stability.[380] But not without limits, however, as even the desire for price stability needs to compete with that for inclusiveness. Indeed, accession is the issue on which Germany had to compromise most during the treaty negotiations.

Accession was the issue least dealt with by the Delors Report. It argued extensively that the achievement of monetary union should happen in three stages, but it refrained from setting out clearly when the transition to the final stage should take place and who would be able to join. Delors realised that accession was a contentious topic and that having the report unanimously approved would be very difficult if it discussed the issue in great detail.[381]

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377 On Germany's consent to 'quasi-automaticity' see Heipertz and Verdun (n 126) 34.

378 The theory was introduced by Robert Mundell in the 1960s and has subsequently been elaborated on by other economists, notably Ronald McKinnon and Peter Kenen. See Robert A Mundell, 'A Theory of Optimum Currency Areas' (1961) 51 The American Economic Review 657; Ronald I McKinnon, 'Optimum Currency Areas' (1963) 53 The American Economic Review 717; Peter Kenen, 'The Theory of Optimum Currency Areas: An Eclectic View', in Robert A Mundell and Alexander K Swoboda (eds), *Monetary Problems in the International Economy* (University of Chicago Press 1969) 41.

379 De Grauwe (n 129) 136.

380 De Grauwe (n 129) 136.

381 Moravcsik (n 116) 436; Dyson and Featherstone (n 2) 718.

He therefore tried to keep the committee away from the subject,[382] which is clearly visible when reading the report. It recognises the fact that a monetary union is hardly sustainable if it is not accompanied by 'a sufficient degree of convergence of economic policies' and therefore stresses the importance of 'parallelism': the 'parallel advancement in economic and monetary integration'.[383] Yet, when it discusses the conditions that should be attached to the transition from one stage to another, in particular the final stage, or when this should take place, it is extremely ambiguous, limiting itself to stating that:

> 'The conditions for moving from stage to stage cannot be defined precisely in advance; nor is it possible to foresee today when these conditions will be realized. The setting of explicit deadlines is therefore not advisable. This observation applies to the passage from stage one to stage two and, most importantly, to the move to irrevocably fixed exchange rates.'[384]

The report subsequently argues that although there should be 'consensus on the final objectives', the legal provisions on economic and monetary union should allow for 'a degree of flexibility concerning the date and conditions on which some member countries would join certain arrangements'.[385] The issue of accession left so undefined, it became the most contentious topic during the treaty negotiations.

Negotiations over accession essentially took place between two groups of states, 'economists' and 'monetarists', each having different ideas about the sequence in which economic and monetary integration should proceed.[386] As with much of the negotiations, Germany and France were the prime exponents of these groups. According to economist states, led by Germany, economic integration should precede closer cooperation in the monetary realm. Monetarists, guided by France, took the opposite stance, arguing that precedence should be attributed to monetary integration which would subsequently 'spill over' to other areas.[387]

Understanding why Germany insisted on having economic integration prior to movement on the monetary front requires a return to ordoliberal thinking. One of its essential features, Dyson and Featherstone explain, is that it 'offered a traditionally German historicist account of how economies functioned'.[388]

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382 Dyson and Featherstone (n 2) 718-720.
383 Delors Report (n 63) para 42.
384 Delors Report (n 63) para 43.
385 Delors Report (n 63) para 44.
386 Tsoukalis (n 9) 90-93; Szász, *The Road* (n 2) 9-10; Chang (n 9) 23.
387 Szász, *The Road* (n 2) 9. As Szász correctly points out, one should not confuse such monetarists with 'monetarism' as an economic school of thought, which is discussed above (see text to n 132 (ch 3)).
388 Dyson and Featherstone (n 2) 277.

Ordoliberals regarded economic preferences and views as products of history, thereby stressing the importance but at the same time also the complexity of economic convergence for monetary union.[389] Not having gone through times of hyperinflation to the same extent as Germany, other states could hardly be expected to be similarly convinced of the value of price stability and the policy prescriptions that go with it.[390] One could require them by law to act in line with certain economic priorities, but such a 'top-down' approach offered no guarantees that they would actually display the desired behaviour.[391] Having durable monetary integration implied that each state should first be intrinsically devoted to stability.[392] Ideally, economic integration should in turn be proceeded by political integration in order to make the enterprise truly sustainable.[393] In short, ordoliberals perceived monetary union to be the 'coronation' of a lengthy process of prior political and economic integration.[394]

The strongest proponent of this coronation theory was the *Bundesbank*. In its view, the recommendations of the Delors Report on *parallelism* represented, at best, the lower bound of what it conceived possible in terms of integration,[395] and it was concerned that the intergovernmental conference would lead to a further weakening of accession arrangements. In an attempt to influence the negotiations, it issued a declaration in which it set out its vision on monetary union shortly before the start of the conference.[396] After stating that it considered it necessary to 'point out which conditions must be met if monetary stability is to be assured in future, too',[397] it stressed the importance of having political and economic integration in tandem with steps towards monetary union.

Although it failed to give clear guidance on political union, the *Bundesbank* was rather precise about economic convergence. Meeting the economic requirements for the start of the final stage was only possible 'in the course of a lengthy *transitional process*'.[398] At the end of this period, a range of 'prerequisites' should be met, of which the 'convergence of anti-inflation policy' received most attention. Inflation should be 'very largely eliminated in all the

389 Dyson and Featherstone (n 2) 277.
390 Dyson and Featherstone (n 2) 277.
391 Dyson and Featherstone (n 2) 275, 277.
392 Dyson and Featherstone (n 2) 275, 277.
393 Dyson and Featherstone (n 2) 277, 291.
394 Dyson and Featherstone (n 2) 291. See also Szász, *The Road* (n 2) 9 (describing it as the 'crowning theory').
395 Dyson and Featherstone (n 2) 291, 390-392.
396 Deutsche Bundesbank, 'Statement on creating Economic and Monetary Union in Europe' (Bundesbank, 19 September 1990) in Richard Corbett, *The Treaty of Maastricht – From Conception to Ratification: A Comprehensive Reference Guide* (Longman 1993) 244-247. See also Dyson and Featherstone (n 2) 391-393.
397 Deutsche Bundesbank, 'Statement on creating Economic and Monetary Union' (n 396) 244.
398 Deutsche Bundesbank, 'Statement on creating Economic and Monetary Union' (n 396) 246.

countries' and price differences 'virtually stamped out'.[399] Moreover, fiscal deficits should have been reduced 'to a level which is tolerable over the longer term and unproblematic in terms of anti-inflation policy'.[400] The sustainability of the convergence in anti-inflation policy should also be 'reflected in the markets' verdict', meaning that there should be a 'virtual harmonization of capital market rates'.[401]

The *Bundesbank* concluded its declaration with a statement on the issue of deadlines, the most sensitive topic. It argued:

> 'A particularly important point in the Bundesbank's eyes is that the transition to another stage (no matter whether this is a transitional stage or the final stage) should be made solely dependent of the fulfilment of previously defined economic and economic policy conditions, rather than on specific timetables. Hence the transition to another stage must not be linked to deadlines fixed in advance.'[402]

The *Bundesbank* subsequently made clear that the points it had discussed were 'indispensable, and not optional, requirements'. It therefore urged the German delegation to stand firm during the negotiations and to 'advocate these points vigorously'.[403] And this the German government did. In its draft treaty it argued that 'the passage to the final stage of economic and monetary union' had to be dependent on states having achieved price stability 'to a large extent', budgetary deficits having been 'brought down to a level….compatible with stability', and 'a clear approximation between the interest rates' on financial markets.[404] Concerning the issue of deadlines, the draft did not speak of final dates. It only provided that no later than three years after the start of the second stage, the European Council should examine whether at least a majority of states fulfilled the requirements.[405] If it decided, unanimously, that this was indeed the case, it had to 'set the date for passage to the final stage' for these states.[406] Otherwise, launching the final stage would have to wait.

Representing the monetarist camp, the French argued differently. Taking the view that economic convergence would actually be stimulated by monetary union, they did not attach so much value to convergence as the Germans. But there was another reason why France thought more permissively about accession. It was afraid that very rigid criteria would lead to a situation in which too many states would not be able to join, at least not at first, and that the

399 Deutsche Bundesbank, 'Statement on creating Economic and Monetary Union' (n 396) 246.
400 Deutsche Bundesbank, 'Statement on creating Economic and Monetary Union' (n 396) 246.
401 Deutsche Bundesbank, 'Statement on creating Economic and Monetary Union' (n 396) 246.
402 Deutsche Bundesbank, 'Statement on creating Economic and Monetary Union' (n 396) 247.
403 Deutsche Bundesbank, 'Statement on creating Economic and Monetary Union' (n 396) 247.
404 Art 8F(2) German EMU-Draft Treaty.
405 Art 8F(1) German EMU-Draft Treaty.
406 Arts 8F(1) and (3) German EMU-Draft Treaty.

currency union would then mainly consist of members reasoning along German lines.[407] Being less strict on convergence would ensure a greater degree of inclusiveness in participation and a more balanced policy approach.

The French draft treaty, as well as the one from the Commission which was almost identical in this respect,[408] clearly reflected this more lenient view on entry. Eager to demonstrate to Germany that it also cared about the durability of monetary union,[409] the government had incorporated a provision on convergence.[410] Yet, it lacked detailed criteria like those in the German draft as it simply stated that the European Council had to verify 'on the basis of an assessment of….the convergence of economic and monetary developments in the Member States ... ' whether the requirements for moving to the final stage had been met.[411] And whereas it envisaged the possibility that not all states would participate in the final stage from the start, it also required the Council to specify in advance 'the duration' of their absence.[412]

Concerning the issue of dates, the French draft required the European Council to conduct the verification of convergence within three years of the commencement of the second stage, which was to begin on 1 January 1994.[413] If it judged positively on convergence, it had to set the period within which the decision to introduce a single currency was to be taken.[414] While the French draft was therefore more specific on dates and deadlines for the final stage compared to the German one, it was still rather indeterminate. But over the course of the negotiations, the French position on deadlines changed. The Treaty would have to mention a final date for the start of monetary union, to be set no later than 1 January 1999, no matter how many states could participate.[415]

6.2 The balance between stability and inclusiveness

Article 140 TFEU shows how this battle for stability and inclusiveness was decided. Its first paragraph sets out several convergence criteria – legal and

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407 Chang (n 9) 49-50. Chang also refers to Willem Buiter who argues that indeed '[A] key albeit unstated objective of the (mainly Dutch and German) drafters of the original fiscal-financial Maastricht criteria was to keep Italy (and perhaps also the two other Iberian nations) out of the EMU'. See Willem H Buiter, 'The 'Sense and Nonsense of Maastricht' Revisited: What Have We Learned About Stabilization in EMU?' (2006) 44 JCMS 687, 692 (fn 7).

408 Of particular interest in this regard are Arts 109f and 109g Commission EMU-Draft Treaty.

409 Dyson and Featherstone (n 2) 230.

410 Art 5-9 French EMU-Draft Treaty.

411 Art 5-9 French EMU-Draft Treaty.

412 Art 5-10 French EMU-Draft Treaty.

413 Art 5-9 French EMU-Draft Treaty.

414 Arts 5-1 and 5-9 French EMU-Draft Treaty.

415 Dyson and Featherstone (n 2) 247-252.

economic – that member states need to fulfil in order to join the currency union. The economic criteria, which are further defined in Protocol No 13 on the convergence criteria, aim to ensure that a state has achieved a high degree of 'sustainable convergence'. In doing so, they clearly reflect Germany's desire to prevent the currency union from having 'an inflationary bias'.[416] What is more, they bear great similarity to the anti-inflation indicators mentioned by the *Bundesbank* in its statement on monetary union.[417] That safeguarding price stability is their first and foremost concern, is also confirmed by the European Central Bank. In its convergence report of 2016, for example, it states:

> '[T]he individual criteria are interpreted and applied in a strict manner. The rationale behind this principle is that the main purpose of the criteria is to ensure that only those Member States having economic conditions that are conducive to the maintenance of price stability and the coherence of the euro area can participate in it.'[418]

The concern with inflation is most obvious with the first criterion as it requires a state to have achieved a high degree of price stability, meaning that it should have 'a rate of inflation which is close to that of, at most, the three best performing states in terms of price stability'.[419] Article 1 of the Protocol on the convergence criteria further defines the notion of 'being close' by stating that the excess over the inflation rate of the best performing states may not be more than 1.5%. Satisfying the price stability condition is not, however, simply a numbers game. Given that convergence needs to be sustainable, the Commission and the European Central Bank pay attention in their reports to issues like expected price developments and the existence of an economic and institutional environment supportive of price stability.[420]

The second criterion focuses on deficits and debts by requiring a government's fiscal position to be sustainable. Article 140(1) TFEU states, rather vaguely, that this sustainability is measured by examining whether or not a member state has 'a budgetary position without a deficit that is excessive as determined in accordance with Article 126(6) TFEU'. This raises the question whether the criterion is substantive or formal. If the criterion has to be read substantively, there should be no deficit or debt in excess of the limits of 3% and 60%, subject

416 De Grauwe (n 129) 136.
417 See text to n 396 (ch 3).
418 European Central Bank, 'Convergence Report June 2016' (ECB June 2016) 5 (ECB Convergence Report 2016).
419 Art 140(1) TFEU. The three best performing member states do not necessarily have to form part of the euro area, something which is criticised by economists. See on this point Amtenbrink, Geelhoed and Kingston (n 184) 933-934; Lastra and Louis (n 9) 78.
420 See eg ECB Convergence Report 2016 (n 418) 7-8. See also Lastra and Louis (n 9) 78-79.

to the exceptions in Article 126(2) TFEU and their clarifications in the Pact.[421] Yet, if it must be interpreted formally, the decisive factor is the presence or absence of a Council decision establishing the existence of an excessive deficit on the basis of Article 126(6) TFEU. Article 2 of the Protocol on the convergence criteria puts beyond doubt that the latter is the case.[422]

This criterion, too, is strongly inspired by the need to maintain price stability. States with a high debt burden may consider it beneficial to create 'surprise inflation'.[423] Some of their bonds have a long maturity and the interest rates for such bonds have been determined in accordance with inflation estimates at the time of their issuance.[424] By pushing up inflation beyond such expectations the 'real value' of the bonds diminishes, making it easier for a state to honour its financial commitments.[425] In addition, as explained above,[426] states with troubling fiscal records may 'pressure' other states or the Bank to bail them out in order to deal with any default risk, which may have equally negative consequences for price stability and central bank independence.[427] Both risks, surprise inflation and default, form reasons to require states to straighten up their fiscal positions before joining the currency union.

The third requirement relates to exchange rate stability. Article 140(1) TFEU prescribes that a member state should have observed 'the normal fluctuation margins of the Exchange Rate Mechanism of the European Monetary System for at least two years, without devaluing against the euro'. Since the start of the monetary union on 1 January 1999, the provision should be read as referring to the second Exchange Rate Mechanism (ERM II),[428] which has

421 See text to n 309 (ch 3).

422 Nonetheless, in its convergence reports the ECB does go beyond what is required by 'black-letter' law as it also pays attention to factors like the sustainability of a state's fiscal position by examining its expected future development. See eg ECB Convergence Report 2016 (n 418) 10-11.

423 De Grauwe (n 129) 139. On 'surprise inflation' see also text to n 137 (ch 3).

424 De Grauwe (n 129) 139.

425 De Grauwe (n 129) 139.

426 See text to n 256 (ch 3).

427 De Grauwe (n 129) 139-140.

428 The requirement that a member state should have observed the 'normal' fluctuations margins formed a problem for the states that were to join the currency union first on 1 January 1999. In the run up to the launch of the currency union the first exchange rate mechanism (ERM I) was still in force. However, the exchange rate crisis of 1992-1993 had led to a 'temporary' widening of the fluctuation bands for most currencies from +/- 2.25 % to +/- 15%. As a result, the question arose which margins, the old or new ones, should be taken into account. In order to avoid many states failing to satisfy the exchange rate criterion, it was decided to adopt a flexible approach, putting emphasis on the objective of the criterion to prevent exchange rate fluctuations from unstable monetary policies. See René Smits, 'Het begin van de muntunie: besluitvorming en regelgeving' (1999) 47 SEW 2, 3-5; John Usher, 'Legal Background of the Euro' in Paul Beaumont and Neil Walker (eds), *Legal Framework of the Single European Currency* (Hart Publishing 1999) 14-15; Amtenbrink, Geelhoed and Kingston (n 184) 935-936.

replaced the first mechanism and now regulates the exchange rates between the single currency and those of states that have not (yet) joined.[429] This second mechanism functions on the basis of central rates of the currencies of participating states against the euro. Formalizing the practice that had been adopted under the first mechanism in response to the 1992-93 exchange rate crisis,[430] it requires states to keep their currencies within standard fluctuation margins of +/- 15%.[431]

Article 3 of the Protocol on the convergence criteria further specifies the exchange rate requirement by stating that a state should have 'respected the normal fluctuation margins' of the mechanism 'without severe tensions for at least the last two years before the examination'. In particular, it may not have 'devalued its currency's bilateral central rate against the euro on its own initiative'. The rationale behind this prohibition on devaluation is clear: a state should not be allowed to 'fix' its exchange rate with a view to joining the currency union at a more advantageous rate that would boost its competitiveness.[432]

The fourth and last requirement focuses on the 'durability' of convergence and stipulates that a member state's convergence and participation in the Exchange Rate Mechanism should be 'reflected in the long-term interest rate levels'.[433] Article 4 of the Protocol on the convergence criteria further defines that over a period of one year prior to the assessment, a state must have had an average nominal long-term interest rate not exceeding by more than 2% that of the states with the best price stability records.[434] Being similar to the convergence requirement on price stability, the condition is based on the idea

429 ERM II is essentially based on two documents. The first is a European Council Resolution setting out the main features of the mechanism. See Resolution of the European Council on the establishment of an exchange rate mechanism in the third stage of economic and monetary union, Amsterdam, 16 June 1997 [1997] OJ C 236/5 (ERM II Resolution). The second document is an agreement between the ECB and the national central banks outside the euro area which contains the mechanism's operating procedures. See Agreement of 16 March 2006 between the European Central Bank and the national central banks of the Member States outside the euro area laying down the operating procedures for an exchange rate mechanism in stage three of Economic and Monetary Union [2006] OJ C 73/21, as last amended by the Agreement of 6 December 2013 [2013] OJ C 17/1.

430 See text to n 81 (ch 3).

431 Point 2.1 ERM II Resolution. Point 2.4, however, makes clear that 'on a case-by-case basis' fluctuation bands narrower than the standards ones may be used. Such narrower bands apply to the Danish krone, which can fluctuate within margins of +/- 2.25%.

432 De Grauwe (n 129) 141.

433 Art 140(1) TFEU.

434 In line with the criterion on price stability, the best performing member states in terms of price stability do not necessarily have to belong to the currency union. See Lastra and Louis (n 9) 82.

that the convergence of interest rates shows the 'trust' of markets in the coming together of inflation levels and fiscal positions.[435]

These four convergence criteria, in particular those on inflation, fiscal positions and interest rates, are strongly focused on price stability. Is there any room for other economic considerations relevant for the currency union's viability? Yes there is. Article 140(1) TFEU concludes by stating that when assessing convergence the Commission and the Bank should also take into consideration issues like market integration, the balance of payments situation and labour cost developments. Both institutions indeed pay attention to such other factors in their convergence reports since they can provide valuable insights about a state's ability to join the currency union without severe problems.[436] However, this does not take away the fact that the law's emphasis is not on these additional criteria, but on the individual ones mentioned above.[437]

The legal criteria, less eye-catching than the economic ones but certainly important, focus on two provisions: Articles 130 and 131 TFEU. Both provisions apply to member states even before they join the currency union, yet conformity with them is specifically assessed at the time of accession.[438] Article 130 TFEU, already discussed above,[439] lays down independence requirements concerning both the European Central Bank and the national central banks. Article 131 TFEU sets out a duty for member states to ensure that their national legislation, including the regulatory regime for their central banks, is compatible with the Treaties and the Statute.[440] Together, they aim to secure that national central banks can carry out their monetary policy tasks effectively and free from improper influence upon accession.[441]

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435 Amtenbrink, Geelhoed and Kingston (n 184) 936-937. See also Lastra and Louis (n 9) 81-82.

436 The Commission examines the additional criteria for each state under a separate heading in its convergence reports. The ECB conducts their assessment under the headings of the 'normal' convergence criteria. See eg Commission, 'Convergence Report 2016' (European Economy Institutional Paper 026, 2016) (Commission Convergence Report 2016); ECB Convergence Report 2016 (n 418).

437 Rosa Maria Lastra and Jean-Victor Louis express the view that the additional criteria could become more important as a consequence of the economic governance reforms that have been introduced in response to the debt crisis. See Lastra and Louis (n 9) 82-83.

438 Note that under the former EC Treaty Art 131 TFEU (ex Art 109 EC) did not apply fully to states outside the currency union. Art 116(5) EC (now Art 139 TFEU) stated that in the second stage of economic and monetary union each state had 'to start the process leading to the independence of its central bank, in accordance with Article 109'.

439 See text to n 187 (ch 3).

440 The fact that Art 131 TFEU only speaks about compatibility with the Treaties and the Statute does not mean that states do not have to ensure compatibility with EU secondary legislation. Indeed, the need to ensure compatibility with Union law results from the principle of primacy, not solely from Art 131 TFEU. See also ECB Convergence Report 2016 (n 418) 18-19.

441 See also Smits, *The European Central Bank* (n 4) 121-123; Lastra and Louis (n 9) 74-75.

A broad range of topics falls under the requirement of legal convergence, ranging from independence and confidentiality, monetary financing and privileged access, to legal integration of national central banks into the Eurosystem.[442] Nonetheless, and in line with the single currency's stability focus, the issue of independence stands out, both in law and in fact. Its legal importance is evident in the fact that Article 140(1) TFEU specifically mentions the independence provision of Article 130 TFEU, whereas a reference to Article 131 TFEU would have sufficed. After all, the duty to ensure compatibility of national legislation with the Treaties and the Statute covers the independence requirements contained therein. Its practical relevance appears from the fact that independence receives much attention in convergence assessments.[443] Or to put it in the words of the Bank:

> 'When assessing legal convergence….The ECB is particularly concerned about any signs of pressure being put on the decision making bodies of any Member State's NCB which would be inconsistent with the spirit of the Treaty as regards central bank independence'.[444]

What about dates and deadlines? Here, Germany had to compromise more, possibly even most out of all issues related to monetary union. This was clearly visible in the former EC Treaty, in particular Article 121. Its third paragraph stipulated that the Council, in its composition of heads of state or government,[445] had to decide by qualified majority and no later than 31 December 1996 whether a majority of states fulfilled the convergence criteria and whether it was appropriate to launch the third stage. If it ruled positively on both issues, it had to set a date for the final stage.[446] Article 121(4) EC subsequently determined that if no such date had been set by the end of 1997, the third stage would commence on 1 January 1999.[447]

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442 See ECB Convergence Report 2016 (n 418) 16-41; Commission Convergence Report 2016 (n 436) 26-27.

443 In their reports the Commission and the ECB use a broad interpretation of Art 130 TFEU in order to examine independence in all its facets (institutionally, organisationally, functionally and financially).

444 ECB Convergence Report 2016 (n 418) 16.

445 Since the entry into force of the Lisbon Treaty, the European Council has the status of a Union institution. As a result, the present treaty provisions governing the accession procedure no longer refer to the 'the Council, meeting in the composition of heads of state or government'.

446 The Council decided at the time that there was no majority of states fulfilling the convergence criteria. See Council Decision 96/737/EC of 13 December 1996 in accordance with Article 109j(3) of the Treaty establishing the European Community, on entry into the third stage of economic and monetary union [1996] OJ L 335/48.

447 In Protocol No 24 on the transition to the third stage of economic and monetary union, annexed to the EC Treaty, member states declared the 'irreversible character' of the transition to the third stage of monetary union and stated that none of them would prevent this transition. The Protocol has been deleted with the entry into force of the Lisbon Treaty.

The insertion of a final date into the EC Treaty was a clear victory for the monetarist camp.[448] Of course, the economist view prevailed in as far as only states fulfilling the convergence criteria would be able to join. However, the decision on fulfilment was a political one, to be taken by the Council in its composition of heads of state and government and acting by qualified majority. Germany's financial establishment feared that the presence of a final date would set in motion a decision-making dynamic in which the issue of stability would be subordinate to that of participation and inclusiveness.[449] And as the next chapter will show, this fear was not without grounds.[450] Leaving states with a special status aside,[451] except for Greece all members of the Community were found to comply with the convergence criteria and consequently joined the currency union on 1 January 1999, even though the fiscal record of some was shaky to say the least.[452] And contrary to the monetarist idea that convergence would benefit from sharing a currency, after the start of monetary union considerable economic imbalances persisted, and in some respects even worsened.

6.3 The stability focus of the 'outs'

Since the entry into force of the Lisbon Treaty much of this compromise on dates and deadlines can no longer be found in primary law.[453] The launch of monetary union being a matter of the past, Articles 140(1)-(3) TFEU merely govern the accession of new member states. Until they accede, they are considered 'states with a derogation' and are subject to a special legal regime laid down in Chapter 5 of Title VIII of the TFEU and Chapter 9 of the Statute. As a result, they are exempted from the focus on stability in several ways.[454]

448 Dyson and Featherstone (n 2) 251-252, 255, 448, 451.

449 Dyson and Featherstone (n 2) 448.

450 See text to n 6 and n 221 (ch 4).

451 See text to n 453 (ch 3).

452 See Council Decision 98/317/EC of 3 May 1998 in accordance with Article 109j(4) of the Treaty [1998] L 139/30.

453 Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community, signed at Lisbon, 13 December 2007 [2007] OJ C 306/01.

454 For more elaborate and general analyses of (legal) 'differentiation' in the economic and monetary union following the crisis see Stefaan Van den Bogaert and Vestert Borger, 'Differentiated integration in EMU' in Bruno De Witte, Andrea Ott and Ellen Vos (eds), *Between Flexibility and Disintegration: The Trajectory of Differentiation in EU Law* (Edward Elgar 2017) 209; Christoph Herrmann, 'Differentiated integration in the field of economic and monetary policy and the use of "(semi-)extra" Union legal instruments: the case for "*inter se* Treaty amendments"' in Bruno De Witte, Andrea Ott and Ellen Vos (eds), *Between Flexibility and Disintegration: The Trajectory of Differentiation in EU Law* (Edward Elgar 2017) 237.

The most important exemption in the area of monetary policy concerns the tasks and objectives of the System of Central Banks. Central banks outside the currency union are not required to make price stability their primary aim.[455] Nonetheless, price stability certainly has legal relevance for states with a derogation, and not only because they will have to deliver on it in order to qualify for euro area membership.[456] Its legal relevance also results from Article 119(3) TFEU, which requires all states, within or outside the currency union, to gear their economic and monetary policies to the principles set out therein, including price stability. Moreover, states with a derogation are subject to the independence requirements in Article 130 TFEU, which is intrinsically linked to price stability.[457]

As regards economic policy, the most notable deviations from the stability focus concern fiscal prudence.[458] States with a derogation are covered in full by the prohibitions relating to market discipline in Articles 123-125 TFEU, yet they benefit from greater assistance possibilities. Whereas members of the currency union can only receive Union assistance on the basis of Article 122(2) TFEU, states with a derogation can also find relief in Article 143 TFEU. Its first and second paragraphs allow the Council to grant assistance to them in case they are 'in difficulties or are seriously threatened with difficulties' concerning their balance of payments and where such difficulties risk 'jeopardising' the internal market or the common commercial policy. The granting of balance of payments aid is further specified in Regulation 332/2002 which establishes a medium-term assistance facility to this end.[459]

Concerning public discipline, states with a derogation are subject to the obligation in Article 126(1) TFEU to avoid excessive deficits just like states in the currency union. However, they cannot be coerced into remedying such

455 Art 139(2)(c) TFEU. More generally speaking, member states with a derogation are also not subject to the acts of the ECB. See Art 139(2)(e) TFEU.

456 See text to n 419 (ch 3).

457 Given that on the basis of Art 139(2)(c) TFEU member states with a derogation are not subject to the tasks and objectives of the System of Central Banks, one may have the impression that Art 130 TFEU has only relevance for central banks belonging to the Eurosystem. This, however, is not the case. Arts 282(1) TFEU and 1 Central Bank Statute put beyond doubt that their central banks form part of the European System of Central Banks and consequently fall under the scope of Art 130 TFEU.

458 Deviations are, however, not confined to fiscal discipline. Art 139(2)(a) TFEU, for example, makes clear that states with a derogation are not subject to the parts of the broad economic policy guidelines, adopted on the basis of Art 121(2) TFEU, that relate to the euro area generally.

459 Council Regulation 332/2002 of 18 February 2002 establishing a facility providing medium-term financial assistance for Member States' balance of payments [2002] OJ L 53/1, as last amended by Council Regulation 431/2009 of 18 May 2009 [2009] OJ L 128/1 (Reg 332/2002). Given that Art 143(2) TFEU (ex Art 119(2) EC) was considered not to provide a legal basis for a Reg that facilitates the granting of Union assistance financed exclusively through the capital markets and not by other member states, Art 352 TFEU (ex Art 308 EC) was used as a legal basis. See also Recital 14 Reg 332/2002.

deficits.[460] This means that the Council cannot give notice to them on the basis of Article 126(9) TFEU to take the measures it deems necessary for the reduction of the deficit, nor can it adopt sanctions on the basis of Article 126(11) TFEU. Logically, the provisions of the Pact's 'corrective arm', in its pre-crisis form, that related to these coercive measures, did not apply to them either.[461]

Differences were also visible in the Pact's preventive arm. States with a derogation also had to reach medium-term budgetary objectives. If they participated in the second Exchange Rate Mechanism, the target for these objectives was even the same as those for members of the currency union, ranging between -1% of GDP and balance or surplus.[462] However, they did not pursue these objectives in the context of 'stability programmes', as states in the currency union do, but on the basis of 'convergence programmes'. The content of both programmes being very similar, the greatest difference lay in the fact that convergence programmes also served to promote exchange rate stability between the euro and the currencies of state's outside the currency union.[463] In addition to a state's budgetary objective, they therefore had to set out its 'medium-term *monetary* policy objectives' and explain how both objectives related to exchange rate stability.[464]

Two member states benefit from a special status governed by separate Protocols: Denmark and the United Kingdom.[465] Denmark is in a similar position to states with a derogation, the only difference being that it is not under an obligation to work towards adoption of the euro.[466] Matters are more complicated for the United Kingdom. In line with its traditional reluctance concern-

460 See Art 139(2)(b) TFEU. They are therefore also refrained from imposing discipline on their fellow states in the currency union. Since the entry into force of the Lisbon Treaty, Art 139(4) TFEU determines that the voting rights of states with a derogation are also suspended for recommendations made on the basis of Art 121(4) TFEU to states in the currency union in the framework of multilateral surveillance. It similarly excludes them from voting on excessive deficit measures for these states taken by the Council on the basis of Arts 126(6)-(8), (12) and (13) TFEU. More generally speaking, Art 139(4) TFEU prevents states with a derogation from voting on the measures listed in Art 139(2) TFEU.

461 See also Recital 9 Reg 1467/97, as amended by Reg 1056/2005.

462 Art 2a Reg 1466/97, as amended by Reg 1055/2005.

463 Recital 10 Reg 1466/97, as amended by Reg 1055/2005. See also Jean-Victor Louis, 'Differentiation and the EMU' in Bruno De Witte, Dominik Hanf and Ellen Vos (eds), *The Many Faces of Differentiation in EU Law* (Intersentia 2001) 53.

464 Art 7(2)(a) Reg 1466/97, as amended by Reg 1055/2005.

465 Sweden has a *de facto* special status. It did not negotiate an opt-out, but in a consultative referendum in September 2003 its population rejected adoption of the single currency. It is therefore unlikely that it will participate in the near future, especially given the fact that it has not brought its legislation on central bank independence in line with Union law and refrains from participating in ERM II. See ECB Convergence Report 2016 (n 418) 63-64, 138-139, 193-198.

466 See Protocol No 16 on certain provisions relating to Denmark.

ing European integration, it was sceptical about plans for monetary union when these appeared on the political agenda at the end of the 1980s. Prime Minister Margaret Thatcher consented to the establishment of the Delors Committee because she thought that *Bundesbank* President Pöhl as well as his British counterpart Leigh-Pemberton 'would manage to put a spoke in the wheel of this particular vehicle of European integration'.[467] But she miscalculated Pöhl's position. He was very critical of plans for monetary union, but not out of political-ideological conviction.[468] Once he felt that the committee's report would represent his views to a considerable extent, he could put his signature under it.[469] Out of fear of making a fool of himself by being the only one to turn down the report, Leigh Pemberton did the same.[470] The final result produced by the Delors Committee therefore turned out to be very different to what Thatcher had hoped for. Reflecting on her years in Downing Street, she says:

> 'When the Delors Report finally appeared in April 1989 it confirmed our worst fears. From the beginning there had been discussion of a "three-stage" approach, which might at least have allowed us to slow the pace and refuse to "advance" further than the first or second stage. But the report now insisted that by embarking on the first stage the Community committed itself irrevocably to the eventual achievement of full economic and monetary union. There was a requirement for a new treaty and for work on it to start immediately ... None of these was acceptable to me.'[471]

The British aversion to a single currency was eventually settled through an 'opt-out'.[472] The United Kingdom is under no obligation to adopt the single

467 Margaret Thatcher, *The Downing Street Years* (Harper Collins Publishers 1993) 741.

468 Szász, *The Road* (n 2) 113; Dyson and Featherstone (n 2) 347-348.

469 Szász, *The Road* (n 2) 113. According to Dyson and Featherstone (n 2) 347-348: 'This development in Pöhl's position reflected the fact that….it was clear that the basic requirements of the Bundesbank had been accepted ... In this respect Pöhl's signature posed no real problem.'

470 According to Leigh-Pemberton himself, quoted in Marsh (n 24) 124: 'My brief from Mrs Thatcher was to follow Pöhl. I wrote a letter to Mrs Thatcher saying that, once Karl Otto Pöhl had signed, I saw no reason why I should not do the same. I would look ridiculous if I was the only governor who did not sign. I would look like Mrs Thatcher's poodle'.

471 Thatcher (n 467) 708.

472 Protocol No 15 on certain provisions relating to the United Kingdom of Great Britain and Northern Ireland. For a discussion about 'the general spread of opt-outs' following the Treaty of Maastricht see Bruno De Witte, 'Variable geometry and differentiation as structural features of the EU legal order' in Bruno De Witte, Andrea Ott and Ellen Vos (eds), *Between Flexibility and Disintegration: The Trajectory of Differentiation in EU Law Today* (Edward Elgar 2017) 11-15.

currency, unless it notifies the Council of its intention to do so.[473] Until that time, which will most likely never arrive now that the British people have voted in a referendum to leave the Union, the Protocol meticulously determines which treaty provisions on economic and monetary policy apply to the state. As a result, it is exempted from the focus on stability in ways that 'normal' states with a derogation are not. Three such ways deserve to be mentioned specifically. The first concerns central bank independence. Paragraph 4 of the Protocol determines that the independence requirements in Article 130 TFEU do not apply to the United Kingdom and its central bank, the Bank of England.[474] The other two exemptions concern the area of fiscal prudence. The instrument of market discipline, in particular the prohibition on monetary financing, is curtailed by the fact that the British government 'may maintain its "ways and means" facility with the Bank of England'.[475] Public discipline is restrained too as the United Kingdom is not subject to the obligation in Article 126(1) TFEU to avoid excessive deficits;[476] it is only supposed to 'endeavour to avoid' them.[477]

Its special status notwithstanding, during the crisis the United Kingdom would not shy away from interfering in the politics of the currency union. In fact, as chapters 5 and 6 will show,[478] at critical points in time it hampered efforts to save the euro. To a great extent these efforts would be devised in the European Council and fora that are reserved for members of the currency union, such as the Euro Summit and the Eurogroup.[479] The European Council and the Euro Summit in particular would come to take up a leading role and thereby show the *existence* and *importance* of a government for the Union and the euro, despite Germany's attempts to ban it from its legal set-up.

473 Para 1 of Protocol No 15 on certain provisions relating to the United Kingdom of Great Britain and Northern Ireland. As point 9(a) of the Protocol makes clear, the United Kingdom shall have the right to adopt the euro only if it satisfies the convergence criteria laid down in Art 140(1) TFEU.

474 Nonetheless, the United Kingdom has granted the Bank of England considerable independence with the Bank of England Act 1998. See also Amtenbrink, 'The Democratic Accountability of Central Banks' (n 220) 65.

475 Para 10 of Protocol No 15. See also Recital 5 Reg 3603/93.

476 Para 4 of Protocol No 15.

477 Para 5 of Protocol No 15. The United Kingdom can, however, become the subject of an excessive deficit procedure. Yet, and similar to all states with a derogation, it cannot be coerced into remedying excessive deficits. Para 4 of the Protocol makes clear that Arts 126(9) and (11) TFEU do not apply to the United Kingdom.

478 See text to n 149 and 310 (ch 5) and n 88 (ch 6).

479 See especially chs 5 and 6.

7 Conclusion

When the member states signed and ratified the Treaty of Maastricht in 1992-93, they jointly committed themselves to a currency union focused on price stability. The solidarity they were required to display was therefore largely negative in kind as the actions they had to perform mainly focused on their own condition, especially in the area of fiscal policy. Economic and political considerations were at the basis of this decision to create a monetary union geared towards price stability. Increasing capital mobility made it difficult to reconcile the system of fixed, but adjustable exchange rates under the European Monetary System with national monetary autonomy. A currency union would put an end to the problems posed by this inconsistent trinity as it entails the transfer of monetary policy competences to Union level. The move towards a single currency also had a strong geopolitical dimension. The fall of the Wall in November 1989 significantly speeded up plans for monetary union that had already been set in motion by the European Council at its Hannover summit in 1988 when it charged Jacques Delors with the task of proposing a plan to achieve monetary union in stages.

Understanding the motives behind, as well as the timing of the currency union's creation also helps to read its legal set-up. This was devised at a time when states experienced a convergence of economic policy preferences, characterised by a shift away from Keynesianism and towards monetarism. This convergence was promoted by the European Monetary System, which allowed states to 'import' price stability by adjusting their policies to that of the *Bundesbank*. Germany's anchor position in the system also equipped the state with a strong bargaining position on monetary union, enabling it to force through its concern for price stability at crucial points during the treaty negotiations. As a result, the single currency's legal set-up came to institutionalise a 'stability paradigm' which attributes overriding importance to price stability and seeks to position the central bank in such a way that it is able to pursue this goal.

The influence of this paradigm becomes most readily apparent at the level of goals and principles, where price stability features prominently, and in the constitutional position of the European Central Bank, which is characterised by great independence. Yet, it also determines the Union's system of economic policy, in two ways in particular. First, the Union has been endowed with few competences in this area. Out of concern for central bank independence, the Union has not been given the competence to ensure an adequate 'policy mix' between economic and monetary policy through prior coordination by the European Council. Second, Union law contains two specific instruments to induce member states to apply fiscal prudence and avoid hampering the Bank's ability to pursue price stability. One of these is the instrument of market discipline. It operates through the prohibitions on monetary financing, privi-

leged access and bail-out and aims to ensure that states have to finance themselves on the markets and under market conditions by cutting off other financing mechanisms.

The other instrument relates to public discipline. Central to this instrument is the obligation to avoid excessive deficits and debts, which Union law defines, albeit it with exceptions, as a deficit exceeding 3% of GDP and a debt above 60% of GDP. The Stability and Growth Pact, created at the initiative of Germany, seeks to put flesh on this obligation. Its preventive part, in its pre-crisis form, obliged states to pursue medium-term budgetary objectives ranging between -1% and balance or surplus so as to prevent excessive deficits. The Pact's corrective arm specified the excessive deficit procedure in Article 126 TFEU by clarifying when states were allowed deficits exceeding the 3% limit, attaching time limits to the specific procedural steps and specifying the sanctioning mechanism that applies in the event a state fails to act on Council recommendations.

Finally, the stability paradigm is evident in the conditions on accession to the currency union. These conditions, legal and economic, focus to a great extent on the need to prevent the currency from developing an inflation bias. Accession is the issue on which Germany and other stability minded states had to compromise most, in particular by consenting to a final date for the launch of the single currency and by leaving the decision on entry in the hands of the heads of state acting by qualified majority. Concerns for stability here clearly had to give in to the desire for inclusiveness.

Legally entrenching economic wisdom to extreme degrees may have seemed the safest route to stability when the member states devised the currency union at the beginning of the 1990s. Yet, as the next chapter will demonstrate, when the debt crisis hit Europe in late 2009, it painfully laid bare the problematic nature of this approach.

4 Law and economic wisdom

1 INTRODUCTION

When the member states signed and ratified the Treaty of Maastricht they stamped their future currency union with the strongest stability imprint one can imagine. Price stability was not just turned into the unassailable goal of the European Central Bank, it determined the monetary union to the bone. Besides its consolidation in the Treaties, this stability set-up also became entrenched in national constitutional law, especially in Germany. In October 1993 its constitutional court, the *Bundesverfassungsgericht*, assessed the permissibility of the Treaty in its *Maastricht Urteil*.[1] The judges in Karlsruhe approved of Germany's participation in the currency union, but only because its legal set-up ensured it would be a '*Stabilitätsgemeinschaft*', a 'community based on stability'.[2] This stability conception of the single currency was 'the basis and subject matter' of Germany's act of accession.[3] If at some point this conception were abandoned, the constitutional court argued, this could ultimately lead to Germany withdrawing from the currency union.[4]

So clearly defining the currency union's rules of life and bestowing them with constitutional status should have generated a feeling of certainty about the solidity of the enterprise; that the currency union would indeed be, to use the language of the *Bundesverfassungsgericht*, a community based on stability. Yet, the line between certainty and a false sense of security can be very thin. On the eve of the launch of the single currency, Matthias Herdegen explained in the *Common Market law Review* why:

> 'Economic wisdom is what economic science in a given moment suggests as economically sound. Freezing institutional rules and substantive principles on this basis implies an obvious risk which is inherent in all dictates of economic wisdom:

▪ This chapter contains and/or builds on previously published work by the author. See especially Vestert Borger, 'Outright Monetary Transactions and the Stability Mandate of the ECB: *Gauweiler*' (2016) 53 CML Rev 139.

1 BVerfG, Cases 2 BvR 2134/92 & 2159/92 of 12 October 1993, as translated in [1994] 1 CMLR 57 (BVerfG *Maastricht*).

2 BVerfG *Maastricht* (n 1) para 80.

3 BVerfG *Maastricht* (n 1) para 90.

4 BVerfG *Maastricht* (n 1) paras 89, 90.

subsequent falsification by new empirical messages or scenarios that have not been anticipated.'[5]

This risk did not materialise immediately. The first ten years following the launch of the euro on 1 January 1999 passed without great disturbances. In fact they gave rise to joy and optimism. The currency union had beaten the odds by taking off with a larger group of participants than most experts thought possible.[6] A year before the launch, several German professors had still gone to Karlsruhe to challenge the transition to the 'third stage' of monetary union, or at least Germany's participation in it, as they considered that the member states had failed to bring about the required convergence of their economies.[7] Yet, they had been unsuccessful. The *Bundesverfassungsgericht* had stressed the discretion inherent in 'the overall assessment of a high degree of lasting convergence' and the fact that this necessitated political decisions 'in which factual findings, empirical values and deliberate creativity are mixed in fluid transitions'.[8]

Little surprise, therefore, that of the member states wanting to join all but one had managed to get in.[9] Some had still been recording debts well above the 60% of GDP limit, in the case of Italy and Belgium even exceeding 120%, yet the Commission and Council had resorted to the escape clause in Article 126(2)(b) TFEU (ex Art 104c(2)(b) EC), arguing that these debt ratios were nonetheless 'sufficiently diminishing and approaching the reference value at a satisfactory pace'.[10] Only Greece had remained outside as it did not fulfil any of the convergence criteria.[11] But this state had also been able to join only 2 years later, just in time to see euro paper money and coins going into circulation the following year.[12] The currency union had subsequently witnessed a further expansion with the entry of Slovenia in 2007 and Cyprus and Malta in 2008.[13]

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5 Matthias J Herdegen, 'Price Stability and Budgetary Restraints in the Economic and Monetary Union: The Law as Guardian of Economic Wisdom' (1998) 35 CML Rev 9.

6 Martin Heipertz and Amy Verdun, *The Politics of the Stability and Growth Pact* (CUP 2010) 114.

7 BVerfG, Cases 2 BvR 1877/97 & 2 BvR 50/96 of 31 March 1998 (BVerfG *EMU stage III*).

8 BVerfG *EMU stage III* (n 7) para 100.

9 Council Decision of 3 May 1998 in accordance with Article 109j(4) of the Treaty [1998] OJ L 139/30.

10 See Commission, 'Convergence Report 1998' (European Economy No 65, 1998) 82ff.

11 Council Decision 98/317/EC of 3 May 1998 in accordance with Article 109j(4) of the Treaty [1998] L 139/30.

12 Council Decision 2000/427/EC of 19 June 2000 in accordance with Article 122(2) of the Treaty on the adoption of Greece of the single currency on 1 January 2001 [2000] OJ L 167/19.

13 Council Decision 2006/495/EC of 11 July 2006 in accordance with Article 122(2) of the Treaty on the adoption by Slovenia of the single currency on 1 January 2007 [2006] OJ L 195/25; Council Decision of 10 July 2007 in accordance with Article 122(2) of the Treaty on the adoption by Cyprus of the single currency on 1 January 2008 [2007] OJ L 186/29;

The performance of the European Central Bank had very simply been impressive. Prior to the start of the currency union, critics had voiced concern about its ability to deliver on its stability mandate. But during the first decade of its existence it had proven them wrong as it managed to keep average inflation very close to its 2% target, a stunning accomplishment for a young bank having to build up its reputation from scratch.[14] Moreover, the euro had boosted financial integration and had rapidly positioned itself as one of the world's major currencies.[15] Looking at all these successes and achievements, commissioner Joaquín Almunia, responsible for economic and monetary affairs, declared in early 2008 in his report assessing the first ten years of the euro's existence:

> 'A full decade after Europe's leaders took the decision to launch the euro, we have good reason to be proud of our single currency. The Economic and Monetary Union and the euro area are a major success. For its member countries EMU has anchored macroeconomic stability, and increased cross border trade, financial integration and investment. For the EU as a whole, the euro is a cornerstone of further integration and a potent symbol of our growing political unity.'[16]

Only months later Europe would be thrown into the worst financial crisis since the Great Depression of the 1930s, followed by the debt crisis late 2009. An unanticipated scenario *par excellence*.

This chapter examines several flaws in the most essential assumptions underlying the single currency's original stability set-up that were exposed by the debt crisis. The first appeared in the instrument of market discipline. Forcing states to turn to the markets for their financing, so treaty drafters thought, will induce them to fiscal prudence. When markets question a state's fiscal health they will charge higher interest rates, which compels the state to change track. The crisis, however, has cast serious doubt on the disciplining nature of markets. Prior to the crisis, it looked as if they were blind to differences in fiscal positions and competitiveness as they charged similar interest rates for all members of the currency union. When the crisis struck they seemed, on the contrary, to be in a state of panic as they asked excessively high risk premia for bonds of certain states, making them hard pressed for money and necessitating extensive aid measures. This chapter looks at some of the key

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Council Decision 2007/504/EC of 10 July 2007 in accordance with Article 122(2) of the Treaty on the adoption by Malta of the single currency on 1 January 2008 [2007] OJ L 186/32.

14 Paul De Grauwe, 'The euro at ten: achievements and challenges' (2009) 36 Empirica 5, 6.

15 Commission, 'EMU@10: successes and challenges after 10 years of Economic and Monetary Union' (European Economy No 2, 2008) 22-23, 94-105, 117-132.

16 Commission, 'EMU@10' (n 15) iii.

explanations for this whimsical behaviour of markets, in particular those professed by the Bank.

That markets have fallen short of expectations in terms of their disciplining force would not have been such a big problem if the single currency's second disciplining device, that of public discipline, had compensated for it. But this instrument has flaws of its own. The Commission's struggle to enforce the Stability and Growth Pact on France and Germany back in 2003 is etched in our memories. In fact, until the debt crisis, the court case to which this struggle gave rise was one of the rare instances in which the monetary union became subject of legal debate.

But even if the instruments of market and public discipline had delivered to the maximum extent possible, they would not have been able to save the single currency from all misery. In its preoccupation with ensuring fiscal prudence, the single currency's legal set-up was blind to risks stemming from other corners of the economy. One of the key factors why markets lost faith in the creditworthiness of some member states in 2010 was that their fiscal record had strongly, and suddenly, deteriorated as a result of financial sector problems. Indeed, it is the combination of troubled sovereign fiscal records and ailing banks that has pushed the currency union to the brink of collapse.

The fourth flaw is the cardinal one which brings the others together. Geared to safeguarding price stability, the single currency's legal set-up left another stability dangerously exposed: *financial* stability. This chapter will demonstrate the importance of financial stability and why the Union and its member states have been searching for mechanisms to protect it. This search will prove the connecting thread for the transformation of the euro that will be discussed in subsequent chapters.

Finally, a word about the nature of this chapter. It neither discusses all the essential moments of the crisis, nor the intricate legal character of the solidarity displayed by the member states and the bond buying action of the Bank to which this led. All that is left for later. What matters now is to gain an understanding of the fundamental flaws of the original stability set-up.

2 The whimsicality of markets

2.1 From extreme tranquillity to absolute panic

The first weakness of the stability framework concerns the instrument of market discipline laid down in Articles 123-125 TFEU. As the previous chapter explained,[17] the prohibitions on monetary financing, privileged access and

17 See text to n 274 (ch 3).

bail-out together intend to induce member states to fiscal prudence by forcing them to finance themselves on the markets just like private entities. Markets, by charging higher interest rates for bonds of states with weaker fiscal records, would force them to keep their budgets within acceptable parameters. Developments on euro area government bond markets both *before* and *after* the start of the financial turmoil cast serious doubt on the ability of markets to discharge this task.

Interest rate, or 'yield', developments for 10-year government bonds tell the story, in particular their 'spreads', that is: the difference in yields. In the currency union, yields on the German *Bund* often serve as a benchmark to assess these spreads, as this bond is generally considered to carry no risk of 'default'.[18] The spread between the *Bund* and other euro area government bonds is influenced by a host of factors,[19] but especially important is the 'credit premium', which reflects 'the compensation that investors demand in order to bear the risk of a government default'.[20] Since the launch of the currency union and up to the start of the financial crisis in 2007-08, euro area government bond spreads were minor, creating the impression that markets considered the default risk to be nearly identical for the various members of the currency union.[21] Yet, they took a dramatic turn for the worse once the crisis started, especially when it developed into a debt crisis during 2010. Yields for certain government bonds, in particular those for states in the currency union's 'periphery', skyrocketed, which made it increasingly difficult for them to obtain financing in the market.

Greece is a telling case. After its adoption of the single currency on 1 January 2001, and until mid-2008, the spread between 10-year Greek and German bonds reached a low of, on average, 30 basis points (0.3%).[22] Since then, however, the spread has taken a horrifying turn for the worse. In July 2011, a year after Greece had received its first assistance package, the spread stood at 1600 basis points (16%).[23] Although not as extreme as Greece's situation, several

18 Paul De Grauwe and Yuemei Ji, 'Mispricing of Sovereign Risk and Macroeconomic Stability in the Eurozone' (2012) 50 JCMS 866, 866.

19 See eg European Central Bank, 'The determinants of euro area sovereign bond yield spreads during the crisis' (ECB Monthly Bulletin, May 2014) 68; Maria-Grazia Attinasi, Cristina Checherita and Cristiane Nickel, 'What Explains the Surge in Euro Area Sovereign Spreads During the Financial Crisis of 2007-2009?' (ECB Working Paper Series 2009, No 1131) 8; Simone Manganelli and Guido Wolswijk, 'What Drives Spreads in the Euro Area Government Bond Market?' (2009) 24 Economic Policy 191, 194; Kerstin Bernoth, Jürgen von Hagen and Ludger Schuknecht, 'Sovereign risk premiums in the European government bond market' (2012) 31 Journal of International Money and Finance 975, 978.

20 ECB, 'The determinants of euro area sovereign bond yield spreads' (n 19) 68-69.

21 ECB, 'The determinants of euro area sovereign bond yield spreads' (n 19) 74 (where the ECB looks back at that period, causing it to think investors 'underpriced' risk).

22 See Attinasi, Checherita and Nickel (n 19) 7.

23 ECB, 'The determinants of euro area sovereign bond yield spreads' (n 19) 77.

other member states have also witnessed sharp increases of the yield difference relative to Germany. In July 2012, at the absolute height of the crisis, the Spanish spread, for example, had risen to 600 bps (6%).[24] The Italian spread had experienced a significant rise too, reaching 500 bps (5%).[25]

This panicky behaviour of markets, characterised by sudden and sharp increases in interest rates, did not come as a total surprise. In fact, the Delors Report had already warned of it, arguing that one should not rely solely on the markets as a disciplining device. It stated in this regard:

> 'To some extent market forces can exert a disciplinary influence ... However, experience suggests that market perceptions do not necessarily provide strong and compelling signals and that access to a large capital market may for some time even facilitate the financing of economic imbalances. Rather than leading to a gradual adaptation of borrowing costs, market views about the creditworthiness of official borrowers tend to change abruptly and result in the closure of access to market financing. The constraints imposed by market forces may either be too slow and weak, or too sudden and disruptive.'[26]

Given that the unreliability of markets was to some extent already foreseen at the time of the drafting of the Treaty of Maastricht, a more interesting and pressing issue is whether markets were right in behaving the way they did during the crisis. In other words: does the classic idea hold that markets, as rationally operating economic agents, at all times adequately price government bonds?

2.2 Searching for an explanation …

Throughout the past years economists have racked their brains about this question. A particularly interesting answer to it is given by Paul De Grauwe and Yuemei Ji.[27] They argue that the currency union's government bond markets suffer from an in-built 'fragility' which prevents them from correctly pricing risk at all times.[28] On the contrary, they are susceptible to the development of 'bubbles' which cause them to charge interest rates that do not correspond to a state's economic health.[29]

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24 ECB, 'The determinants of euro area sovereign bond yield spreads' (n 19) 77-78.

25 ECB, 'The determinants of euro area sovereign bond yield spreads' (n 19) 77-78.

26 Committee for the study of economic and monetary union, *Report on economic and monetary union in the European Community* (17 April 1989) para 30 (Delors Report).

27 De Grauwe and Ji, 'Mispricing of Sovereign Risk' (n 18). The ideas set out in this article have subsequently been further elaborated on by the authors themselves. See eg Paul De Grauwe and Yuemei Ji, 'Self-fulfilling crises in the Eurozone: An empirical test' (2013) 34 Journal of International Money and Finance 15.

28 De Grauwe and Ji, 'Mispricing of sovereign risk' (n 18) 877-878.

29 De Grauwe and Ji, 'Mispricing of sovereign risk' (n 18) 877-878.

To show the existence of such bubbles during the crisis De Grauwe and Ji identify several 'economic fundamentals' that may affect a state's solvency, such as its debt to GDP ratio and 'fiscal space' (the 'ratio of government debt to total tax revenues'),[30] and examine whether the shocking development of euro area government bond spreads between 2008 and 2011 corresponds to them. Although prior to the financial crisis these fundamentals influenced the spreads to some extent, markets became much more sensitive to them after 2008.[31] Interestingly, however, De Grauwe and Yi also find that a considerable portion of the quick and sudden hike in spreads, especially after the start of the sovereign debt crisis in spring 2010, had no connection to weakening fundamentals.[32] This is particularly true for member states in the currency union's 'periphery'.[33]

On the basis of these findings, De Grauwe and Ji argue that the 'mispricing of risks' forms an 'endemic feature' of markets in the currency union.[34] Prior to the crisis, they were blind to the differences in economic fundamentals, which caused them to underestimate the risk of purchasing bonds of certain member states.[35] However, after its outbreak they overestimated risks, and spreads started to exceed what could be explained by fundamentals.[36] Markets were not operating rationally, but acted out of fear and anxiety.

As an explanation of this market tendency to lapse into panic De Grauwe and Ji point out that the currency union suffers from an in-built fragility: its participants 'issue debt in a currency over which they have no control'.[37] This lack of control makes them 'susceptible to movements of distrust' on the markets which can generate 'self-fulfilling' crises.[38] Whereas states which do control their own currency can (implicitly) guarantee their creditors that they will always be able to respect their financial commitments by having recourse to their central banks, the members of the currency union cannot.[39] When investors get concerned about a default, for example due to a rise in a state's debt to GDP ratio, they will start to dispose of their bonds, resulting

30 Other fundamentals that are taken into account are a state's current account position, real effective exchange rate and economic growth rate. See De Grauwe and Ji, 'Self-fulfilling crises in the Eurozone' (n 27) 20-21.

31 De Grauwe and Ji, 'Self-fulfilling crises in the Eurozone' (n 27) 26.

32 De Grauwe and Ji, 'Self-fulfilling crises in the Eurozone' (n 27) 30-31.

33 De Grauwe and Ji, 'Self-fulfilling crises in the Eurozone' (n 27) 30-31. The authors explain that the exception is Greece where around 60% of the spread's rise is related to weakening fundamentals.

34 De Grauwe and Ji, 'Self-fulfilling crises in the Eurozone' (n 27) 27.

35 De Grauwe and Ji, 'Self-fulfilling crises in the Eurozone' (n 27) 27.

36 De Grauwe and Ji, 'Self-fulfilling crises in the Eurozone' (n 27) 27.

37 De Grauwe and Ji, 'Self-fulfilling crises in the Eurozone' (n 27) 16.

38 De Grauwe and Ji, 'Self-fulfilling crises in the Eurozone' (n 27) 16-17.

39 De Grauwe and Ji, 'Self-fulfilling crises in the Eurozone' (n 27) 16.

in a liquidity crisis.[40] If caught by panic this can lead to such high interest rates that the liquidity crisis becomes a solvency crisis.[41] In this way fears of default increase the probability that it will materialise.

The currency union's fragility, De Grauwe and Yi argue, creates the potential for 'multiple equilibria'.[42] If a state has the confidence of investors it will experience a 'good' equilibrium, in which it has no problem in attracting liquidity and benefits from favourable interest rates when (re)financing its debt.[43] Yet, if it is distrusted it will suffer from a 'bad' one, characterised by high interest rates that necessitate a regime of austerity, which in turn sets off a recession and weakens its fiscal position.[44] Default then becomes a self-fulfilling prophecy in which markets, caught by panic, 'push' a state into default despite its initially solid fundamentals.[45] The cruelty of a currency union, moreover, is that problems may not stay confined to a single state. Once panic takes hold of markets a distrusted member may 'contage' others,[46] triggering developments unrelated to fundamentals there as well.[47]

In support of their fragility hypothesis, De Grauwe and Ji contrast the situation in the currency union with that of developed states having their own currency.[48] Despite the fact that some of these states have debt positions worse than the euro area average, their spreads vis-à-vis the German *Bund* are only influenced by them to a limited extent.[49] What is more, during the crisis these spreads did not experience large and abrupt increases in excess of what can be explained by fundamentals.[50] In contrast to distressed states in the currency union, De Grauwe and Ji argue, those having their own currency 'seem to

40 De Grauwe and Ji, 'Self-fulfilling crises in the Eurozone' (n 27) 16-17; De Grauwe and Ji, 'Mispricing of Sovereign Risk' (n 18) 877-878.
41 De Grauwe and Ji, 'Self-fulfilling crises in the Eurozone' (n 27) 17.
42 De Grauwe and Ji, 'Self-fulfilling crises in the Eurozone' (n 27) 17.
43 De Grauwe and Ji, 'Self-fulfilling crises in the Eurozone' (n 27) 17.
44 De Grauwe and Ji, 'Self-fulfilling crises in the Eurozone' (n 27) 17.
45 De Grauwe and Ji, 'Self-fulfilling crises in the Eurozone' (n 27) 17.
46 As Vítor Constâncio, vice-president of the European Central Bank, explains: '[F]inancial contagion refers to a situation whereby instability in a specific market or institution is transmitted to one or several other markets or institutions ... Criteria that have been used in the literature to identify contagion include: (i) the transmission is in excess of what can be explained by economic fundamentals….' See Vítor Constâncio, 'Contagion and the European debt crisis' (Banque de France, Financial Stability Review No 16, April 2012) 110-111 (footnotes omitted). See also ECB, 'The determinants of euro area sovereign bond yield spreads' (n 19) 71.
47 De Grauwe and Ji, 'Mispricing of Sovereign Risk' (n 18) 877-878.
48 Australia, Canada, the Czech Republic, Denmark, Hungary, Japan, South Korea, Norway, Poland, Singapore, Sweden, Switzerland, the UK and the US. See De Grauwe and Ji, 'Self-fulfilling crises in the Eurozone' (n 27) 19.
49 De Grauwe and Ji, 'Self-fulfilling crises in the Eurozone' (n 27) 15-16, 20.
50 De Grauwe and Ji, 'Self-fulfilling crises in the Eurozone' (n 27) 20.

be able to "get away with murder" and still not be disciplined by financial markets'.[51]

2.3 … that fits central bank action

Now, this study does not necessarily wish to defend De Grauwe and Ji's analysis or claim that it presents the most accurate account of what happened on euro area government bond markets during the crisis.[52] Certainly, their hypothesis about the currency union's fragility has been subscribed to by some authoritative colleagues.[53] Again others, moreover, do not necessarily subscribe to this hypothesis but do find that the currency union is susceptible to self-fulfilling crises that are unrelated to fundamentals.[54] But some economists, using other variables and models, reach different conclusions. According to Bernoth, von Hagen and Schuknecht, for example, the rise in the spreads of Greece and Ireland, at least until mid-2009, was to a large extent due to the fact that after the collapse of Lehmann in 2008 markets became much more sensitive to poor fiscal records.[55]

This study singles out De Grauwe and Ji's analysis because its reading of multiple equilibria corresponds best to the reasoning of the European Central Bank to justify purchases of government bonds on the secondary

51 De Grauwe and Ji, 'Self-fulfilling crises in the Eurozone' (n 27) 26.

52 For an overview of different explanations of the surge in bond spreads during the crisis see Leo de Haan, Jeroen Hessel and Jan Willem van den End, 'Are European Sovereign Bonds Fairly Priced? The role of modeling uncertainty' (DNB Working Paper No 399, November 2013) 5-7; ECB, 'The determinants of euro area sovereign bond yield spreads' (n 19) 67ff.

53 Paul Krugman, for example, states that: '[T]he proposition [*is*, ed] that countries without a printing press are subject to self-fulfilling crises in a way that nations that still have a currency of their own are not. The point is that fears of default, by driving up interest costs, can themselves trigger default – and that's because there's a crossing-the-Rubicon aspect to default, once a country crosses that line it will probably impose fairly severe losses on creditors. A country with its own currency isn't in the same position….'. See Paul Krugman, 'The Printing Press Mystery' *New York Times* (17 August 2011) <krugman.blogs.nytimes.com/2011/08/17/the-printing-press-mystery/> accessed 5 April 2017. See also Paul Krugman, 'Currency Regimes, Capital Flows, and Crises' (2014) 62 IMF Econ Rev 470, 473-475; Daniel Gros, 'On the Stability of Public Debt in a Monetary Union' (2012) 50 JCMS 36, 37-38; Willem Buiter and Ebrahim Rahbari, 'The European Central Bank as a Lender of Last Resort for Sovereigns in the Eurozone' (2012) 50 JCMS Annual Review 6, 6-8, 18.

54 See eg Peter Hördahl and Oreste Tristani, 'Macro factors and sovereign bond spreads: a quadratic no-arbitrage model' (mimeo, 10 May 2013) <hkimr.org/uploads/seminars/469/paper_08-08.pdf> accessed 5 April 2017; Manfred Gärtner and Björn Griesbach, 'Rating agencies, self-fulfilling prophecy and multiple equilibria? An empirical model of the European sovereign debt crisis 2009-2011' (Universität St. Gallen Discussion Paper No 2012-15, June 2012). See also ECB, 'The determinants of euro area sovereign bond yield spreads' (n 19) 73-74 for further references.

55 Bernoth, Von Hagen and Schuknecht (n 19) 984-985.

market, a crucial element of the currency union's transformation that will be discussed in detail in chapter 6.[56] Indeed, shortly before the Bank announced the details of its most far-reaching intervention, called 'Outright Monetary Transactions', President Draghi explained in an opinion piece in *Die Zeit* on 29 August 2012 how the panic on government bond markets had prevented the Bank from delivering on price stability, forcing it to resort to 'unconventional' measures:

> '[I]t should be understood that fulfilling our mandate sometimes requires us to go beyond standard monetary policy tools. When markets are fragmented or influenced by irrational fears, our monetary policy signals do not reach citizens evenly across the euro area. We have to fix such blockages to ensure a single monetary policy and therefore price stability for all euro area citizens. This may at times require exceptional measures. But this is our responsibility as the central bank of the euro area as a whole.'[57]

At a press conference right after the Governing Council had announced its intervention, on 6 September 2012, Draghi again referred to the dysfunctioning of markets in defence of the Bank's exceptional move:

> '[T]he assessment of the Governing Council is that we are in a situation now where you have large parts of the euro area in what we call "a bad equilibrium", namely an equilibrium where you may have self-fulfilling expectations that feed upon themselves and generate very adverse scenarios. So, there is a case for intervening, in a sense, to "break" these expectations, which, by the way, do not only concern specific countries, but the euro area as a whole. And this would justify the intervention of the central bank.'[58]

According to the Bank, therefore, market panic was driving up bond spreads to such heights that it caused 'financial fragmentation', characterised by 'divergent borrowing costs' for individuals and companies, making it very difficult to have its monetary policy reach out to all corners of the currency union.[59] What is more, in the summer of 2012, right before the launch of its far-reaching intervention, spreads were even so extreme that markets seemed

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56 According to Martin Wolf, chief economics commentator at the *Financial Times*, the Governing Council's decision to establish the Outright Monetary Transactions programme 'marks belated acceptance of strong arguments made by the Belgian economist, Paul de Grauwe, at the London School of Economics'. See Martin Wolf, 'Draghi alone cannot save the euro' *Financial Times* (12 September 2012).

57 Mario Draghi, 'So bleibt der Euro stabil!' *Die Zeit* (30 August 2012). English translation available at <ecb.europa.eu/press/key/date/2012/html/sp120829.en.html> accessed 13 May 2017.

58 Introductory statement to the press conference (with Q&A) (ECB, 6 September 2012). See also Paul De Grauwe and Yuemei Ji, 'From Panic-Driven Austerity to Symmetric Macroeconomic Policies in the Eurozone' (2013) 51 JCMS 31, 31.

59 ECB, 'The determinants of euro area sovereign bond yield spreads' (n 19) 81.

to anticipate a collapse of the currency union as bond rates started to reflect a 'currency redenomination risk premium'.[60] This means that investors were requesting 'compensation' for the, in the eyes of the Bank unfounded, scenario that one or more states would have to leave the currency union and live on with a new, devalued currency.[61]

Why were these high bond rates so problematic for the transmission of monetary policy, as the Bank argued? The answer is that its policy rates are 'transmitted' to the 'real economy' via several 'channels'.[62] In normal times the channels work well, but during the crisis some of them were 'dysfunctional' due to the high rates for certain government bonds, as a result of which the Bank's policy 'signals' were no longer effective in all parts of the currency union.[63] Philippine Cour-Thimann and Bernhard Winkler identify three dysfunctional transmission channels with special relevance.[64] The first concerns the 'price channel'.[65] As the previous chapter explained,[66] states 'compete' with banks on the markets for capital.[67] Higher government bond rates can therefore also drive up those for banks, which in turn may lead to higher 'bank lending rates'.[68] The second channel relates to 'liquidity'.[69] Government bonds are much used as collateral for lending operations between banks.[70] They also figure as 'benchmarks' to decide the value of other collateral assets in such operations.[71] A hike in government bond rates can therefore make it more difficult for banks to obtain liquidity as it affects the 'eligibility' of their assets as collateral.[72] The third and final channel has to do with the 'balance sheets' of banks.[73] Changes in the price of government bonds can seriously weaken a bank's capital position, which negatively affects its ability to provide credit to customers.[74]

60 ECB, 'The determinants of euro area sovereign bond yield spreads' (n 19) 77-78.
61 ECB, 'The determinants of euro area sovereign bond yield spreads' (n 19) 78.
62 Philippinne Cour-Thimann and Bernhard Winkler, 'The ECB's non-standard monetary policy measures: the role of institutional factors and financial structure' (2012) 28 Oxf Rev Econ Policy 765, 774.
63 Cour-Thimann and Winkler (n 62) 774, 778.
64 Cour-Thimann and Winkler (n 62) 774-775.
65 Cour-Thimann and Winkler (n 62) 774.
66 See text to n 250 (ch 3).
67 Cour-Thimann and Winkler (n 62) 774.
68 Cour-Thimann and Winkler (n 62) 774. See also European Central Bank, 'Assessing the retail bank interest rate pass-through in the euro area at times of financial fragmentation' (ECB Monthly Bulletin, August 2013) 86-87.
69 Cour-Thimann and Winkler (n 62) 775.
70 Cour-Thimann and Winkler (n 62) 775.
71 Cour-Thimann and Winkler (n 62) 775.
72 Cour-Thimann and Winkler (n 62) 775.
73 Cour-Thimann and Winkler (n 62) 775.
74 Cour-Thimann and Winkler (n 62) 775. See also Gros (n 53) 39.

The European Central Bank thus sees its government bond purchases as necessary to secure the 'transmission' and 'singleness' of its monetary policy in view of the panic on bond markets.[75] They would therefore fall squarely within its monetary policy mandate. Critics, however, argue that this is not all there is to the Bank's motivation to intervene. Rather than pursuing a monetary policy objective, its bond purchases would aim to provide distressed states with a 'lender of last resort', thereby setting foot on the terrain of economic policy. At the end of this chapter this view will be further analysed. First, however, it is necessary to take a look at the second disciplining device of the original stability framework, that of public discipline. After all, if Greece had not had such a weak fiscal record in the first place, chances are that markets would not have lapsed into panic. But just as markets had not been able to induce states to fiscal prudence prior to the crisis, the instrument of public discipline had fallen short too.

3 The weakness of public discipline

3.1 Fiscal politics under the original Pact

The Delors Committee had already anticipated the unreliability of markets, and it had advised that any lack of discipline provided by them should be compensated for by putting limits on the fiscal powers of member states. Such public discipline would not only add to that provided by markets, it would also strengthen it. Neglect of fiscal rules and reprimands by authorities would 'guide' markets in assessing the fiscal performance of states.[76]

As the previous chapter showed,[77] the Union Treaties consolidate public discipline in Articles 121 and 126 TFEU (ex Arts 99 and 104 EC). The first provision creates a framework for the coordination of national economic policies, in particular through the multilateral surveillance procedure set out in its third to fifth paragraphs. The second curbs the fiscal powers of member states by obliging them, subject to certain exceptions, to avoid deficits and debts exceeding the limits of 3% and 60% of GDP respectively and, moreover, by setting out the excessive deficit procedure to examine compliance with these limits. Both procedures, the multilateral one and that for excessive deficits, are specified in the Stability and Growth Pact. The Pact's preventive arm, laid down in Regulation 1466/97, details the multilateral surveillance procedure, in particular by requiring states to pursue medium-term budgetary objectives

75 ECB, 'The determinants of euro area sovereign bond yield spreads' (n 19) 81: 'The goal of OMTs is to ensure an appropriate monetary policy transmission and the singleness of the monetary policy'.

76 Manganelli and Wolswijk (n 19) 196-197.

77 See text to n 294 (ch 3).

so as to avoid excessive deficits. The corrective arm, governed by Regulation 1467/97, speeds up and clarifies the excessive deficit procedure by defining the exceptions to the obligation to avoid deficits, attaching time limits to the different phases of the procedure and specifying sanctions for violations of the fiscal rules.

Did this system succeed in imposing public discipline on member states, in particular on those belonging to the currency union? Interestingly, in the run-up to the launch of the single currency, before the Pact had come into force, states managed to significantly improve their fiscal records. Keen on qualifying for membership of the currency union, they put great effort into bringing their budgets in line with the convergence criteria, in particular by pushing down their deficits below the limit of 3% of GDP.[78] All states that were first to join the currency union on 1 January 1999 recorded deficits below this limit at the time of entry. Even Italy, still with a deficit of 9.5% in 1993, had managed to reduce it to 2.5% by 1998.[79]

But once the single currency had taken off, fiscal 'fatigue' set in.[80] In part this resulted from the fact, as stability hardliners had predicted at the time of the treaty negotiations on monetary union,[81] that the carrot of euro area membership had lost its appeal for those states that had managed to get 'in'.[82] Having succeeded in passing the 'convergence' test, they were now less eager to pursue fiscal prudence. Yet, it was also a consequence of the changeover of Europe's political landscape at the turn of the millennium.[83] In many capitals conservative governments were replaced by leftist, social-democratic ones, with different perceptions of the role and function of fiscal policy.[84]

Germany is a prime example. After 16 years of Christian-liberal rule, in 1998 the Kohl government made way for one consisting of social democrats and greens, led by Gerhard Schröder. As a result, Germany's position on fiscal issues changed significantly.[85] Whereas former Finance Minister Theo Waigel had argued for a stability pact to avoid fiscally imprudent states from threatening price stability and central bank independence, his social-democrat

78 Ludger Schuknecht and others, 'The Stability and Growth Pact: Crisis and Reform' (ECB Occasional Paper Series No 129, September 2011) 9. The same cannot be said of their debt to GDP ratios as some of these were still far above 60%. See also text to n 9 (ch 4).

79 Commission, 'Convergence Report 1998' (European Economy No 65, 1998) 81. See also Schuknecht and others (n 78) 9.

80 Antonio Fatás and Ilian Mihov, 'On Constraining Fiscal Policy Discretion in EMU' (2003) 19 Oxf Rev Econ Policy 112, 121. See also Charles Wyplosz, 'European Monetary Union: The Dark Sides of a Major Success' (2006) 21 Economic Policy 207, 230-231; Heipertz and Verdun (n 6) 115.

81 See text to n 314 and 449 (ch 3).

82 Fatás and Mihov (n 80) 120-124; Wyplosz (n 80) 230-231.

83 Heipertz and Verdun (n 6) 114.

84 Heipertz and Verdun (n 6) 114.

85 Heipertz and Verdun (n 6) 114.

successor, Oskar Lafontaine, was not convinced of such monetarist ideas.[86] Faced with Germany's highest unemployment rate in decades – 4 million – almost immediately after taking office, he pressured the European Central Bank to lower its interest rates arguing that 'Monetary policy is certainly the preferred instrument to respond to this shock'.[87] 'If it is not used', he continued, 'fiscal measures cannot be ruled out, because the option of doing nothing could turn out to be extremely expensive'.[88] Lafontaine's remarks failed to impress Wim Duisenberg, the Bank's first president. Eager to establish the credibility of the new monetary authority, he replied that 'The main cause of unemployment is not a lack of domestic demand. It is structural. Monetary policy can do nothing about it, and neither can demand-side policies. Labour and goods markets must become more flexible…'.[89]

Schröder eventually realised this too. In 2003 his government embarked on a major reform agenda for the German labour market.[90] Known as the '*Hartz*-reforms', the changes introduced by the government struck at the very core of Germany's welfare system, not in the least by economising unemployment and social welfare benefits.[91] Whereas the reforms would revitalise the German economy in the long-run, they negatively impacted the budget in the short term.[92] Schröder therefore became increasingly sceptical of the fiscal constraints imposed by the Pact, which in his view left too little room for investments that would ultimately benefit the economy.[93]

The change in views on fiscal policy did not immediately show up in 'nominal' fiscal data.[94] During the first two years of the single currency's existence, Europe experienced growth 'above trend' which allowed member states to

86 Heipertz and Verdun (n 6) 114.

87 Quoted in 'Comment & Analysis: Germany's blame game' *Financial Times* (24 February 1999).

88 Quoted in 'Comment & Analysis: Germany's blame game' *Financial Times* (24 February 1999).

89 Quoted in 'Comment & Analysis: Germany's blame game' *Financial Times* (24 February 1999).

90 See Abraham Newman, 'The Reluctant Leader: Germany's euro experience and the long shadow of reunification' in Matthias Matthijs and Mark Blyth (eds), *The Future of the Euro* (OUP 2015) 127.

91 European Central Bank, 'The short-term fiscal implications of structural reforms' (ECB Economic Bulletin No 7, 2015) 65-66.

92 ECB, 'The short-term fiscal implications of structural reforms' (n 91) 66. Matthias Matthijs therefore relativises Germany's shift away from ordoliberalism under the sceptre of Schröder. He argues that 'while seemingly moving away from ordoliberalism on the budgetary front, Schröder's government was doubling down on it through structural reform'. See Matthias Matthijs, 'Powerful rules governing the euro: the perverse logic of German ideas' (2016) 23 Journal of European Public Policy 375, 381 (footnote omitted).

93 See text to n 118 and 201 (ch 4).

94 Heipertz and Verdun (n 6) 116.

keep up appearances by running budgets below the 3% limit.[95] However, most of them failed to reach the far more ambitious target in the Pact's preventive arm of a budget that is 'close to balance or in surplus'.[96] What is more, they did not use the time of favourable growth for 'structural improvement' of their budgets, instead resorting to loose fiscal policies through increased spending and tax relief.[97] In some large states structural positions even worsened, which left them ill-prepared for less rosy times.[98]

From a legal point of view it is hard to blame the Pact, in particular its preventive arm, for this fiscal fatigue. Of course, one can argue that it failed because states dragged their feet in reaching their medium-term objectives of running a budget that is in balance or surplus.[99] Yet, such criticism disregards the fact that Article 121 TFEU, the legal basis for the Pact's preventive arm, offers no room for imposing hard obligations to achieve precise fiscal results.[100] It is in the nature of a system that has to rely on benchmarking, peer pressure and promises to perform to the best of one's ability – the so-called 'open method of coordination' –[101] that results can be off target, in particular when it concerns a most sensitive area like fiscal policy.[102] But even from a non-legal, practical point of view it is difficult to criticise the Pact's preventive arm as the impossibility to verify what fiscal policy would have looked like without it makes it hard to assess its effectiveness.[103] Without the Pact, fiscal records may have even been worse!

Where public discipline has more clearly fallen short, especially from a legal point of view, is in the operation of the excessive deficit procedure and the Pact's corrective arm. The lack of ambition in bringing down deficits after

95 Commission, 'Public Finances in EMU 2001' (European Economy No 3, 2001) 11.

96 Heipertz and Verdun (n 6) 114.

97 Heipertz and Verdun (n 6) 116-117.

98 Commission, 'Public Finances in EMU 2001' (n 95) 11-12.

99 In particular given the fact that in the political Resolution on the Pact states had committed themselves to 'respect' their medium-term objectives and 'to take the corrective budgetary action they deem necessary'. See Resolution of the European Council on the Stability and Growth Pact, Amsterdam, 17 June 1997 [1997] OJ C 236/1 (section 'member states', point 1).

100 A different issue is whether it provides a legal basis for the imposition of sanctions for failing to observe the adjustment path towards the medium-term budgetary objective. See n 272 (ch 5).

101 For an analysis of the OMC method in the context of the Pact in its original form Fabian Amtenbrink and Jakob de Haan, 'Economic Governance in the European Union: Fiscal policy discipline versus discipline' (2003) 40 CML Rev 1075, 1079-1085.

102 This is not to say that hard law obligations would necessarily lead to better results or be more desirable. Dermot Hodson and Imelda Maher, for example, argue that soft law may be the best instrument for economic policy given the 'uncertainty' over how to 'measure' respect of the medium-term budgetary objective. See Dermot Hodson and Imelda Maher, 'Soft law and sanctions: economic policy coordination and reform of the Stability and Growth Pact' (2004) 11 Journal of European Public Policy 798, 801, 803-804.

103 Wyplosz (n 80) 230. On the basis of an indirect evaluation, however, Wyplosz himself argues that the Pact failed to bring about fiscal discipline during the years following the launch of the euro.

the launch of the single currency was bound to create problems once the economy took a turn for the worse. Luck had to run out at some point. And indeed, from 2001 onwards growth conditions worsened and started to negatively affect national budgets, in particular of those member states that had failed to bring down their deficits in the years before.[104] Portugal was the first to run into serious trouble.[105] With little room to accommodate the cyclical downturn, its deficit went up from 2.4% in 1999 to 4.1% in 2001, well above the 3% limit.[106] As it feared that the state would exceed the limit for a second year in 2002, the Council adopted a decision on the basis of Article 104(6) EC establishing the existence of an excessive deficit on 5 November 2002.[107]

Soon, larger member states came under pressure as well.[108] Having managed to escape the initiation of an excessive deficit procedure in 2001 by a narrow margin, Germany had to capitulate on 21 January 2003 when the Council established the existence of an excessive deficit of 3.7% for the year 2002 and recommended measures for its reduction.[109] It subsequently did the same with France on 3 June 2003 when, despite having issued an early warning under the Pact's preventive arm in January,[110] it identified an excessive deficit of 3.1% for the previous year.[111]

Being subject to the excessive deficit procedure, a divide took place between Portugal on the one hand, and France and Germany on the other.[112] Portugal used the procedure as an 'external constraint' to justify fiscal reform efforts.[113] Illustrative is the following remark of José Manuel Barroso, at the time the state's prime minister. Having succeeded in cutting down the deficit from 4.4%

104 Heipertz and Verdun (n 6) 119.
105 Heipertz and Verdun (n 6) 119, 131.
106 Recital 7 Council Decision 2002/923/EC of 5 November 2002 on the existence of an excessive deficit in Portugal – Application of Article 104(6) of the Treaty establishing the European Community [2002] OJ L 322/30 (Council Decision 2002/923/EC).
107 Council Decision 2002/923/EC.
108 Heipertz and Verdun (n 6) 128ff.
109 Council Decision 2003/89/EC of 21 January 2003 on the existence of an excessive deficit in Germany – Application of Article 104(6) of the Treaty establishing the European Community [2003] OJ L 34/16 (especially Recital 7); Council Recommendation of 21 January 2003 with a view to bringing an end to the situation of an excessive government deficit in Germany – Application of Article 104(7) of the Treaty Establishing the European Community, Brussels 28 January 2003, No 5540/03.
110 Council Recommendation 2003/90/EC of 21 January 2003 with a view to giving early warning to France in order to prevent the occurrence of an excessive deficit [2003] OJ L 34/18.
111 Council Decision 2003/487/EC of 3 June 2003 on the existence of an excessive deficit in France – application of Article 104(6) of the Treaty establishing the European Community [2003] OJ L 165/29 (especially Recital 7); Council Recommendation to France with a view to bringing an end to the situation of an excessive government deficit – Application of Article 104(7) of the Treaty, Brussels 18 June 2003, No 10125/03.
112 Heipertz and Verdun (n 6) 149-151.
113 Heipertz and Verdun (n 6) 128, 149.

in 2001 to 2.7% the following year,[114] he praised the Pact for its restraining force by attributing it mythical strengths:

> 'It's like the legend of Ulysses….The pact helps a government to tie itself to the mast and resist the sirens who are trying to lure us to destruction with seductive songs of more state spending and bigger bureaucracies.'[115]

Germany and France, however, were hostile to the procedure. As the most powerful member states they were not prepared to be lectured to by the Union on fiscal policy. Yet, each of them justified their refusal differently.[116] France went for a face-to-face confrontation. Even before it was formally placed under the excessive deficit procedure its Prime Minister Jean-Pierre Raffarin had made it clear that he would not 'conduct a policy of austerity'.[117] Germany sought a more conciliatory stance. Having fought hard to introduce the Pact to convince the rest of Europe of the virtues of 'stability' only several years earlier, it did not want to publicly abandon it.[118] Instead, it argued that it should be interpreted 'in an economically sensible way'.[119] Focused on implementation of the *Hartz*-reforms, Chancellor Schröder stressed that the Pact was a 'stability *and* growth pact…', and that in times of a slackening economy it was 'necessary to take measures to stimulate growth'.[120] Germany was therefore still 'acting in the spirit of the pact'.[121]

Despite this difference in language, both states refrained from reducing their deficits in line with the recommendations of the Council. Over the course of 2003 it became clear that Germany's deficit would not go down to 2.75% as recommended by the Council, but rise to 4.2%, making it very unlikely that the state would manage to push it below the 3% limit in 2004.[122] The French budget too significantly overshot the target set by the Council. Contrary to

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114 See Recital 5 of Council Decision 2006/135/EC of 11 May 2004 abrogating the decision on the existence of an excessive deficit in Portugal [2005] OJ L 47/24.

115 Quoted in Peter Wise, 'Portugal learns to love stability pact' *Financial Times* (29 January 2003). See also Heipertz and Verdun (n 6) 137.

116 Heipertz and Verdun (n 6) 142, 149-150.

117 Quoted in Martin Arnold, Francesco Guerrera and Jo Johnson, 'France refuses to take steps to curb budget deficit' *Financial Times* (26 February 2003).

118 See also George Parker, 'EU haunted by spectre of pact no one will let die' *Financial Times (FT.Com)* (2 July 2003).

119 Quoted in Hugh Williamson, '"Many countries" back easing stability pact' *Financial Times (FT.Com)* (28 August 2003). See also Heipertz and Verdun (n 6) 142.

120 Quoted in Hugh Williamson and Bettina Wassener, 'Transcript of the interview with Gerhard Schröder' *Financial Times (FT.Com)* (11 July 2003) (emphasis added).

121 Quoted in Williamson and Wassener, 'Transcript of the interview with Gerhard Schröder' (n 120).

122 Commission, 'Recommendation of 18 November 2003 for a Council decision establishing, in accordance with Article 104(8) of the EC Treaty, that the action taken by Germany in response to the recommendations made by the Council pursuant to Article 104(7) of the Treaty is proving to be inadequate' SEC (2003) 1316 final (explanatory memorandum).

cutting its deficit in 2003 to bring it below the red line of 3% in the following year, France expected its deficit to reach 4%.[123] Moreover, Raffarin indicated he had no intention of bringing the budget into safe havens already in 2004, trivialising the Pact's fiscal rules as the 'obsession of "notaries" in Brussels'.[124]

Fearing a breach of the Pact for a third year in a row, the Commission decided to step up the excessive deficit procedures of France and Germany, thereby bringing closer, at least in theory, the imposition of sanctions by the Council. On 8 October 2003 it recommended the Council to issue a recommendation on the basis of Article 104(8) EC establishing that France had taken no effective action in response to its earlier recommendations.[125] Subsequently, on 21 October 2003, it also recommended the Council to give notice to the state under Article 104(9) EC to take measures to reduce its deficit.[126] Similar steps were taken in relation to Germany on 18 November 2003.[127]

By taking the procedure to another level, the Commission forced a tug-of-war in the Council between member states supporting and opposing sanctions.[128] The Netherlands was perhaps the most arduous proponent. Its Finance Minister Gerrit Zalm, having introduced serious budgetary cuts himself in order to stay in line with the Pact's requirements in 2004,[129] argued that that the Union's fiscal rules were 'crucial to monetary and economic stability in Europe, and therefore have to be respected by all EU member states'.[130] Yet, he would taste defeat when the Commission recommendations were put

123 Commission, 'Recommendation of 8 October 2003 for a Council decision establishing, in accordance with Article 104(8) EC, whether effective action has been taken by France in response to recommendations of the Council according to Article 104(7) EC of the Treaty establishing the European Community' SEC (2003) 1083 final (explanatory memorandum, para 2).

124 Jo Johnson and George Parker, 'France given more time to pull back budget deficit' *Financial Times* (21 October 2003) (using these words to describe Raffarin's position).

125 SEC (2003) 1083 final.

126 Commission, 'Recommendation of 21 October 2003 for a Council decision giving notice to France, in accordance with Article 104(9) of the EC Treaty, to take measures for the deficit reduction judged necessary in order to remedy the situation of excessive deficit' SEC (2003) 1121 final.

127 SEC (2003) 1316 final; Commission, 'Recommendation of 18 November 2003 for a Council decision giving notice to Germany, in accordance with Article 104(9) of the EC Treaty, to take measures for the deficit reduction judged necessary in order to remedy the situation of excessive deficit' SEC (2003) 1317 final.

128 Heipertz and Verdun (n 6) 147, 150-152.

129 Heipertz and Verdun (n 6) 144.

130 Quoted in Ian Bickerton, 'Dutch slash spending to haul economy out of crisis' *Financial Times* (17 September 2003).

to a vote on 25 November 2003. With mostly small member states voting in favour, the Council failed to adopt them.[131]

Interestingly, however, the Union's fiscal rules had not lost all of their normative appeal. Instead of issuing recommendations the Council adopted 'conclusions' on the basis of the same voting procedure as for recommendations under Article 104(9) EC.[132] In these conclusions it took note of 'public commitments' made by Germany and France to take the required measures to correct their excessive deficits and set the deadline for correction at 2005, thereby granting both another year to put their fiscal house in order.[133] The Council subsequently stated that, taking into account these commitments, it had decided 'not to act, at this point in time' on the Commission recommendations for Council decisions under Article 104(9) EC.[134] Instead, and parallel to the arrangements in the Pact's corrective arm, it decided to hold the excessive deficit procedure 'in abeyance for the time being', although it indicated that it was ready to act under Article 104(9) EC if the two member states did not live up to their commitments.[135] The Council ended its conclusions by confirming its continuing 'strong commitment to sound public finances' and to the Pact 'as the framework for the coordination of budgetary policies in the European Union…'.[136]

For a stability hardliner like Dutch Finance Minister Zalm, however, these salvaging final words were no more than a cynical way of covering the Pact's ineffectiveness with the cloak of charity. When he came out of the meeting he was furious and told the press how the Franco-German coalition had managed to assemble a 'blocking minority' in the Council,[137] arguing that 'some ministers may have been intimidated by those two big countries'.[138] Zalm's anger was shared by the Commission. As 'guardian' of the Treaties

131 Heipertz and Verdun (n 6) 147, 150-151. The group of states voting in favour differed depending on whether the voting concerned a recommendation under Article 104(8) (now Art 126(8) TFEU) or 104(9) EC (now Art 126(9) TFEU) as Arts 122(3) and 122(5) EC (now Arts 139(2)(c) and 139(4) TFEU) determined that only members of the currency union could vote on the latter. As a result, the coalition of states voting in favour of the recommendations under Art 104(8) EC consisted of Belgium, Denmark, Greece, Spain, the Netherlands, Austria, Finland and Sweden, whereas only Belgium, Greece, Spain, the Netherlands, Austria and Finland supported the recommendations under Art 104(9) EC. See also the Council minutes in 2546th Council meeting (ECOFIN), Brussels, 25 November 2003, 14492/1/03 REV1, 15ff (English version).

132 ECOFIN minutes in 2546th meeting, 25 November 2003, 15ff. See also Heipertz and Verdun (n 6) 148.

133 ECOFIN minutes in 2546th meeting, 25 November 2003, 17, 20.

134 ECOFIN minutes in 2546th meeting, 25 November 2003, 17, 21.

135 ECOFIN minutes in 2546th meeting, 25 November 2003, 17, 21.

136 ECOFIN minutes in 2546th meeting, 25 November 2003, 17, 21.

137 On this 'blocking minority' see Heipertz and Verdun (n 6) 151.

138 Quoted in Bertrand Benoit and others, 'Sanctions deal leaves euro pact in tatters' *Financial Times* (26 November 2003). See also Heipertz and Verdun (n 6) 148.

it felt bullied and humiliated by the Council.[139] To underline its discontent with the course of events it had a statement inserted in the minutes of the Council meeting, saying:

> 'The Commission deeply regrets that the Council has not followed the spirit and the rules of the Treaty and the Stability and Growth Pact that were agreed unanimously by all Member States. Only a rule-based system can guarantee that commitments are enforced and that all Member States are treated equally. The Commission will continue to apply the Treaty and reserves the right to examine the implications of these Council conclusions and decide on possible subsequent actions.'[140]

Soon it became clear what kind of 'actions' the Commission had in mind: it took the Council to Court.

3.2 Testing public discipline in court

The Commission requested the Court to do two things.[141] It asked the Court to annul the decisions of the Council not to follow the Commission's recommendations under Articles 104(8) and 104(9) EC. And it sought annulment of the Council's conclusions to the extent that they held the excessive deficit procedures for France and Germany in abeyance, had recourse to an instrument not provided for by the Treaty and modified the Council's own recommendations under Article 104(7) EC. The Council, in turn, requested the Court to declare the action inadmissible.

The Court, sitting in full and acting under an expedited procedure, took a balanced approach to the politically delicate matter, acknowledging some of the Commission's grievances, but at the same time underlining the Council's discretion at crucial points of the excessive deficit procedure. It began by declaring the Commission's action inadmissible in as far as it concerned the annulment of the Council's inability to adopt the instruments set out in the Commission's recommendations.[142] The essence of the Court's reasoning was clear and simple:

> '[W]here the Commission recommends to the Council that it adopt decisions under Article 104(8) and (9) EC and the required majority is not achieved within the Council, no decision is taken for the purpose of that provision'.[143]

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139 Bertrand Benoit and others, 'Sanctions deal leaves euro pact in tatters' (n 138).
140 ECOFIN minutes in 2546th meeting, 25 November 2003, 22. See also Heipertz and Verdun (n 6) 148.
141 Case C-27/04 *Commission v Council* [2004] EU:C:2004:436, para 22 (*SGP* case).
142 *SGP* case (n 141) para 36.
143 *SGP* case (n 141) para 31.

Consequently, there is no act that could give rise to an annulment action under Article 230 EC (now Art 263 TFEU).[144]

Yet, the Court supported this conclusion with another argument focusing on the fact that nowhere does Union law lay down 'a period on the expiry of which an implied decision under Articles 104(8) and 104(9) EC is deemed to arise…'.[145] It recognised that one of the aims of Regulation 1467/97, the corrective arm of the Pact, was to speed up the excessive deficit procedure by attaching time limits to its different stages,[146] but argued that their expiration does not preclude the Council from adopting the acts at a later point in time.[147] In fact, a 'lapse' of the Council's power to act on expiration of the deadline would run counter to the objective of speeding up the procedure as it would necessitate relaunching the procedure afresh.[148]

This part of the Court's reasoning may be strained. Whilst the conclusion that the expiration of deadlines set by the Pact, in its pre-crisis form,[149] did not lead to an implied decision is sound,[150] the purposive argument used in support of it is much less so.[151] Of course, and as Advocate General Tizzano noted in his View on the case, the political balance of power within the Council may change at short notice.[152] Those who find themselves in a minority position today can form a majority tomorrow. The expedience of the excessive deficit procedure would be negatively affected if due to such a brief lack of support the Council was to forego its power to adopt the act. But voting coalitions may equally well stay unchanged for long periods of time. Seen from that perspective, the purposive reasoning of the Court is rather cynical,

144 *SGP* case (n 141) paras 31, 34.

145 *SGP* case (n 141) para 32.

146 See in this regard text to n 365 (ch 3).

147 *SGP* case (n 141) para 33.

148 *SGP* case (n 141) para 33.

149 The system has changed significantly as a result of the amendments that have been introduced to the Pact since the crisis, in particular through the introduction of reversed majority voting. See text to n 224 (ch 5).

150 See in this regard the View of AG Tizzano which contrasts the situation under the excessive deficit procedure with the *Eurocoton* case (C-76/01P, ECLI:EU:C:2003:511) which dealt with the Council's failure to adopt a proposal for a Regulation imposing a definitive anti-dumping duty. In that case the Court found that the failure to act did form an implied decision as the applicable Reg (Art 6(9) Reg 384/96 [1996] OJ L 56/1, repealed by Reg 1125/2009 [2009] OJ L 343/51) determined that a failure to take a decision turned into a definitive Council position following lapse of the deadline. Reg 1467/97 did not contain such an arrangement. As a result, the Council could still adopt the instruments contained in the Commission recommendations under Arts 104(8) and 104(9) EC, even though the deadlines set out in the Pact's corrective arm had expired. See *SGP* case (n 141), View of AG Tizzano, paras 25, 35-47.

151 See also Imelda Maher, 'Economic policy coordination and the European Court: excessive deficits and ECOFIN discretion' (2004) 29 EL Rev 831, 836-837; Dimitrios Doukas, 'The Frailty of the Stability and Growth Pact and the European Court of Justice: Much Ado about Nothing?' (2005) 32 LIEI 293, 300-301.

152 *SGP* case (n 141), View of AG Tizzano, paras 44-45.

as it allows the Council to delay the excessive deficit procedure for a prolonged period of time just because of the mere possibility that its internal power balance may change.[153]

Having declared the action inadmissible in as far as it concerned the Council's failure to act, the Court turned to the Commission's second request: annulment of the conclusions. And contrary to the first, it considered this one admissible.[154] Basing itself on 'settled case law' that an action for annulment must be available in the case of all measures of institutions 'intended to have legal effects', the Court considered as essential the fact that the Council had made holding the excessive deficit procedures of France and Germany in abeyance conditional on compliance by these states with their own commitments.[155] As a result, the conclusions did not 'merely confirm' that the procedure was '*de facto* held in abeyance' due to the absence of the required majority of votes to adopt the acts recommended by the Commission under Articles 104(8) and 104(9) EC.[156] Holding the procedure in abeyance was now conditional on 'unilateral' commitments of France and Germany.[157] What is more, the Council thereby effectively changed the procedure's nature. Any decision of the Council to give notice on the basis of Article 104(9) EC would no longer have as point of departure its earlier recommendations under Article 104(7) EC, but these French and German commitments.[158] The Council's conclusions therefore 'in reality' even changed these previous recommendations as they postponed the deadline for the correction of excessive deficits with one year.[159]

On substance the Court found the conclusions to be unlawful, and consequently annulled them for two reasons that were strongly linked to its admissibility analysis. The first concerned the holding in abeyance of the excessive deficit procedure. This procedure, the Court reasoned, is exclusively governed by Article 104 EC (now Art 126 TFEU) and Regulation 1467/97. Consequently, either the procedure is *de facto* held in abeyance due to the absence of the required majority in the Council to adopt Commission recommendations, or it is held in abeyance on grounds mentioned in Regulation 1467/97.[160] The only grounds mentioned in this Regulation were action by the state concerned in compliance with a Council recommendation made under Article 104(7) EC or a notice issued by this institution on the basis of Article 104(9) EC.[161] Making the holding in abeyance of the procedure conditional

153 See also Doukas (n 151) 301.
154 *SGP* case (n 141) para 51.
155 *SGP* case (n 141) paras 46-47.
156 *SGP* case (n 141) para 47.
157 *SGP* case (n 141) paras 47-48.
158 *SGP* case (n 141) para 48.
159 *SGP* case (n 141) para 49.
160 *SGP* case (n 141) paras 84-86.
161 See Art 9(1) Reg 1467/97 (unamended).

on compliance by Germany and France with their unilateral commitments was a move unforeseen by the Regulation, and therefore unlawful.[162]

The second reason for annulling the conclusions related to the modifications made by them to previous recommendations of the Council under Article 104(7) EC. Building on its previous finding that the excessive deficit procedure is solely governed by Article 104 EC and the Pact's corrective arm, the Court pointed out that Article 104(13) EC indicates that recommendations under Article 104(7) EC could only be adopted on the basis of a Commission recommendation.[163] Once the Council has adopted such a recommendation it cannot subsequently modify them without a new recommendation of the Commission as this would run counter to the latter's right of initiative under the procedure.[164] Yet, this is precisely what the Council had done by unilaterally postponing the deadline for the correction of the excessive deficits of France and Germany.[165] Moreover, in doing so it had resorted to the wrong voting procedure, that in Article 104(9) EC which only allows members of the currency union to vote, whereas it should have used the one in Article 104(7) EC.[166]

3.3 Changing the Pact: flexibility versus discipline

By declaring the case partly inadmissible whilst at the same time annulling the Council's conclusions, the Court issued a 'Solomonic ruling' allowing both Commission and Council to claim triumph.[167] The Commission could point to the condemnation of the Council's decision to abandon the excessive deficit procedure by adopting its own 'conclusions' on the fiscal positions of France and Germany. Given the importance attached by the Court to sticking to the terms of the procedure, the Commission could even argue that the judgment had strengthened its position. It sits behind the steering wheel as every step of the Council is dependent on a previous step it has taken, without the ministers of finance being able to withdraw from this regime. However, if the

162 *SGP* case (n 141) paras 85, 87-89. The Court was quick to add in para 90 that by accepting that the excessive deficit procedure can *de facto* be held in abeyance it did not pronounce on whether the Council could be forced, on the basis of an action for failure to act under Article 232 EC (now Art 265 TFEU), to adopt a decision under Art 104(9) EC where a state 'persists in failing to put into practice recommendations under Article 104(7) EC…' It seems highly unlikely, however, that the Court could establish a failure to act given the discretion of the Council in making up its mind about a state's fiscal position and the underlying economic data, a fact also recognised by the Court itself in para 80. See also Doukas (n 151) 303-304.

163 *SGP* case (n 141) para 91.

164 *SGP* case (n 141) para 92.

165 *SGP* case (n 141) para 94.

166 *SGP* case (n 141) para 95.

167 'Solomonic ruling: The possibility of a sensible eurozone reform is preserved' *Financial Times* (14 July 2004). See also Maher (n 151) 831; Heipertz and Verdun (n 6) 162.

Commission is in charge of steering the wheel, the Council controls the pedals. The Court confirmed that the procedure can *de facto* be held in abeyance when the required majority in the Council for the adoption of an act is missing. This makes public discipline, in particular the imposition of sanctions, susceptible to political horse trading. Or to put it in the more carefully chosen words of the Court: '[R]esponsibility for making Member States observe budgetary discipline lies essentially with the Council'.[168]

To many, in particular those who are inclined to assess the Pact solely in terms of efficiency and discipline, it was this latter element of the judgment that really mattered. In their view, the Council came out of the dispute as the real winner.[169] But even if that is the case, the Court can hardly be blamed for it. Right from the start of the monetary union one realised that when things came to a crunch, it would be the Council pulling the strings. In fact, and as the previous chapter showed,[170] putting the Council in this position was a deliberate choice of the treaty drafters. If there is therefore one thing that the Court's judgment made clear, or rather reminded us of, it is that the Pact does not exist merely by the grace of its sanctioning mechanism. On the contrary, the Treaty system of public discipline functions best if its economic rationale is sound, making member states want to play by its rules.[171]

The Commission realised this all too well and consequently found itself being torn in two directions. It had challenged the Council before court in order to uphold the system's legal integrity, but knew that in their present form the fiscal rules would not work.[172] In fact, long before initiating legal proceedings, in the fall of 2002, its President Romano Prodi had called the Pact 'stupid' for seeking to squeeze all member states into the same fiscal straightjacket of keeping deficits below the 3% limit and reaching budgets that are in balance or surplus over the medium term.[173] The Court's judgment only made the Commission more convinced of the necessity of reform. But political room for reform was limited. Although most states were seeking a change in the Union's system of public discipline, they had little appetite in

168 *SGP* case (n 141) para 76.

169 An example of such a view is that of Wolfgang Münchau, according to whom 'the part of the judgment that really matters for economic policy is that European finance ministers can, in effect, do whatever they like. They can apply the rules or not'. See Wolfgang Münchau, 'A great chance for Europe to get its act together' *Financial Times* (19 July 2004).

170 See text to n 309 (ch 3).

171 Some even take the extreme view that the Union could do without the excessive deficit procedure in Art 126 TFEU and the Pact's corrective arm, focusing completely on 'soft' policy coordination through peer and public pressure. See Henrik Enderlein, 'Break it, Don't Fix it!' (2004) 42 JCMS 1039, 1044-1045.

172 Heipertz and Verdun (n 6) 155.

173 Quoted in George Parker, 'Euro rules 'stupid', says Prodi' *Financial Times* (18 October 2002). See also Heipertz and Verdun (n 6) 135.

a complete overhaul of its constitutional fundamentals.[174] What is more, at the intergovernmental conference on a Constitution for Europe, on which political agreement had been reached just months before the Court gave its interpretation of the excessive deficit procedure,[175] political leaders had left these fundamentals mostly untouched.[176] No wonder, therefore, that right after the Court's judgment, the Commission issued a statement in which it expressed only modest ambitions for reform, writing that it perceived the judgment as a confirmation to work on 'proposals for strengthening and clarifying the implementation of the Stability and Growth Pact…'.[177]

This strengthening and clarification came in the form of two Regulations amending the Pact's preventive and corrective arms.[178] Since the previous chapter has already discussed the Pact as it stood after its first amendment in 2005,[179] only the most notable changes will be highlighted here. Central to these changes, as the Council made clear in its report accompanying the amendments,[180] was the desire to 'enhance the economic underpinnings' of

174 See also Fabian Amtenbrink and Jakob de Haan, 'Reforming the Stability and Growth Pact' (2006) 31 EL Rev 402, 407-408; Jean-Victor Louis, 'The Review of the Stability and Growth Pact' (2006) 43 CML Rev 85, 85-86.

175 Political agreement on the final text was reached under the Irish presidency in June 2004. See European Council, Conclusions, Brussels, 17-18 June 2004, para 4. The constitution was signed by the member states on 29 October 2004 in Rome. Needless to say, however, it has never entered into force, not in the least due to the negative outcome of referenda on the constitution in France and the Netherlands.

176 For a thorough analysis of the changes the constitution would have introduced in the area of economic policy see René Smits, 'The European Constitution and EMU: An Appraisal' (2005) 42 CML Rev 425, 439-444. Most of these changes have eventually ended up in the Union Treaties through the Lisbon Treaty.

177 Commission, 'Statement on the Court of Justice ruling relating to the excessive deficit procedure' (IP/04/897, 13 July 2004). This phrase corresponds exactly to the one adopted by the intergovernmental conference on a Constitution for Europe, which calls on the Commission to introduce such proposals. See Declaration 17 on Article III-184 attached to the Treaty establishing a Constitution for Europe [2004] OJ C 310/01. For the document setting out the Commission's view on how to strengthen and clarify the Pact see Commission, 'Communication of 3 September 2004 to the Council and the European Parliament on strengthening economic governance and clarifying the implementation of the Stability and Growth Pact' COM (2004) 581 final.

178 Council Regulation 1055/2005 of 27 June 2005 amending Regulation 1466/97 on the strengthening of the surveillance of budgetary position and the surveillance of and coordination of economic policies [2005] OJ L 174/1 (Reg 1055/2005); Council Regulation 1056/2005 of 27 June 2005 amending Regulation 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure [2005] OJ L 174/5 (Reg 1056/2005).

179 See text to n 334 (ch 3).

180 As the previous chapter noted, this report, adopted by the Ecofin Council in March 2005, also forms an integral part of the Pact. See text to n 335 (ch 3).

the Union's fiscal framework so as to 'strengthen credibility and enforcement'.[181] Clearly, the Court's judgment and the realisation that the Pact works best if member states support its rationale were resonating here.

As far as the Pact's preventive arm is concerned, three changes stood out.[182] The first addressed the desire to make the Pact more tailor-made.[183] Instead of requiring all member states to pursue the same medium-term objective, the Pact now determined that each state should have its own target, stretching between close to balance or in surplus. For states participating in the currency union or in the second Exchange Rate Mechanism this objective was further defined as ranging 'between -1% of GDP and balance or surplus',[184] the idea being that member states with modest debts and high growth would be allowed to run budgets closer to the lower bound whereas those with weaker records should aim for the higher end.[185] Importantly, the objective was defined in 'cyclically adjusted terms' in order to avoid that states, as they did in the years following the launch of the euro,[186] would use 'one-off measures' to bring down their budgets without improving them structurally.[187]

The second change related to the adjustment path towards the medium-term objective. In its original form, the Pact's preventive arm had left undefined how states were to reach their targets, which had enabled them to procrastinate with adjustment efforts. Since its amendment in 2005 it made clear that members of the currency area or the second Exchange Rate Mechanism had to ensure, as a minimum, a yearly adjustment in structural terms of '0.5% of GDP as a benchmark'.[188] They were expected, however, to achieve a 'higher adjustment' in good times so as to prevent pro-cyclicality.[189] A deviation from the adjustment path, and this leads to the third change, was possible, provided that it was due to 'structural reforms', still allowed a state's budgetary position to return to the objective within the period covered by the programme and kept a 'safety margin' from the limit of 3% of GDP.[190] More-

181 Council report to the European Council, *Improving the implementation of the Stability and Growth Pact*, Brussels, 21 March 2005, 7423/05, 3 (Council report of 21 March 2005 on improving the Pact).
182 See also Heipertz and Verdun (n 6) 167-168.
183 Amtenbrink and De Haan, 'Reforming the Stability and Growth Pact' (n 174) 408; Louis (n 174) 92.
184 Art 2a Reg 1466/97, as amended by Reg 1055/2005.
185 Council report of 21 March 2005 on improving the Pact (n 181) 9.
186 See also text to n 94 (ch 4).
187 See also Amtenbrink and De Haan, 'Reforming the Stability and Growth Pact' (n 174) 410.
188 Arts 5(1) and 9(1) Reg 1466/97, as amended by Reg 1055/2005.
189 Arts 5(1) and 9(1) Reg 1466/97, as amended by Reg 1055/2005. See also Council report of 21 March 2005 on improving the Pact (n 181) 10-11; Amtenbrink and De Haan, 'Reforming the Stability and Growth Pact' (n 174) 408; Louis (n 174) 93.
190 Arts 5(1) and 9(1) Reg 1466/97, as amended by Reg 1055/2005.

over, these reforms had to be such that they would improve a state's fiscal position in the long run.[191]

Changes to the corrective arm were more eye-catching, which is not very surprising given that this part of the Pact had caused most political stir. They all reflected the changed political perception of the Pact. Telling is the description of the procedure's purpose given by the Council in its report on the Pact's reform. In sheer contrast to the intentions of the Pact's originator, Theo Waigel,[192] this purpose was 'to *assist* rather than to *punish*' by creating 'incentives' for fiscal discipline.[193] The notion of assistance now used in tandem with that of discipline, some of the most profound changes to the Pact's corrective arm led to a significant easing of fiscal rigour.[194]

Take the definition in Article 126(2)(a) TFEU of an 'exceptional and temporary' budgetary excess over the 3% limit, allowing member states to avoid becoming subject to the excessive deficit procedure. In its original form, the Pact's corrective arm had stated that an excess could be considered exceptional when it resulted from a 'severe economic downturn' in the form of 'an annual fall of real GDP of at least 2%'.[195] States could show that a fall of less than 2% was also exceptional 'in light of supporting evidence',[196] yet in the political Resolution on the Pact they had committed themselves not to make use of this possibility if it was below 0.75% of GDP.[197] After all that had happened with France and Germany, however, the Council considered this arrangement 'too restrictive'.[198] As a result, it changed it to the effect that any 'negative growth rate' could now form a severe downturn.[199] Even an 'accumulated loss of output during a protracted period of very low growth relative to its potential' could do so.[200]

An easing of pressure also occurred through clarifying the 'other relevant factors' which Article 126(3) TFEU requires the Commission to take into account when drawing up its report on the existence of an excessive deficit. Originally, the Pact's corrective arm had left these factors undefined. Yet, as a follow-up to his demand that the Pact should secure a better balance between growth and stability,[201] Chancellor Schröder argued that the provision should be

191 Arts 5(1) and 9(1) Reg 1466/97, as amended by Reg 1055/2005. Structural reforms are not only taken into account for states that deviate from their adjustment path, but also for those that have already achieved it and temporarily backtrack from it.
192 See text to n 314 (ch 3).
193 Council report of 21 March 2005 on improving the Pact (n 181) 12 (emphasis added).
194 For an overview see also Heipertz and Verdun (n 6) 168-169.
195 Arts 2(1) and 2(2) Reg 1467/97 (unamended)
196 Art 2(3) Reg 1467/97 (unamended).
197 See text to n 362 (ch 3).
198 Council report of 21 March 2005 on improving the Pact (n 181) 14.
199 Art 2(2) Reg 1467/97, as amended by Reg 1056/2005.
200 Art 2(2) of Reg 1467/97, as amended by Reg 1056/2005.
201 See text to n 118 (ch 4).

operationalised. States with deficits exceeding the 3% limit, he wrote in an opinion piece in the *Financial Times* in the run-up to the Pact's reform, should escape the excessive deficit procedure if the excess was due to policies promoting growth and employment.[202] More specifically, the Commission should turn a blind eye to deficits caused by expenses related to i) social security, labour market and tax reforms as well as research and development, ii) cyclical incentives and iii) the promotion of solidarity within and between member states, in particular German reunification.[203] Being convinced that 'The pact will work better if intervention by European institutions in the budgetary sovereignty of national parliaments is only permitted under very limited conditions',[204] the chancellor argued that a member state fulfilling these criteria should be able to decide on its own when and 'how to bring its deficit ratio below 3 per cent'.[205]

The Pact's amended corrective arm paid considerable tribute to Schröder's proposal. When drawing up its report under Article 126(3) TFEU, the Commission had to take into account a host of factors broadly corresponding to the chancellor's list.[206] What is more, it had to pay due consideration to 'any other factors' which the state in question considered 'relevant' for assessing the transgression of the 3% limit.[207] These factors should also be taken into account in all other steps of the excessive deficit procedure, except for the Council's decision on the basis of Article 126(12) TFEU to abrogate all are some of its decisions taken.[208] The difference with the chancellor's proposal, however, lay in the fact that these factors did not amount to 'block exemptions' to be deducted from a state's deficit before deciding whether or not it was excessive.[209] Only after having established that a state's deficit was 'exceptional and temporary' and stayed 'close to the reference value' within the meaning of Article 126(2)(a) TFEU, could the Council take them into account when deciding on the existence of an excessive deficit on the basis of Article 126(6) TFEU.[210] This made the arrangement less permissive of growth and employment than Schröder had hoped for.

The third notable change to the Pact's corrective arm concerned the issue of deadlines. Before its amendment, the Pact's corrective arm had required that excessive deficits should be corrected in the year following their identifica-

202 Gerhard Schröder, 'A Framework for a Stable Europe' *Financial Times* (17 January 2005). See also Louis (n 174) 95-96.
203 Schröder (n 202).
204 Schröder (n 202).
205 Schröder (n 202).
206 Art 2(3) Reg 1467/97, as amended by Reg 1056/2005.
207 Art 2(3) Reg 1467/97, as amended by Reg 1056/2005.
208 Arts 2(4) and 2(6) Reg 1467/97, as amended by Reg 1056/2005.
209 Louis (n 174) 97. See also Heipertz and Verdun (n 6) 169.
210 Art 2(4) Reg 1467/97, as amended by Reg 1056/2005; Council report of 21 March 2005 on improving the Pact (n 181) 15.

tion by the Council under Article 126(6) TFEU, unless there were special circumstances.[211] More specifically, 10 months could pass between identification and rectification.[212] After the changes to the Pact in 2005, a state was in principle still required to bring its deficit under the red line of 3% in the following year, yet the period that could lapse between identification and correction had been extended to 16 months.[213] Moreover, a state had to achieve a minimum annual structural improvement of 0.5% of GDP so as to facilitate correction of the excessive deficit within the deadline set by the Council.[214] Yet, if despite having taken effective action it failed to meet the deadline due to 'unexpected adverse economic events', the Council could, depending on the stage of the procedure, issue a revised recommendation or notice extending the deadline by one year.[215] The Pact here clearly came to terms with the Court's judgment that the Council had the power to hold the excessive deficit procedure *de facto* in abeyance.[216] It was better to have the Council extending deadlines within the confines of the procedure, instead of forcing a stand-still or even another adventure outside its boundaries.

Did the amended Pact fare any better? Again, it is hard to answer such a question regarding effectiveness,[217] yet it is fair to say that views on the Pact after its first amendment in 2005 were not undividedly positive. Jürgen Stark, former member of the European Central Bank's Executive Board, argued together with several other economists that its implementation was 'lenient' and that member states made 'little further progress towards sound public finances…', leaving them ill-prepared for the crisis.[218] And judging by the number of member states that were subject to an excessive deficit procedure by the end of 2010 – 26 out of (then) 27 – it is hard to disagree with them.[219] No surprise, therefore, that many of the post-crisis structural reforms to the legal framework underpinning the single currency focus on strengthening the instrument of public discipline. As this study will show in chapter 5,[220] several of the key reforms of this instrument concern the introduction of voting arrangements that aim to prevent a reoccurrence of the French and German

211 Art 3(4) Reg 1467/97 (unamended).
212 Louis (n 174) 99. See also text to n 365 (ch 3).
213 Art 7 Reg 1467/97, as amended by Reg 1056/2005.
214 Arts 3(4) and 5(1) Reg 1467/97, as amended by Reg 1056/2005.
215 Arts 3(5) and 5(2) Reg 1467/97, as amended by Reg 1056/2005.
216 Heipertz and Verdun (n 6) 169.
217 See text to n 103 (ch 4).
218 See Schuknecht and others (n 78) 10-11.
219 An overview of all ongoing and closed excessive deficit procedures can be found at the site of the Commission's DG ECFIN. See <ec.europa.eu/info/departments/economic-and-financial-affairs_en>.
220 See text to n 224 (ch 5).

fiscal saga by making sure that the excessive deficit procedure can no longer *de facto* be halted due to a shortage of votes in the Council.

At the same time, however, it would be wrong to think that the debt crisis is solely due to lenient fiscal policies of member states and that future crises could simply be prevented by tightening the fiscal rules. Certainly, Greece's problems, which triggered the crisis, are to a large extent due to fiscal negligence and a persistent fiddling with budgetary data. But this cannot be said of all states that have fallen victim to the markets. They were certainly also struggling with worrying fiscal problems, but these problems did not necessarily have public roots. They were private too.

4 The fixation on fiscal policy

4.1 The private roots of fiscal problems

Understanding the private roots of sovereign fiscal problems and their relation to Union law requires a return to the key driving forces behind the single currency's original legal set-up. The previous chapter explained how a swing towards monetarism as well as Germany's strong negotiating position contributed to the currency's modest set-up in terms of economic policy, especially outside the fiscal sphere.[221] As a result of these two forces teaming up, the Union received only few economic competences in Article 121 TFEU, allowing it to steer national policies through broad guidelines, early warnings and recommendations, but falling short of having a real policy of its own. This limited armoury was, moreover, not put to full use at the level of secondary law. Whereas the multilateral surveillance procedure in Articles 121(3)-(4) TFEU may in principle cover a range of economic issues, the Union legislator chose to largely focus it on fiscal policy. Set out in the Pact's preventive arm, the procedure originally aimed first and foremost at the prevention of excessive deficits, pushing other issues to the background.

Doubts already existed before the launch of the single currency as to whether this set-up would suffice to guarantee the currency union's viability. An issue of particular concern was whether the Union would manage to ensure a sufficient degree of convergence of national economies. Although Article 121(3) TFEU pays tribute to convergence, just as the Pact's preventive arm in its pre-crisis state,[222] it was seriously questioned whether the instrument of multilateral surveillance would suffice to bring differing national economies

221 See text to n 224 (ch 3).

222 See eg Recital 11 Reg 1466/97, as amended by Reg 1055/2005. It goes without saying that for states outside the currency union, in particular those with a derogation, achieving a sufficient degree of convergence is a primary objective of the multilateral surveillance procedure, which also shows in the fact that they have to submit 'convergence programmes'.

into line. These concerns only increased once the currency union had taken off. Contrary to the view of many specialists that only a limited group of states – say Germany, the Netherlands, Austria, France, Luxembourg, Finland, and Belgium[223] – was fit for sharing a currency, from all those willing to join only Greece did not make it to the first group. All others had managed, in the view of the Council, to comply with the convergence criteria and consequently joined the currency union right from the start. Greece then followed just two years later, in 2001. Even if the optimality of a currency union is a highly theoretical question, few would argue that the euro area was close to optimum with this composition.[224]

Why was convergence attributed such importance? One reason relates to the risk of a 'one-size-fits-all' monetary policy.[225] In a currency union with greatly differing national economies the central bank may be unable to cater for the needs of participating members. This may particularly occur when these members have diverging inflation rates.[226] In such a situation the central bank's uniform policy may translate into different real interest rates – the nominal interest rate minus inflation – across the currency union, which could set off diverging developments. Fear of such developments was an important argument for the United Kingdom not to join the currency union. In fact, Thatcher's chief economic advisor, Alan Walters, had already used it to discourage his prime minister from allowing the pound to enter the Exchange Rate Mechanism. In his book *Sterling in Danger* he describes the essence of his fear in clear, simple terms:

> '[T]he EMS forces countries to have the same nominal interest rates. If, however, Italy is inflating at a rate of 7 per cent and Germany at a rate of 2 per cent……then there is a problem of perversity. With the same interest rate at, say, 5 per cent, the *real* rate of interest for Italy is *minus* 2 per cent and for Germany *plus* 3 per cent. Thus Italy will have an expansionary monetary policy while Germany will pursue one of restraint. But this will exacerbate inflation in Italy and yet restrain further the already low inflation in Germany. This is the opposite of "convergence", namely, it induces divergence.'[227]

In other words, Walters feared that a uniform policy rate would cause states with relatively high rates of inflation to experience a lower real interest rate,

223 See eg Barry Eichengreen, 'European Monetary Integration with Benefit of Hindsight' (2012) 50 JCMS 123, 124-125.

224 See also Jean Pisany-Ferry, 'The Known Unknowns and Unknown Unknowns of EMU' (Bruegel Policy Contribution No 18, October 2012) 2: 'The first thing everyone knew was that the countries participating in the monetary union were no siblings'.

225 Pisani-Ferry, 'The Known Unknowns and Unknown Unknowns' (n 224) 2. See also Eichengreen (n 223) 124, 126-127.

226 Eichengreen (n 223) 127.

227 Alan A Walters, *Sterling in Danger: The Economic Consequences of Pegged Exchange Rates* (FONTANA/Collins 1990) 79-80.

in turn triggering 'pro-cyclical' policies, spending booms and even higher inflation.[228]

Did these fears indeed materialise? They did in as far as following the euro's introduction member states in the currency union's periphery did indeed experience a significant decline in their real interest rates.[229] This led to a massive expansion of lending to the private sector, spurring the build-up of debt in this corner of the economy.[230] The story of Spain and Ireland is particularly interesting. In both member states 'domestic' banks – relying considerably on foreign funds, thereby contributing to growing current account imbalances – greatly expanded their extension of financing to private operators, fuelling 'construction booms' and 'housing bubbles'.[231] With the onset of the financial crisis, these bubbles burst. All of a sudden banks had to take significant losses, even to such an extent that governments had to step in with state guarantees and recapitalisation measures.[232] In combination with a recession setting in, this led to plunging fiscal positions. Between 2007 and 2010 Spain saw its budgetary surplus of 2% of GDP transforming into a deficit of 9.4%.[233] Ireland's situation is even more shocking. Whereas it still ran a surplus of 0.2% in 2007, its budget noted a sky-rocketing deficit of 32.4% in 2010. Its debt position met with a similar fate over the same period, going up from just 24% of GDP to 87.4%.[234]

All this reveals an important blind spot of the single currency's original set-up. Treaty drafters were right in trying to prevent member states from building up unsustainable fiscal positions, but they were wrong in thinking

228 Pisani-Ferry, 'The Known Unknowns and Unknown Unknowns' (n 224) 2. See also Francesco P Mongelli and Charles Wyplosz, 'The euro at ten: unfulfilled threats and unexpected challenges' in Bartosz Maækowiak and others (eds), *The Euro at Ten: Lessons and Challenges* (Fifth ECB Central Banking Conference, Frankfurt, 2009) 39.

229 Pisani-Ferry, 'The Known Unknowns and Unknown Unknowns' (n 224) 3. For a detailed analysis of the extent to which Walters' fear has materialised see Mongelli and Wyplosz (n 228) 39-41, 44-50.

230 Pisani-Ferry, 'The Known Unknowns and Unknown Unknowns' (n 224) 3.

231 Francesco Giavazzi and Luigi Spaventa, 'Why the current account may matter in a monetary union: lessons from the financial crisis in the euro area' in Miroslav Beblavý, David Cobham and L'udovít Ódor (eds), *The Euro Area and the Financial Crisis* (CUP 2011) 211-216. See also Zsolt Darvas, 'The Euro Crisis: Ten Roots, but Fewer Solutions' (Bruegel Policy Contribution No 17, October 2012) 3-4.

232 For specific analyses of the crisis in Ireland and Spain see Philip R Lane, 'The Irish crisis' in Miroslav Beblavý, David Cobham and L'udovít Ódor (eds), *The Euro Area and the Financial Crisis* (CUP 2011) 59; Angel Gavilán and others, 'The crisis in Spain: origin and developments' in Miroslav Beblavý, David Cobham and L'udovít Ódor (eds), *The Euro Area and the Financial Crisis* (CUP 2011) 81.

233 These figures have been obtained from Eurostat. See <ec.europa.eu/eurostat/web/main/home>.

234 These figures have been obtained from Eurostat. See <ec.europa.eu/eurostat/web/main/home>.

that such positions always have public 'roots'.[235] The case of Ireland and Spain shows how states that are best performers in terms of fiscal policy can very abruptly suffer from indebtedness when they have to take responsibility for private sector problems. Neither primary law nor the Pact provided the necessary tools to deal with such 'contingent liabilities' stemming from macro-economic imbalances outside the realm of fiscal policy.[236]

4.2 The stifling embrace between states and banks

The sudden reversal of fiscal positions points to an even more severe problem. Despite states forming part of a currency union, their bonds are still largely held by 'domestic banks'.[237] After the launch of the single currency bond holdings certainly diversified, but banks kept investing in bonds of their own state to a significant extent.[238] After the start of the financial crisis this 'home bias' only intensified, especially in peripheral states, as foreign banks disposed of the bonds of these states, which in turn passed into the hands of domestic ones.[239]

The resulting picture, then, is one of banks and states holding each other in a suffocating 'embrace'.[240] Given that the onus of saving banks rested on the states in whose 'jurisdiction' they were located,[241] and that these states often had no choice but to do so when the ailing banks were considered 'too big to fail',[242] their fiscal position could quickly take a horrifying turn for the worse.[243] Banks, on their part, could suffer brutally too due to their 'sovereign exposure'.[244] Having invested considerably in their own state's bonds, a rise in the 'risk premium' for these securities could seriously harm their own operations.[245] This, in turn, caused them to scale down their provision of liquidity to other banks, which further upset the banking sector.[246]

235 Darvas (n 231) 3-4.
236 Marco Buti and Nicolas Carnot, 'The EMU Debt Crisis: Early Lessons and Reforms' (2012) 50 JCMS 899, 903-905.
237 Jean Pisani-Ferry, 'The Euro Crisis and the New Impossible Trinity' (Bruegel Policy Contribution No 1, January 2012) 6-7.
238 Pisani-Ferry, 'The New Impossible Trinity' (n 237) 7.
239 Pisani-Ferry, 'The New Impossible Trinity' (n 237) 7. See also Hans Geeroms, Stefaan Ide and Frank Naert, *The European Union and the Euro: How to Deal with a Currency Built on Dreams* (Intersentia 2014) 172-173.
240 Geeroms, Ide and Naert (n 239) 172.
241 Pisani-Ferry, 'The New Impossible Trinity' (n 237) 6.
242 Geeroms, Ide and Naert (n 239) 173-174.
243 Pisani-Ferry, 'The New Impossible Trinity' (n 237) 6.
244 Pisani-Ferry, 'The New Impossible Trinity' (n 237) 7.
245 Gros (n 53) 39. See also text to n 73 (ch 4).
246 Gros (n 53) 39.

As it turned out, the substantial current account imbalances and the 'vicious circle' between states and banks together created a toxic cocktail with the capacity to deprive entire states – public and private entities alike – from financing.[247] Uncertainty about the solvency of governments (Greece) could 'spill over' to their banking sectors and vice versa (Ireland, Spain),[248] eventually culminating in enormous 'flights' of capital, called 'sudden stops', and huge threats to financial stability.[249]

Whereas one may criticise treaty drafters for leaving the currency union ill-equipped to deal with solvency risks stemming from private sector imbalances, one can hardly blame them for having failed to anticipate the spectacular breakdown of capital movements during the crisis.[250] The prevailing opinion was that these sudden capital flights usually occur in balance of payments crises, characterised by foreign investors pulling out funds when they start panicking about the amount of debt piling up in a state, and that such crises could no longer take place in a currency union.[251] With a single currency, so one thought, any creditworthy entity would be able to obtain financing, no matter its location.[252]

A look at some of the key documents on European monetary integration suffices to see how strongly entrenched this idea was among policy-makers and economists.[253] The Werner Report, paving the way for Europe's first attempt at achieving a single currency, stated that with the advent of a currency union 'only the global balance of payments of the Community vis-à-vis the outside world is of any importance'.[254] Twenty years later, minds had not changed much. In its *One Market, One Money* report the Commission similarly reasoned that 'A major effect of EMU is that balance of payments will disappear in the way they are experienced in international relations. Private markets will finance all viable borrowers…'.[255] No wonder, therefore, that with the start of the third stage of monetary union only member states outside the currency union could still qualify for balance of payments assistance under

247 Pisani-Ferry, 'The Known Unknowns and Unknown Unknowns' (n 224) 5-6. The notion 'vicious circle' is used by Pisany-Ferry in other publications. See eg Pisani-Ferry, 'The New Impossible Trinity' (n 237) 10.

248 Pisani-Ferry, 'The New Impossible Trinity' (n 237) 10.

249 For analysis of capital 'flight' and 'sudden stops' see Sylvia Merler and Jean Pisani-Ferry, 'Sudden Stops in the Euro Area' (Bruegel Policy Contribution No 6, March 2012).

250 Pisani-Ferry, 'The Known Unknowns and Unknown Unknowns' (n 224) 6.

251 Merler and Pisani-Ferry (n 249) 2-3.

252 Benedicta Marzinotto, Jean Pisani-Ferry and André Sapir, 'Two Crises, Two Responses' (Bruegel Policy Brief No 1, March 2010) 5; Giavazzi and Spaventa (n 231) 202, 208; Merler and Pisani-Ferry (n 249) 2.

253 See also Marzinotto, Pisani-Ferry and Sapir (n 252) 5; Merler and Pisani-Ferry (n 249) 2.

254 Werner Group, *Report to the Council and the Commission on the realization by stages of Economic and Monetary Union in the Community* (Luxembourg 8 October 1970) 10.

255 Commission, *One Market, one money: An evaluation of the potential benefits and costs of forming an economic and monetary union* (DG ECFIN, October 1990) 24.

Article 143(2) TFEU.[256] No one simply imagined that states sharing a currency could experience similar capital flights.[257]

This leads to the fourth and final flaw in the single currency's original set-up: its limited reading of *stability* as an objective and the resulting absence of adequate insurance mechanisms to take on crises.

5 THE NARROW READING OF STABILITY

5.1 Financial stability and the lender of last resort

The fourth, and last, pitfall of the single currency's original set-up, in particular its economic branch, follows on from the previous ones and ties them all together. Strongly focused on safeguarding price stability, the system lacked the instruments to fight a debt crisis once it occurred. Inspired by the idea that the stability of the currency union would be guaranteed as long as member states displayed fiscal prudence, it left the Union ill-equipped to deal with the system being hit by any calamity. Paul De Grauwe explains it as follows:

> 'The official doctrine in the Eurozone has been that an insurance mechanism is not necessary for a smooth functioning of the Eurozone ... just make sure that countries abide by the rules. If they do so, i.e. if they are always well-behaved, there is no need for an automatic insurance mechanism provided by a centralized budget, or by a European Monetary Fund. This is like saying that if people follow the fire code regulations scrupulously there is no need for a fire brigade. The truth is that there will always be some people who do not follow the rules scrupulously, making a fire brigade necessary.'[258]

In other words, the system put almost all its eggs into the basket of prevention and consequently lacked the means to deal with situations in which prevention failed. The debt crisis shows the short-sightedness of this policy set-up in two

256 See also text to n 458 (ch 3).

257 The unwinding of capital flows became very visible in TARGET2, the Eurosystem's settlement instrument for payments in euros, which operates through the ECB and national central banks. Due to the fact that the interbank market became dysfunctional as investors became increasingly sceptical about investing in certain parts of the currency union, there was a huge increase in TARGET liabilities and corresponding claims of national central banks. This shows the importance of the ECB's enhanced liquidity provision to the banking system (see text to n 22 (prologue) and n 326 (ch 4)). If it had not been for the ECB's decisive action, the consequences of this massive capital flight would have been disastrous. For an extensive analysis of TARGET balances during the crisis see Philippine Cour-Thimann, 'Target balances and the crisis in the euro area' (April 2013) 14 CESifo Forum Special Issue 5.

258 Paul De Grauwe, 'Fighting the wrong enemy' (*Vox*, 19 May 2010) <voxeu.org/article/europe-s-private-versus-public-debt-problem-fighting-wrong-enemy> accessed 6 April 2017.

ways. The first has already been extensively discussed and concerns the idea that states always play by the fiscal rules. Greece's case showed the foolishness of this view during the crisis, just as Germany's and France's had already done much earlier. The second reason is even more profound and touches upon the system's very essence. In its desire to safeguard price stability, it left another stability dangerously exposed: *financial* stability.

In general terms, financial stability relates to the stability of the financial system, whose 'main task is to channel funds from sectors that have a surplus to sectors that have a shortage of funds'.[259] This system, in turn, consists of all 'financial intermediaries and financial markets and their relations with respect to the flow of funds to and from households, governments, business firms, and foreigners'.[260] Giving a specific definition, however, is very difficult. Unlike price stability, which the European Central Bank has defined as a rate of inflation of below, but close to 2% over the medium term,[261] financial stability cannot easily be captured in a standard measure or phrase.[262] It is for this reason that economists often prefer to define the notion negatively by identifying situations of its absence. Illustrative is the following remark by the economist Tommaso Padoa-Schioppa, made at the time he served on the Bank's Executive Board:

> 'While monetary stability simply means price stability, no such straightforward definition exists for financial stability. Defining financial stability is notoriously difficult and that is why people find it more convenient to define financial *in*stability.'[263]

Central to many definitions of financial instability is the notion of 'systemic risk', which the G10 has defined as 'the risk that an event will trigger a loss of economic value or confidence in, and attendant increases in uncertainties about, a substantial proportion of the financial system that is serious enough to quite probably have significant adverse effects on the real economy'.[264]

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259 Jakob de Haan, Sander Oosterloo and Dirk Schoenmaker, *Financial Markets and Institutions: A European Perspective* (2nd ed, CUP 2012) 5.

260 De Haan, Oosterloo and Schoenmaker (n 259) 33.

261 See also text to n 205 (ch 3).

262 Jakob de Haan, Sander Oosterloo and Dirk Schoenmaker (n 259) 405 state in this regard that 'threats to financial stability are often surrounded by major uncertainty and are therefore difficult to capture in a quantitative analysis'.

263 Tommaso Padoa-Schioppa, 'Central Banks and Financial Stability' (Speech given in Jakarta, 7 July 2003) (emphasis added).

264 Group of Ten, *Report on Consolidation in the Financial Sector* (January 2001) 126. See also De Haan, Oosterloo and Schoenmaker (n 259) 394; Sylvester Eijffinger, 'Defining and Measuring Systemic Risk' in Syvester Eijffinger and Donato Masciandaro (eds), *Handbook of Central Banking, Financial Regulation and Supervision: After the Financial Crisis* (Edward Elgar 2011) 316-317.

Without such risks the financial system is presumed 'stable', which means that it has the ability to absorb 'shocks' that could otherwise have a negative impact on its ability to channel 'savings to profitable investment opportunities'.[265]

Opting for a negative definition of financial stability is not simply a language game. On the contrary, it has important consequences for the instruments needed to protect financial stability and therefore ultimately for the law. Due to the fact that financial stability is best understood by focusing on risks to it, it is hard to protect it merely through prohibitions requiring authorities and private entities to refrain from certain behaviour. There can be many situations in which financial stability can be at risk, and preventing them *ex ante* through all-encompassing prohibitions is extremely difficult, if not impossible.[266] In addition, combating risks that have already materialised often requires *action*.

A doctrine from which this becomes clearly apparent is that of 'lender of last resort'. This doctrine is an old one, dating back to the 19th century when it was extensively discussed by Walter Bagehot. In his book *Lombard Street* Bagehot sheds his light on the world of finance and banking.[267] He argues that in a liquidity crisis, characterised by an acute shortage of funds, the onus is on the central bank to secure the stability of the financial system by acting as lender of last resort. The classic, straightforward example of such a crisis concerns a 'bank run'.[268] Traditionally, a bank's assets usually consist of loans that are not 'readily marketable', whilst their liabilities are made up of deposits that can be withdrawn by customers at the blink of an eye.[269] In normal times

265 De Haan, Oosterloo and Schoenmaker (n 259) 394-395 (reference omitted). It is precisely the prevention and mitigation of such risks to financial stability that form the essence of the mission entrusted to Europe's macro-prudential watchdog that has been established in response to the financial crisis of 2007/8: the European Systemic Risk Board (ESRB). See Art 3(1) of Regulation (EU) 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board [2010] OJ L 331/1.

266 For an overview of indicators of systemic risk see De Haan, Oosterloo and Schoenmaker (n 259) 400-407.

267 Walter Bagehot, *Lombard street: a description of the money market* (London 1875). Bagehot was, however, not the first to introduce the doctrine. This honour falls to Henry Thornton, who discussed it in his book *An Enquiry into the Nature and Effects of the Paper Credit of Great Britain* of 1802. See also Charles Goodhart, 'Myths About the Lender of Last Resort' in Charles Goodhart and Gerhard Illing (eds), *Financial Crises, Contagion, and the Lender of Last Resort: A Reader* (OUP 2002) 227-228.

268 For a detailed analysis of the underlying dynamic of 'bank runs' see Douglas W Diamond and Philip H Dybvig, 'Bank Runs, Deposit Insurance and Liquidity' (1983) 91 Journal of Political Economy 401.

269 Xavier Freixas and others, 'Lender of Last Resort: A Review of the Literature' in Charles Goodhart and Gerhard Illing (eds), *Financial Crises, Contagion, and the Lender of Last Resort: A Reader* (OUP 2002) 28.

this 'maturity mismatch' is of no concern as depositors will not demand their money back all at once.[270] During a crisis, however, things are different. Since depositors realise that if others ask their money back at an early stage the bank may not be able to pay out all of them, they rush to the bank to get their money out first.[271] Any exogenous shock can create such panic, which can get even solid banks into serious trouble.[272]

The 'classical position' on the lender of last resort prescribes that in such crisis situations a central bank needs to step in as follows.[273] It should prevent the collapse of 'temporarily illiquid but solvent banks' by granting them short-term liquidity support.[274] Moreover, it should indicate beforehand that it is prepared to do this.[275] Any bank that can provide 'good collateral, valued at pre-panic prices', should qualify for the support.[276] In order to prevent moral hazard – profiteering from insurance paid by others – the central bank should only lend at a 'penalty rate'.[277] Finally, it operates as a lender of last resort out of its responsibility for the financial system as a whole, not to protect individual banks.[278] This means that it should particularly act when the failure of an illiquid bank carries the risk of contaminating others, thereby upsetting the financial system at large.[279]

Bagehot's views have significantly influenced central banking practice, even though they have been debated and modified considerably over time, on two counts notably. The first concerns the requirement that only solvent institutions should be helped out. This is not always followed in modern practice. The urgency surrounding last resort operations often makes it very hard to decide on-the-spot whether a bank is merely illiquid or insolvent.[280] Moreover, with today's sophisticated interbank markets, a bank usually faces a liquidity shortage when other funding channels have already closed, which shows that it is at least considered insolvent by other market participants.[281] Yet if insol-

270 Kleopatra Nikolaou, 'Liquidity Risk Concepts: Definitions and Interactions' (ECB Working Paper Series No 1008, February 2009) 24-25.
271 Freixas and others (n 269) 28-29.
272 Freixas and others (n 269) 29.
273 Michael D Bordo, 'The Lender of Last Resort: Alternative Views and Historical Experience' in Charles Goodhart and Gerhard Illing (eds), *Financial Crises, Contagion, and the Lender of Last Resort: A Reader* (OUP 2002) 111-112. See also Rosa M Lastra, 'Lender of Last Resort, an International Perspective' (1999) 49 ICLQ 340, 341-342; Freixas and others (n 269) 27.
274 Lastra, 'Lender of Last Resort' (n 273) 342.
275 Lastra, 'Lender of Last Resort' (n 273) 342.
276 Lastra, 'Lender of Last Resort' (n 273) 342.
277 Lastra, 'Lender of Last Resort' (n 273) 342.
278 Lastra, 'Lender of Last Resort' (n 273) 342.
279 Lastra, 'Lender of Last Resort' (n 273) 342.
280 Lastra, 'Lender of Last Resort' (n 273) 346-347; Freixas and others (n 269) 36-37.
281 Charles Goodhart and Dirk Schoenmaker, 'Should the Functions of Monetary Policy and Banking Supervision Be Separated?' (1995) 47 Oxford Economic Papers 539, 548-549; Lastra, 'Lender of Last Resort' (n 273) 346.

vent, it may still pose a contagion risk to the financial system as a whole. In such a situation it therefore falls on the central bank to balance the benefits of granting assistance for financial stability at the cost of helping out a failing bank.[282]

A second issue surrounding the lender of last resort concerns the question of whether its operations should only target the market in its entirety, via open market operations using general monetary policy instruments, or could also focus on specific institutions.[283] Those adhering to the first view, argue that the lender of last resort should step in particularly when the interbank market faces a general liquidity crisis.[284] They contend that this market operates with such precision that it will channel the injected liquidity to banks in need.[285] Others, however, consider that a central bank should also be in a position to extend credit to specific institutions.[286] Due to market deficiencies, general injections of liquidity may not reach distressed banks, necessitating targeted lending operations.[287] In fact, as systemic liquidity injections take place via normal monetary policy operations, making it very difficult to determine whether they pursue a strictly monetary purpose or provide last resort support, some argue that only lending to specific banks should qualify as last resort action.[288]

Despite the fact that being a lender of last resort is nowadays considered one of the key responsibilities of a central bank, the Union Treaties are silent about the issue. In fact, they hardly attribute the European Central Bank with any responsibility for financial stability at all.

5.2 The search for a lender of last resort for banks ...

'[P]rice and financial stability', Dirk Schoenmaker argues, 'are equally important and affect the economy at large'.[289] What is more: they are connected,

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282 Goodhart and Schoenmaker (n 281) 548-549; Lastra, 'Lender of Last Resort' (n 273) 346-347; Freixas and others (n 269) 37-38.

283 Freixas and others (n 269) 35-37; George G Kaufman, 'Lender of Last Resort: A Contemporary Perspective' in Charles Goodhart and Gerhard Illing (eds), *Financial Crises, Contagion, and the Lender of Last Resort: A Reader* (OUP 2002) 180-181.

284 Marvin Goodfriend and Robert G King, 'Financial Deregulation, Monetary Policy, and Central Banking (excerpts)' in Charles Goodhart and Gerhard Illing (eds), *Financial Crises, Contagion, and the Lender of Last Resort: A Reader* (OUP 2002) 153-156, 158-159.

285 Goodfriend and King (n 284) 155, 158-159.

286 See Freixas and others (n 269) 36-37.

287 Freixas and others (n 269) 36.

288 See eg Goodhart (n 267) 230-231.

289 Dirk Schoenmaker, 'Central Banks Role in Financial Stability' in Gerard Caprio Jr (ed), *Handbook of Safeguarding Global Financial Stability: Political, Social, Cultural and Economic Theories and Models, Vol 2* (Elsevier 2013) 273.

as monetary policy may have an impact on financial stability and vice-versa.[290] Yet, before the debt crisis financial stability clearly lost out to price stability at the level of primary law.[291] In contrast to price stability, which was central to the single currency's set-up, the only reference to financial stability in the TFEU could be found in Article 127(5).[292] The provision states that the European System of Central Banks shall, as one of its 'non-basic' tasks,[293] 'contribute to the smooth conduct of policies pursued by the competent authorities relating to prudential supervision and the stability of the financial system'. A similar formula appears in Article 3.3 of the Statute. Article 25.1 of the Statute further specifies that the European Central Bank 'may offer advice to, and be consulted by the Council, the Commission and competent authorities of the Member States on the scope and implementation of Union legislation relating to prudential supervision of credit institutions and to the stability of the financial system'. Not a word about the possibility of having the Bank operate as a lender of last resort.

How to explain this meagre attention to financial stability? Monetarist ideas as well as Germany's strong treaty bargaining position are again key. 'Traditionally', Schoenmaker explains, 'central banks have two major objectives: monetary stability and financial stability'.[294] But when the Treaty of Maastricht was negotiated, the latter kind of stability had been snowed under by the first. Due to the high rates of inflation prevailing during the 1970s and the coming into fashion of monetarism, treaty drafters were primarily concerned with ensuring price stability, neglecting its financial counterpart.[295] What is more, there were serious concerns that attributing the Bank with considerable tasks in the area of financial stability could hamper its ability to keep inflation in check.[296] Lending money to a bank in difficulty could

290 Schoenmaker, 'Central Banks Role in Financial Stability' (n 289) 273-274.

291 Some call this a consolidation of a 'narrow' concept of central banking, according to which the central bank should focus on the single objective of price stability, as opposed to a 'broad' concept on the basis of which the bank should also pursue the objective of financial stability. See David Folkerts-Landau and Peter M Garber, 'The European Central Bank: A Bank or a Monetary Policy Rule' (NBER Working Paper Series No 4016, 1992) 3; Alessandro Prati and Garry J Schinasi, 'Financial Stability in European Economic and Monetary Union' in CAE Goodhart (ed), *Which Lender of Last Resort for Europe?* (Central Banking Publications 2000) 87.

292 See also Lorenzo Bini Smaghi, 'Who Takes Care of Financial Stability in Europe?' in CAE Goodhart (ed) *Which Lender of Last Resort for Europe?* (Central Banking Publications 2000) 227-228.

293 For the distinction between 'basic' and 'non-basic' tasks see n 199 (ch 3) and text to n 274 (ch 7).

294 Schoenmaker, 'Central Banks Role in Financial Stability' (n 289) 272.

295 Schoenmaker, 'Central Banks Role in Financial Stability' (n 289) 272.

296 Charles Goodhart and Dirk Schoenmaker give an overview of the risks and benefits associated with having the central bank in charge of securing both price and financial stability. On balance, however, they opt for a system in which the central bank is in charge of both, making it possible to 'internalise' any conflicts, instead of having two separate

lead to a higher 'net inflow' of central bank money to the financial system, reaching levels that are undesirable from a monetary policy perspective.[297] Likewise, keeping interest rates low out of a concern for the stability of the financial system could conflict with the demands of price stability.[298] Moreover, a failure to perform on its financial stability mandate could negatively affect the central bank's good name, leading to lower expectations among the public that it is able to control inflation.[299]

These concerns were felt particularly strongly by Germany. It was heavily opposed to an initial draft of the Statute of the Bank, drawn up by the Committee of Central Bank Governors, which attributed the System of Central Banks with bolder powers concerning financial stability.[300] Listing it as a 'basic' task, the draft stated that it should 'participate as necessary in the formulation, co-ordination and execution of policies relating to prudential supervision and the stability of the financial system'.[301] This led to fears that the system would impinge on the supervisory powers of national authorities and could possibly be put in a spot where it would have to make calls at odds with price stability.[302] At the intergovernmental conference, member states therefore decided to significantly soften the text.[303] Not only did they change the supervisory task from a basic one into a non-basic one, they also made clear that most competences in this area would stay at the national level.[304] The words 'formulation' and 'execution' did not make it to the final text of Articles 127(5) TFEU and 3.3 of the Statute, instead having to give way to the phrase that the system should 'contribute' to the policies of 'the competent authorities'. At the same time the treaty drafters did decide to put in place a provision, now laid down in Article 127(6) TFEU, enabling the Council 'to confer specific tasks upon the European Central Bank concerning policies relating to the prudential

institutions each focusing on one stability objective. See Goodhart and Schoenmaker (n 281) 545-549. See also René Smits, *The European Central Bank: Institutional Aspects* (Kluwer Law International 1997) 323-327.

297 Goodhart and Schoenmaker (n 281) 545.

298 Goodhart and Schoenmaker (n 281) 546.

299 Goodhart and Schoenmaker (n 281) 546; Smits, *The European Central Bank* (n 296) 325-326.

300 Rosa M Lastra, 'The Governance Structure for Financial Regulation and Supervision in Europe' (2003/2004) 10 Colum J Eur L 49, 56.

301 Art 3 Committee of Governors of the Central Banks of the Member States, 'Draft Statute of the European System of Central Banks and of the European Central Bank' (Agence Europe No 1669/1670, 8 December 1990) (Draft Central Bank Statute).

302 Smits, *The European Central Bank* (n 296) 336-337; Lastra, 'The Governance Structure for Financial Regulation' (n 300) 56.

303 This leads Dirk Schoenmaker to conclude that 'The ECB is largely modelled after the Bundesbank and follows the narrow central banking concept focusing on monetary stability'. See Schoenmaker, 'Central Banks Role in Financial Stability' (n 289) 280.

304 See also Smits, *The European Central Bank* (n 296) 337-338.

supervision of credit institutions' in case future developments in the area of financial integration would make this necessary.[305]

Nonetheless, the silence about the lender of last resort issue does not mean that the European Central Bank or national central banks cannot perform this task. At the start of the currency union, several economists argued that this silence fits the tradition of 'constructive ambiguity' that should surround any lender of last resort.[306] By keeping financial institutions in the dark about whether, how and when the central bank will exercise its lender of last resort powers, they cannot know for certain that it will help them out in the event of need, which reduces the risk they will engage in morally hazardous conduct.[307] Legally, however, the situation is more complicated and necessitates a distinction between lending to specific institutions and general injections of liquidity.

As far as assistance to specific institutions is concerned, Article 14.4 of the Statute is key.[308] It provides that national central banks 'may perform functions other than those specified in the Statute, unless the Governing Council of the European Central Bank finds, by a two thirds majority of votes cast, that these interfere with the tasks and objectives of the ESCB'. Such functions,

305 Note, however, that this enabling clause is also a watered down version of the one included in the draft statute prepared by the Committee of Central Bank Governors. Whereas the committee had envisaged the inclusion of all credit and other financial institutions (see Draft Central Bank Statute, Art 25(2)), in its final form Article 127(6) TFEU explicitly excludes insurance undertakings from its scope. See also Smits, *The European Central Bank* (n 296) 338.

306 According to Tommaso Padoa-Schioppa, for example: 'Indeed, it may be even advisable not to spell out beforehand the *procedural and practical details* of emergency actions ... I know of no central bank law within which the lender-of-last-resort function is explicitly defined'. See Tommaso Padoa-Schioppa, 'EMU and Banking Supervision' (1999) 2 International Finance 295, 306. See also Smits, *The European Central Bank* (n 296) 270; Willem H Buiter, 'Alice in Euroland' (1999) 37 JCMS 181, 201 (arguing that this stance is 'unduly coy'). But there are certainly counterarguments as well. In particular, one can argue that the notion of constructive ambiguity relates to the situations in, and the terms on the basis of which, the central bank will act as lender as last resort. In other words: it relates to the use of a discretionary power. However, as regards the ECB the question is not simply when and how it will use such a power, but whether it actually has this power in the first place. See Michel Aglietta, 'A Lender of Last Resort for Europe' in CAE Goodhart, *Which Lender of Last Resort For Europe* (Central Banking Publications 2000) 55; Prati and Schinasi (n 291) 114-116.

307 See eg Freixas and others (n 269) 40-42.

308 In its annual report of 1999 the ECB made clear that individual support belongs to the responsibility of national central banks within the limits set out by Art 14.4 Central Bank Statute. See European Central Bank, *Annual Report 1999* (ECB 2000) 98. Nonetheless, several scholars argue that the ESCB in principle also has the competence to provide individual support. See Smits, *The European Central Bank* (n 296) 269-270; Rosa M Lastra, 'The division of responsibilities between the European Central Bank and the National Central Banks within the European System of Central Banks' (2000) Colum J Eur L 167, 174-175; Armin Steinbach, 'The Lender of Last Resort in the Eurozone' (2016) 53 CML Rev 361, 370-371.

the provision makes clear, are 'performed on the responsibility and liability of national central banks and shall not be regarded as being part of the functions of the ESCB'. The Governing Council has indeed used this provision to put in place a procedure for individual support, called Emergency Liquidity Assistance (ELA), by national central banks.[309]

During the crisis national central banks, especially those in distressed member states, made extensive use of the emergency facility. This also created the possibility for the European Central Bank to steer economic policy developments in these states.[310] As its Governing Council can turn down the extension of emergency liquidity, it has the power to make the provision of this support *de facto* conditional on states pursuing a certain course of action. Cyprus forms a case in point.[311] On 25 June 2012 it formally lodged a request for financial assistance with the Eurogroup.[312] Yet, it was dragging its feet in reaching agreement on an adjustment programme which, as this study will discuss in the next chapter, is a prerequisite for receiving assistance from European assistance funds.[313] At the same time, Cypriot banks were greatly dependent on emergency liquidity support as they held large amounts of Cypriot government bonds which no longer met the collateral requirements for liquidity operations of the Bank.[314] On 21 March 2013, however, the Governing Council decided to maintain the current level of emergency assistance only until 25 March.[315] Hereafter, and given the fact that it no longer considered Cypriot banks solvent, assistance would be dependent on the Cypriot government reaching agreement on an adjustment programme contain-

309 For a general overview of the content of the procedure see European Central Bank, 'ELA Procedures' (21 February 2014) .

310 See extensively Thomas Beukers, 'The New ECB and Its Relationship with the Eurozone Member States: Between Central Bank Independence and Central Bank Intervention' (2013) 50 CML Rev 1579, 1593-1594.

311 Cyprus is by no means the only state that had to face such ECB pressure. Ireland and Greece, for example, have experienced it too. See Steinbach (n 308) 362.

312 Statement by the president of the Eurogroup, 25 June2012.

313 See text to n 89, n 108, n 192 and n 308 (ch 5).

314 Former Cypriot Central Bank Governor Athanasios Oprhanides explains that by refusing to ease collateral requirements for Cypriot government debt, as it had done earlier for Greek, Irish and Portuguese debt, the Bank forced the Cypriot government to request financial assistance in June 2012. He states in this regard: 'In the case of Cyprus, the ECB decided not to suspend the eligibility rule. This was important because if Cyprus debt had remained eligible as collateral, Cyprus banks could continue to buy treasury bills and continue financing the needs of the country for some time. The ECB was trying to convince the Cypriot government that it had to make structural adjustments and fiscal adjustments and by that point in June, get into a programme'. See 'An interview with Athanasios Orphanides; What happened in Cyprus' *The Economist* (*Economist.com*) (28 March 2013). See also Beukers, 'The New ECB and its Relationship with the Eurozone Member States' (n 310) 1593-1594; Daniel Wilsher, 'Ready to Do Whatever It Takes? The Legal Mandate of the European Central Bank and the Economic Crisis' (2012-2013) 15 CYEL 503, 512.

315 ECB Press Release, 'Governing Council decision on Emergency Liquidity Assistance by the Central Bank of Cyprus' (ECB, 21 March 2013).

ing conditions for the recapitalisation of its banks.[316] Cornered as a result of this pressure, the Cypriot government then reached a political agreement with the Eurogroup on the key features of such a programme on 25 March 2013.[317]

What about general, system-wide, liquidity injections through monetary policy operations? Initially, some took the view that Article 25.1 of the Statute regulates exhaustively the ways in which the System of Central Banks can discharge its prudential task in Articles 127(5) TFEU and 3.3 of the Statute.[318] Consequently, the only way in which it could contribute to policies of the national authorities relating to prudential supervision and financial stability is through the issuance of advice by the European Central Bank on the scope and implementation of Union legislation on these topics.[319] Others, however, were not convinced by such a restrictive interpretation. According to René Smits, for example, textual as well as purposive arguments would justify a wider range of instruments than those specifically mentioned in Article 25.1 of the Statute.[320]

Textually, there are some notable differences between Articles 127(5) TFEU and 3.3 of the Statute on the one hand, and Article 25.1 of the Statute on the other. Whereas the latter provision only concerns the European Central Bank, the former two address the System of Central Banks in general. By limiting the latter's contribution to the issuance of legislative advice by the Bank, Smits argues, it is deprived of playing its complete role as there is no involvement of the national central banks.[321] Moreover, Article 25.1 speaks about 'legis-

316 ECB Press Release, 'Governing Council decision on Emergency Liquidity Assistance by the Central Bank of Cyprus' (ECB, 21 March 2013).

317 Eurogroup Statement on Cyprus, 25 March 2013.

318 It should be noted that there is an inconsistency in the applicability of, on the one hand, Arts 127(5) TFEU and 3.3 Central Bank Statute and, on the other hand, Art 25.1 Central Bank Statute. According to Arts 139(2)(c) TFEU and 42.1 Central Bank Statute the first two provisions do not apply to states with a derogation. The same goes for the UK and Denmark (see point 1 of Protocol No 16 and points 4 and 7 of Protocol No 15). However, Art 25.1 Central Bank Statute does apply to these states. To put it in the words of René Smits: 'This arrangement is clearly an oversight of the authors of the EC Treaty. As consultation under Article 25.1 was considered to be the primary instrument for the ESCB with which to exercise its supervisory task, it is an anomaly not to grant the task and yet to give the instrument'. See Smits, *The European Central Bank* (n 296) 352.

319 This also seems to be the view taken by the Committee of Central Bank Governors. In its commentary on the draft Statute it stated that 'Article 25 specifies the activities which might be undertaken by the ECB when carrying out the tasks mentioned in Article 3, indent 5, in respect of prudential supervision'. See Draft Central Bank Statute (n 301) 25.

320 See Smits, *The European Central Bank* (n 296) 339-343.

321 Smits, *The European Central Bank* (n 296) 339-340. One can have doubts, however, about the conclusiveness of this argument. The ESCB generally functions on the basis of a division of responsibilities between the ECB and NCBs (see also n 191 (ch 3)). One could argue, therefore, that limiting the role the ESCB can play in the context of Art 127(5) TFEU to the giving of legislative advice by the ECB fits this tradition.

lation' while Articles 127(5) TFEU and 3.3 of the Statute employ the more general, and broader notion of 'policies'. This too would support a wider range of instruments than mere legislative advice.[322] *Purposively*, one can point out that one of the reasons for involving the System of Central Banks in prudential supervision and the maintenance of financial system stability is that these are basic prerequisites for an effective monetary policy.[323] As a result, liquidity operations carried out on the basis of Article 18.1 of the Statute would not only be possible for strictly monetary purposes, but also for securing financial stability.[324] Such last resort injections of liquidity could take place provided they do not conflict with the Bank's primary objective of maintaining price stability.[325]

In hindsight one can say that the latter interpretation has prevailed, as the Bank's crisis policy of 'enhanced credit support' is widely seen as lender of last resort action.[326] What is more, this is how the Bank views it. The following statement of Vice-President Vítor Constâncio is telling:

> 'The provision of liquidity to prevent a collapse of sound financial institutions during a liquidity crisis is also consistent with the broader ESCB's responsibility to contribute to financial stability. This is in line with the provisions in the Treaty, which gives the ESCB the competence, without prejudice to the primary objective of price stability and to the ECB independence, to support the general economic policies of the European Union and notably to contribute to the smooth conduct of policies pursued by the competent authorities relating to the stability of the financial system. Most central banks have performed such a role as financial lender of last resort to the banking sector in history when severe crises struck.'[327]

322 Smits, *The European Central Bank* (n 296) 340.

323 Smits, *The European Central Bank* (n 296) 324-327, 340-341.

324 The question is, then, whether the liquidity injection would fall under the task of monetary policy set out in Art 127(2) TFEU or the financial stability task in Art 127(5) TFEU. Art 127(2) TFEU also comes into play when the supply of liquidity is necessary to safeguard the stability of the payment system (TARGET, see n 257 (ch 4)) as this provision also provides the ESCB with the task to ensure 'the smooth operation of payment systems'. See also Steinbach (n 308) 366-368. From a practical point of view, there is no immediate need to answer this question given that Art 18 Central Bank Statute allows for open market and credit operations in relation to all the tasks entrusted to the ESCB.

325 Smits, *The European Central Bank* (n 296) 268-269, 348-349. See also Lastra, 'The Division of Responsibilities' (n 308) 175.

326 See eg Schoenmaker, 'Central Banks Role in Financial Stability' (n 289) 281; Alex Cukierman, 'Reflections on the Crisis and on its Lessons for Regulatory Reforms and for Central Bank Policies' in Sylvester Eijffinger and Donato Masciandaro (eds) *Handbook of Central Banking, Financial Regulation and Supervision: After the Financial Crisis* (Edward Elgar 2011) 82-83; Rosa M Lastra, 'The Evolution of the European Central Bank' (2011-2012) 35 Fordham Int'l L J 1260, 1270-1272. For an overview of 'enhanced credit support' measures, especially during the financial crisis, see text to n 34 (prologue).

327 Vítor Constâncio, 'Challenges to monetary policy in 2012' (Speech at the 26th International Conference on Interest Rates, Frankfurt, 8 December 2011).

5.3 ... and possibly for states too

The Union's search for a lender of last resort perhaps does not end with banks. Some argue that the crisis shows that member states also need one. Jean Pisany-Ferry sketches the problem by means of an 'impossible trinity', a favourite among economists to point out a system's flaws by breaking it down into three each digestible, yet inconsistent elements.[328] He argues that the currency union suffers from a 'unique' trinity consisting of bank-state interdependence, a no-bailout clause and a prohibition on monetary financing.[329] Given that states in the currency union were primarily the ones having to take responsibility for the rescue of banks in their jurisdictions, they were vulnerable to greatly, and suddenly, deteriorating fiscal records.[330] Earlier on, this chapter explained how such weak records may cause serious problems for states.[331] Since they do not control their central bank they cannot (implicitly) guarantee their bondholders that they will always have enough liquidity to honour their financial commitments. This uncertainty may generate crises of liquidity, even solvency, on government bond markets, of a self-fulfilling nature. To prevent such crises states, just like banks, would need a lender of last resort capable of fighting any 'liquidity squeeze' and safeguarding financial stability.[332] Unfortunately, the prohibitions on monetary financing and bail-out in Articles 123 and 125 TFEU seem to rule out such a lender, at least on the face of it.

Now, in theory, the problems flowing from an inconsistent trinity can be solved by radically eliminating one its elements, leaving intact the other two. But such clean solutions rarely apply in practice. Especially in crisis situations action is often improvised, intuitive and takes place on more than one front at the same time. The debt crisis forms a case in point as each of the currency union's inconsistent elements is subject to change. The banking union, about which more will be said in chapter 6, aims to tackle the vicious circle between banks and states. One of its constituent pillars, the Single Resolution Mechanism

328 Another such trinity, for example, is the one presented in the former chapter concerning the co-existence of free movement of capital, fixed exchange rates and monetary autonomy. See text to n 79 (ch 3). Lately, Dirk Schoenmaker has pointed to another inconsistent trinity relating to financial stability, international banking and national financial policies. See Dirk Schoenmaker, *Governance of International Banking: The Financial Trilemma* (OUP 2013) 7.

329 Pisani-Ferry, 'The New Impossible Trinity' (n 237) 4-9.

330 Which in turn, as has been discussed above, may backfire on these banks in as far as they are exposed to their states. See text to n 240 (ch 4).

331 See text to n 27 (ch 4).

332 See Paul De Grauwe, 'The European Central Bank as Lender of Last Resort in the Government Bond Markets' (2013) 59 CESifo Economic Studies 520, 520-522. See also Buiter and Rahbari (n 53) 6-9, 18; Thomas Mayer, *Europe's Unfinished Currency: The Political Economics of the Euro* (Anthem Press 2012) 150-151; Pisani-Ferry, 'The New Impossible Trinity' (n 237) 6, 9; Krugman, 'Currency Regimes' (n 53) 473-475.

(SRM), addresses this problem by lifting responsibility for the rescue of banks from national to European level. Its other pillar, the Single Supervisory Mechanism (SSM), is based on the enabling clause in Article 127(6) TFEU.[333]

This study is more interested in changes concerning the other two elements: the no-bailout clause and the prohibition on monetary financing. In their effort to combat the crisis, both the Union and its member states have taken actions that could be seen as lender of last resort moves targeting financial stability. This is particularly true for the assistance operations carried out by emergency funds and the bond purchases of the European Central Bank, especially its 'Outright Monetary Transactions'. In this regard, an interesting divide is taking place. The emergency funds, as the next chapter will show, all operate on a legal mandate making financial stability their primary aim. But the Bank's bond purchases do not. In fact, shortly after taking office, and prior to the launch of 'Outright Monetary Transactions', President Draghi was adamant in stressing that the Bank would not be turned into a lender of last resort. In reply to a journalist's question about this issue he stated:

> '[W]hat makes you think that the ECB becoming the lender of last resort for governments is what is needed to keep the euro area together? No, I do not think that this is really within the remit of the ECB. The remit of the ECB is maintaining price stability over the medium term.'[334]

After the launch of the programme the Bank kept insisting, as discussed earlier, that the instrument is chiefly focused on price stability.[335] In line with an increasing number of economists who argue that financial stability concerns should play a role in monetary policy,[336] it targets this stability as its purchases aim to remedy dysfunctioning bond markets.[337] Yet, it does not pro-

333 Gijsbert Ter Kuile, Laura Wissink and Willem Bovenschen argue that by basing the SSM on Art 127(6) TFEU the Union legislator has opted for a 'wide' interpretation of this provision as opposed to a 'narrow' one. They make clear that 'One could take a narrow or a wide reading of this Article, which would be of influence on the appropriateness of the legal basis. A narrow reading might lead one to object to granting the ECB supervisory powers ... The reasoning would then probably be that the provision only allows the ECB to develop policies rather than actually supervise'. See Gijsbert Ter Kuile, Laura Wissink and Willem Bovenschen, 'Tailor-made Accountability Within the Single Supervisory Mechanism' (2015) 52 CML Rev 155, 162.

334 'Introductory statement to the press conference (with Q&A)' (ECB, 3 November 2011). See also David Marsh, 'Unfair to mark out Bundesbank chief on OMT credibility' *Financial Times* (25 October 2012).

335 See text to n 56 (ch 4).

336 See also Matthias Goldman, 'Adjudicating Economics? Central bank independence and the appropriate standard of judicial review' (2014) 15 GLJ 265, 269-270.

337 That reasoning is supported by central bank theory. Garry Schinasi, for example, argues that 'the banking system is the transmission mechanism through which monetary policy has its effect ... For this reason alone central banks have a natural interest in sound financial

vide an implicit guarantee that a member state will always be able to pay off its creditors. Its purchases serve the transmission and singleness of its monetary policy and therefore ultimately its primary objective of price stability.[338] They can only occur to the extent they are warranted from that perspective, and to the extent that yields exceed a state's fundamentals, thereby ruling out that it acts as a lender of last resort for member states.[339]

Not surprisingly, though, several prominent economists regard it as a last resort operation aimed at safeguarding financial stability.[340] Read Paul De Grauwe, shortly after the announcement of the programme:

> 'Central banks were created to deal with the endemic problem of financial capitalism: its instability and the impact this has on the banking system. This has led to the consensus that the central bank should be a lender of last resort in the banking system to ensure that the bubbles and crashes that are part and parcel of capitalism do not bring down the banking system. Should this lender of last resort also be extended to the government? It must be, if financial stability is to be maintained, because the sovereign and the banks hold each other in a deadly embrace ... The eurozone did not have such a contract between the sovereigns and the common central bank, explaining its fragility. It now has one with the OMT programme.'[341]

Both kinds of actions, the rescue funds and the Bank's bond programmes, therefore raise the question of whether, and to what extent, the prohibitions on bail-out and monetary financing can accommodate greater attention for financial stability. In fact, this issue is central to the legal analysis in subsequent chapters of the transformation experienced by the Union during the crisis.

6 Conclusion

By signing and ratifying the Treaty of Maastricht, the member states committed themselves to a currency union imbued by the desire to safeguard price

institutions and stable financial markets'. See Garry J Schinasi, 'Responsibility for central banks for stability in financial markets' (IMF Working Paper No 03/121, June 2003) 8.

338 Former ECB President Trichet stated in this regard: '[W]e had to consider that there is a serious problem of the transmission of our monetary policy because financial stability is not ensured at the level of the euro area as a whole and because we have a number of countries which have their own "risk-free" benchmark rates at levels that are different from country to country'. See 'Introductory Statement to the press conference (with Q&A)' (ECB, 6 October 2011).

339 Both these elements will be discussed extensively in chs 6 and 7 where the Bank's bond purchases, as well as the Court's view on them, are discussed in greater detail.

340 See references in n 53 (ch 4).

341 Paul De Grauwe, 'Stop this guerrilla campaign against the ECB policy' *Financial Times* (23 October 2012).

stability. When the crisis hit, it painfully exposed the flaws op this set-up. This chapter has singled out four of them. The first concerns the instrument of market discipline, more specifically the idea that markets always adequately price risk. The crisis has thrown the rationality of markets into doubt as they went from extreme tranquillity to absolute panic which, according to the European Central Bank, bestowed the debt crisis with a self-fulfilling nature.

The second relates to public discipline. Markets might not have lapsed into panic if member states had had solid fiscal records. But they did not. Greece stands out. Having fiddled with its budgetary figures for years, it lost all trust from markets when it revealed its true state of affairs late 2009. After the trouble with enforcing public discipline on France and Germany, this once more showed the difficulty of making states pursue a certain fiscal course of action within the confines of the Union's original economic policy set-up.

At the same time, however, fiscal negligence only tells part of the story. Another important cause of the crisis concerns the indebtedness of the private sector, the burden of which can very quickly shift to the public sector due to financial rescue operations by the state. Such 'contingent' liabilities of states were not on the radar of the single currency's legal set-up and were a major cause of financial actors' fear to invest in certain parts of the currency union during the crisis. Somewhat paradoxically, then, the original stability set-up did not always achieve what it desired – public discipline – whilst this desire made it blind to other, probably even more dangerous, threats to stability.

All of the above come together in the original set-up's narrow reading of stability as an objective. The set-up was indeed aiming for stability, but only a specific kind: price stability. Its important counterpart, financial stability, received little attention. The crisis has forced the Union and its member states to better safeguard this second kind of stability. European rescue funds are aimed at it and the European Central Bank has served it by acting as lender of last resort for banks, and perhaps for states too. Each of these actions, however, in particular those aimed at states, raises questions of legal compatibility that reach the very heart of the original stability framework.

This in turn demonstrates the problematic nature of legally consolidating the currency union's design to extreme degrees. When the member states signed and ratified the Treaty of Maastricht back in the 1990s, this may have seemed the safest route to stability. But when the crisis hit, as the next chapter will show, it actually made achieving this much harder.

Part III

The new stability conception

5 The shift in solidarity

1 INTRODUCTION

By concluding the Treaty of Maastricht, the member states incorporated the single currency in their Founding Contract and consequently committed themselves to a solidarity that was largely negative in kind. Most of the key demands Union law made on them sought to safeguard price stability by requiring them to perform actions that targeted their own condition. In particular the prohibitions focusing on fiscal discipline in Articles 124-126 TFEU had this aim.[1] Each tried to ensure that member states act in the interest of the collective by demanding that they themselves exhibit fiscal prudence. At the time of the launch of the euro, Wolfgang Schäuble, not yet the important finance minister he would become during the crisis but still a member of the *Bundestag*, aptly put the solidarity states had to display. Echoing Theo Waigel when he had tabled his proposal for a stability pact in 1995,[2] Schäuble argued:

> 'It is inherent in the very meaning of an economic and monetary union that the observance of agreed policy forms the founding act of solidarity among the member states, given that – notwithstanding the no-bailout clause in the Treaty – all participants of the euro have to bear the consequences of the wrong policy of one of its members.'[3]

▪ This chapter contains and/or builds on previously published work by the author. See especially Vestert Borger, 'De eurocrisis als katalysator voor het Europese noodfonds en het toekomstig permanent stabilisatiemechanisme' (2011) 59 SEW 207; Vestert Borger, 'The ESM and the European Court's Predicament in *Pringle*' (2013) 14 GLJ 113; Vestert Borger, 'How the Debt Crisis Exposes the Development of Solidarity in the Euro Area' (2013) 9 EuConst 7; Vestert Borger, 'The European Stability Mechanism: a crisis tool operating at two junctures' in Matthias Haentjens and Bob Wessels (eds), *Research Handbook on Crisis Management in the Banking Sector* (Edward Elgar 2015) 150.

1 The prohibition on monetary financing in Art 123 TFEU equally focuses on fiscal discipline, yet it is targeted at the ECB, not the member states.

2 See text to n 1 and n 314 (ch 3).

3 Wolfgang Schäuble and Karl Lamers, 'Europa braucht einen Verfassungsvertrag: Überlegungen zur europäischen Politik II' (UiD-Extra, 1999), para 2.5 (translation by the author). The author would like to thank Peter Maessen, former master student at Leiden University, for pointing to this document in his thesis. See Peter Maessen, 'Schäuble's Vindication: How Article 136(3) TFEU Sets the New Legal Standard for Solidarity in the Euro Area' (Master thesis, Leiden University 2012).

As much as Schäuble's words may at the time have created the impression that the kind of solidarity that the currency union demands of its members is immutable, it is susceptible to change, no matter its consolidation in primary law. In fact, the crisis has led to such a change and Schäuble has witnessed it from nearby. Central to this change is a widening of the currency union's stability conception. Whereas in its original form the currency union attributed predominant importance to price stability, it has transformed into one that is better at taking financial stability into account as well. This widened stability conception leads member states to not only display negative solidarity, characterised by actions in support of the collective that focus on the acting state itself, but to increasingly resort to positive solidarity, expressed through actions that directly benefit others.

In the past years, perhaps the most popular narrative to explain this move towards positive solidarity was to say that it served the self-interest of member states. Take Frank Schimmelfennig. Following liberal intergovernmentalist logic,[4] he points to the 'negative interdependence' between the members of the currency union, due in particular to the vicious circle between states and banks,[5] and argues that it lies at the basis of the actions they have taken in support of cohesion.[6] Leaving a financially distressed member state on its own was simply not an option when the crisis erupted late 2009; the threat that a sovereign default posed to other states and their banking systems was too high. States may have negotiated fiercely about how to devise their rescue operations legally and institutionally, and how to split the bill between those at the receiving and granting ends,[7] it was the realisation that each of them would be better off with than without the single currency that made them willing to back it in the first place.[8] Focusing specifically on Germany, Andrew Moravscik similarly reasons that it has come to the rescue as it 'is the greatest beneficiary of financial stability and the common currency. A sudden default of a eurozone country or the collapse of the currency itself would devastate the German economy…'.[9]

4 See text to n 113 (ch 2).

5 For a discussion of this vicious circle and the risks it has posed to the members of the currency union during the crisis see text to n 237 (ch 4).

6 Frank Schimmelfennig, 'Liberal intergovernmentalism and the euro area crisis' (2015) 22 Journal of European Public Policy 177, 179-183.

7 For an assessment of the negotiations in light of intergovernmental bargaining theory see Schimmelfennig (n 6) 184-188.

8 To put it in the words of Schmimmelfennig (n 6) 178: 'National preferences resulted from strong interdependence in the EA and the fiscal position of its member states: a common preference for the preservation of the euro was accompanied by divergent preferences regarding the distribution of adjustment costs'.

9 Andrew Moravscik, 'Europe After the Crisis: How to Sustain a Common Currency' (2012) 91 Foreign Affairs 54, 61.

Now, the members of the currency union have indeed acted in support of the collective for reasons of self-interest. The solidarity displayed by them therefore undeniably has a very important factual dimension to it.[10] And this factual solidarity not only resulted from financial interdependence. It was also rooted in a common destiny. The threatening prospect of the crisis spreading like a contagious disease throughout the currency union united its members in their battle against financial markets.[11] Especially in the first years of the crisis, markets' 'herd-like behaviour',[12] characterised by steep and sudden interest rate increases for bonds of 'peripheral' states,[13] tied the fate of each individual member to that of the whole.

Yet, those who argue that it is only self-interest that has made the members of the currency union act in unison fail to appreciate the normative dimension to their solidarity.[14] States did not only defend the single currency for utilitaristic reasons. They were also obligated to do so due the Founding Contract which commits them to the single currency, and ultimately to the Union itself.[15] This chapter seeks to capture this normative dimension to the solidary

10 On factual solidarity see text to n 107 (ch 2). For the argument that such rescue actions, to the extent they are based on self-interest, should not be seen as solidarity see Fabian Amtenbrink, 'Europe in Times of Economic Crisis: Bringing Europe's Citizens Closer to One Another?' in Michael Dougan, Niahm Nic Shuibhne and Eleanor Spaventa (eds), *Empowerment and Disempowerment of the European Citizen* (Hart 2012) 185.

11 Politicians themselves recognised at a very early stage of the crisis that they were engaged in such a battle. Angela Merkel, for example, likened the crisis in May 2010 to 'a battle of the politicians against the markets' which she was 'determined to win'. See quote in Tony Barber, Quentin Peel and Telis Demos, 'Markets tumble on European debt fears' *Financial Times* (7 May 2010).

12 See in this regard Arne Niemann and Demosthenes Ioannou, 'European Economic Integration in Times of Crisis' (2015) 22 Journal of European Public Policy 196, 207-209 which also contains further references. The authors point out that even though financial markets may simply be seen as market places in which individual players pursue their own 'strategies', due to this 'herd-like behaviour' during the crisis states perceived their actions as 'unitary'.

13 See text to n 17 (ch 4).

14 Sofia Fernandes and Eulalia Rubio, for example, argue that 'Concerning the type of solidarity exercised, all over the crisis decisions on bail-outs and solidarity arrangements have been driven by enlightened self-interest considerations'. See Sofia Fernandes and Eulalia Rubio, 'Solidarity within the Eurozone: how much, what for, for how long?' (Notre Europe Policy Paper No 51, February 2012) 19.

15 Liberal intergovernmentalists like Frank Schimmelfennig to some extent recognise this too by pointing out that the shared willingness of member states to rescue and reform the euro has its origin in their original commitment to the single currency. To put it in the words of Schimmelfennig: '[T]he common interest of EA countries in preserving and stabilizing the euro and their preparedness to engage in institutional reforms strengthening the credibility of their commitment to the euro is best explained as endogenous to the previous decision to create a common currency'. See Schimmelfennig (n 6) 192 (reference omitted). For such a 'historical-institutionalist' analysis of the response to the crisis see Amy Verdun, 'A historical-institutionalist explanation of the EU's responses to the euro area financial crisis' (2015) 22 Journal of European Public Policy 219. Note, however, that her historical institutional explanation does not specifically focus on the normative constraints imposed by the Founding Contract. She rather posits that the crisis 'reconfirmed' that the member

ties between the member states, especially those in the currency union.[16] Its purpose is not to show to what extent they were acting on their political obligation, chasing their self-interest, or responding to other motivating forces each time they supported the collective. Rather, it uses their Founding Contract, and the change it underwent during the crisis, as a guide to understanding the transformation of the single currency's set-up.

The chapter is divided into three parts. The first concerns the positive solidarity that member states displayed towards Greece at the very beginning of the crisis. Like all acts of positive solidarity, it had its roots in a historic meeting of the heads of state or government on 11 February 2010. At that meeting, the leaders initiated a change in the Founding Contract between their states by jointly committing themselves to defend the single currency through safeguarding financial stability. In the months that followed they would confirm and specify this change through other, more specific commitments, which would eventually bind member states not only in their executive capacity, but in full: in May 2010 states put in place a rescue package for Greece of € 110bn.

The second part deals with the positive solidarity displayed towards other distressed member states. Almost immediately after the Greek assistance package had been announced on 2 May 2010, leaders realised it would not suffice to stem the crisis from spreading. Only days later, on 10 May, they therefore decided to put in place a rescue package of € 500bn for the currency union at large. Part of the assistance was provided by the Union through a rescue facility based on the support clause in Article 122(2) TFEU. Most of it, however, was paid out of the purses of the member states and mobilised through an intergovernmental rescue facility outside the confines of the Union Treaties.

This display of positive solidarity, to Greece and other member states, put great demands on the currency union's political leaders. The decisions they had to take in honour of the commitment to safeguard financial stability not only created difficulties for them back home, politically and legally, it also caused them to put great strain on the single currency's legal set-up that still

states 'were unwilling to let EMU unravel' (p 231) and, taking that as a starting point, then examines how the existing political-institutional setting influenced the political response to the crisis. For other historical-institutional accounts of the crisis response see Jonathan Yiangou, Mícheál O'keeffe and Gabriel Glöckner, 'Tough Love: How the ECB's Monetary Financing Prohibition Pushes Deeper Euro Area Integration' (2013) 35 Journal of European Integration 223 (analysing how the prohibition on monetary financing triggers and shapes further integration in the currency union); Ledina Gocaj and Sophie Meunier, 'Time Will Tell: The EFSF, the ESM and the Euro Crisis' (2013) 35 Journal of European Integration 239 (analysing how the establishment of the permanent rescue fund ESM results from 'path dependence', more particularly from the prior decision to set up the temporary rescue fund EFSF as an intergovernmental vehicle).

16 On normative solidarity see text to n 98 (ch 2).

reflected a stability conception from the past. The third part of the chapter therefore discusses the attempt of member states to take away this strain by incorporating the shift in solidarity in Union law. At the end of 2010, when the currency union had managed to make it through the first storm of the crisis, the European Council decided to amend Article 136 TFEU so as to allow states in the currency union to establish a permanent rescue mechanism. This chapter traces the process and considerations behind both the amendment and the creation of the mechanism, not only to show how they build on the decisions political leaders took in the very first months of the crisis, but also to allow an informed discussion of the Court's judgment on the currency union's transformation later in the study.

2 Saving Greece

2.1 Changing the Contract

Probably the most common criticism of European leaders during the crisis, especially in the first years, was that they failed to stem it at an early stage. Economists were at pains to stress their inability to take decisive action. According to Jean Pisany-Ferry and his colleagues, they 'procrastinated for months' to help out distressed governments.[17] Charlez Wyplosz similarly moaned that 'In this crisis, Eurozone leaders motto seems to be "too little, too late"'.[18]And from an economic perspective, such criticism was probably well-founded. Perhaps, if leaders had put in place a rescue package the moment Greece revealed its problems late 2009, markets would not have lapsed into panic. Perhaps too, then, this would have prevented the crisis from spreading to other member states. At the same time, however, such a grim view of the early response to the crisis fails to appreciate what politicians did achieve.[19] In a world in which only economics matters, and in which all economists agree, they might have responded differently. But they do not operate in such a world. They have to take into account electorates, coalitions, competing priorities and, importantly, the law. Yet, despite all these constraints, political leaders managed to commit themselves to the survival of the single currency

17 See François Gianviti and others, 'A European mechanism for sovereign debt resolution: a proposal' (Bruegel Blueprint Series No 10, 2010) 9.

18 Charles Wyplosz, 'They still don't get it' (*Vox*, 25 October 2011) <voxeu.org/article/eurozone-leaders-still-don-t-get-it> accessed 16 April 2017.

19 Former European Council president Herman Van Rompuy states in this regard that: '[T]hose who complain that on each occasion the European Union did "too little, too late" tend to underestimate the political constraints under which we in Europe operate ... Looking back, now that we are four or five years down the line, all the different steps we have taken amount to quite a leap'. See Herman Van Rompuy, *Europe in the Storm: Promise and Prejudice* (Davidsfonds Uitgeverij 2014) 32.

and have their states display solidarity in ways they had never done before. And the first to benefit from this solidarity was Greece.

When the true state of Greece's fiscal record became known to the public in the fall of 2009, action indeed did not follow immediately. Part of this inaction can be explained by the fact that not everyone was aware straight away of the magnitude of Greece's problems and the risks they posed to the currency union at large. Swedish prime minister Reinfeldt, whose state held the presidency of the Council at that time, was still saying in December 2009 that the Greek situation was 'of course problematic' but 'basically a domestic problem that has to be addressed by domestic decisions'.[20] More important, however, was the fact that the currency union needed time to reconcile itself with a new reality that was painful for each of its members, not in the least Greece itself.[21] The state shuddered to think of having to ask its partners or, even worse, the feared IMF, for financial assistance of which it knew it would only be granted in return for severe austerity measures and structural reforms.[22] 'We need no bilateral loans. We haven't asked for any help and don't need any', Prime Minister Papandreou reassured the Greek people.[23] Nor was there any 'issue of leaving the euro or of asking for help of the IMF'.[24] To enhance the credibility of its pledge, the government revised its budget plans several times in December and January, promising to push down the deficit by no less than 4% in 2010 only.[25]

But the markets were not impressed. By the end of January yields on ten-year Greek government bonds were far above 6%, at times even breaking through the 7% ceiling.[26] Barely a week earlier, European Central Bank President Jean-Claude Trichet had still dismissed a Greek departure from the currency union as an 'absurd hypothesis' at his monthly press conference.[27] In the corridors of power, however, awareness had set in that far from being absurd, the possibility of a departure from the currency union was real and could not be averted by Greece on its own. Telling is a confidential note

20 Quoted in Wolfgang Münchau, 'European farce descends into Greek tragedy' *Financial Times (*14 December 2009). See also Matthew Lynn, *Bust: Greece, the Euro and the Sovereign Debt Crisis* (Bloomberg Press 2011) 130.

21 See also text to n 66 (prologue).

22 Carlo Bastasin, *Saving Europe: Anatomy of a Dream* (Brookings Institution Press 2015) 139.

23 Quoted in Chris Giles and Richard Edgar, 'Greek PM denies reports of EU bail-out' *Financial Times (FT. Com)* (28 January 2010).

24 Quoted in Kerin Hope, 'Greek PM rejects fears over eurozone' *Financial Times* (14 January 2010).

25 Kerin Hope and David Oakley, 'Greece unveils 3-year plan to curb deficit' *Financial Times (FT.Com)* (14 January 2010). See also Peter Ludlow, 'Van Rompuy Saves the Day: The European Council of 11 February 2010' (Eurocomment Briefing Note Vol 7, No 6) 3; Bastasin (n 22) 144-145.

26 David Oakley, 'End of tough week for eurozone bonds' *Financial Times* (30 January 2010).

27 'Introductory statement to the press conference (with Q&A)' (ECB, 14 January 2010).

European officials had prepared for a meeting of the Economic and Financial Committee on 5 February. Entitled 'Elements of external communication on the fiscal situation in Greece', it paid most attention to Greece's efforts to straighten up its fiscal record, yet it ended by posing the question: 'Will the euro area (or the EU) provide help to Greece in case of a risk of default?'[28]

The day before, on 4 February, chancellor Merkel had discussed that question with President Sarkozy when they met in Paris to decide on the Franco-German cooperation strategy until 2020.[29] She had told the French president that she was aware of Greece's predicament, but she also explained to him the constraints she faced at home that severely limited her room for manoeuvre.[30] Part of these constraints were rooted in electoral concerns. A considerable part of the German population found it difficult to accept having to help out a state whose problems they perceived as self-inflicted.[31] Such sentiment was further fostered by some of the media. *'Betrüger in der Euro-Familie'* (Swindlers in the Euro-family) read the front page of the conservative German magazine *Focus* in February 2010 whilst displaying the *Venus de Milo* statue sticking up her middle finger.[32] This popular resentment towards assistance for Greece was something to reckon with as such, yet it gained even greater importance due to the upcoming elections in North Rhine-Westphalia on 9 May, which the coalition parties had to win in order to maintain their majority in Germany's upper house of parliament, the *Bundesrat*.[33] Merkel's CDU was not doing well in the polls and the chancellor was therefore hesitant to make grand gestures to Greece, especially before the elections.

But it was not only electoral concerns that worried Merkel. She felt the constraining force of the law as well. Less than two decades earlier, the *Bundesverfassungsgericht* had approved of Germany's participation in the currency union on the condition that it would be a *Stabilitätsgemeinschaft*.[34] By rescuing Greece, Merkel now risked bringing down one of its most fundamental pillars – the no-bailout clause in Article 125 TFEU – and she feared that it would not stand before the court in Karlsruhe. Prominent stability hardliners already anticipated such a ruling by publicly ringing the alarm bells. According to Otmar Issing, former *Bundesbank* president and member of the Executive Board of the European Central Bank:

28 Quoted in Ludlow, 'Van Rompuy Saves the Day' (n 25) 8. See also Bastasin (n 22) 149.
29 Quentin Peel and Ben Hall, 'Germany and France to boost faltering alliance' *Financial Times* (4 February 2010).
30 Bastasin (n 22) 148-149.
31 Lynn (n 20) 136-138; Bastasin (n 22) 149-150.
32 'Titelseite: Betrüger in der Euro-Familie' *Focus* (22 February 2010). See also Lynn (n 20) 138.
33 Bastasin (n 22) 169, 183.
34 See text to n 1 (ch 4).

> '[F]inancial aid from other EU countries or institutions that amounted, directly or indirectly, to a bail-out would violate EU Treaties and undermine the foundations of Emu. Such principles do not allow for compromise … Emu is a "no transfers" community of sovereign states ... with firm rules accepted by entrants. These rules must not be changed ex-post. Governments must not forget what they promised their citizens when they gave up their national currencies.'[35]

His successor at the Executive Board, Jürgen Stark, put it even more bluntly:

> 'The Treaties set out a "no bail-out" clause, and the rules will be respected ... This is crucial for guaranteeing the future of a monetary union among sovereign states with national budgets. Markets are deluding themselves if they think that the other member states will at a certain point dip their hands into their wallets to save Greece.'[36]

These concerns in turn fed back into German politics, thereby putting more strain on the government. 'We are a stable-currency party', chairman of coalition party CSU Horst Seehofer told the public early 2010.[37] 'That's why we're helping Greece politically – but not a single euro can go there'.[38] But despite these harsh words, and just like most other members of the currency union, Germany would grant assistance to Greece only months later. The European Council summit of 11 February 2010 is key to understanding why.

In the days following the rendezvous between Merkel and Sarkozy on 4 February, expectations were growing that they would end the uncertainty surrounding Greece at the European Council summit of 11 February.[39] Newspapers talked about Franco-German plans to stem the crisis, [40]causing market sentiment to slightly improve.[41] The reality is, however, that for a long time it was highly uncertain whether the summit would produce any results. In fact, one day before the summit the possibility of a breakthrough seemed far away.[42] In the Eurogroup, the ministers of finance had discussed the dire

35 Otmar Issing, 'A Greek bail-out would be a disaster for Europe' *Financial Times* (16 February 2010).

36 Quoted in 'La Bce: tassi fermi e nessun aiuto ai conti della Grecia' *Il Sole 24 Ore* (6 January 2010) (as cited in Lynn (n 20) 142).

37 Quoted in Gerrit Wiesmann and Kerin Hope, 'Merkel hits out at banks over Greek deals' *Financial Times (FT.Com)* (17 February 2010).

38 Quoted in Wiesmann and Hope, 'Merkel hits out at banks over Greek deals' (n 37).

39 Ludlow, 'Van Rompuy Saves the Day' (n 25) 7-9.

40 See eg Tony Barber, Gerrit Wiesmann and Ben Hall, 'Athens' salvation lies with Paris and Berlin' *Financial Times* (9 February 2010); Arnaud Leparmentier, 'Paris et Berlin vont présenter un plan commun pour sauver la Grèce' *Le Monde (Le Monde.fr)* (10 February 2010).

41 See eg 'Greek "firewall" talk drives markets' *Financial Times* (10 February 2010).

42 Ludlow, 'Van Rompuy Saves the Day'(n 25) 8-9; Bastasin (n 22) 153.

situation of Greece and had come to an agreement on a draft declaration.[43] Its final paragraph stated that 'The members of the euro area share a common responsibility for the stability in the euro area' and then immediately followed this up with the remark that 'on the one hand' participating states had 'to conduct sound national policies in line with the agreed rules', whilst 'on the other hand' the members of the currency union would 'provide support, if needed…'. Although it remained far from launching an assistance programme for Greece, let alone mentioning any concrete numbers, the statement went too far for the German chancellor, as it suggested that Greece's duty to restore its own budget was of equal weight to that of its partners to grant assistance.[44]

The uncertainty surrounding Greece forced European Council President Herman Van Rompuy, who had been in office for only two months, to step in. Looking back at his presidency he tells how the agenda of his first European Council meeting of 11 February 2010, which was supposed to address the Union's 'economic growth prospects', was completely taken over by the Greek crisis.[45] With the Hellenic state verging on the brink of collapse, he considered it absolutely essential to have all heads of state or government agree on a common line of action. But that was easier said than done. 'We could not turn to our joint rulebook for answers', Van Rompuy explains, 'but had to invent from scratch'.[46] 'In fact', he continues, 'the EU treaties explicitly forbid member states to assume each other's financial commitments; this so-called "no-bailout-clause" was a founding principle of the Economic and Monetary Union'.[47] Given the disagreement about the Eurogroup's draft statement, early in the evening of 10 February he decided to adjourn the meeting of the European Council, which had been scheduled for 10.00 the next morning, to midday and first talk to the most important actors involved: Papandreou, Sarkozy and Merkel.[48] At the same time, he put his staff to work on a new draft statement.

When Van Rompuy tabled the new statement the next morning he managed to have all three leaders accept it.[49] Having ensured their consent, he subsequently discussed the text with all other members of the European Council and secured their backing too.[50] In its final form the statement contained three sentences that would turn out to be key to the transformation that the currency union would undergo in the following years. The first is

43 The draft declaration is available in Ludlow, 'Van Rompuy Saves the Day' (n 25) 9, 22. See also Bastasin (n 22) 152.
44 Ludlow 'Van Rompuy Saves the Day' (n 25) 9, 11; Bastasin (n 22) 152-153.
45 Van Rompuy, *Europe in the Storm* (n 19) 11-15.
46 Van Rompuy, *Europe in the Storm* (n 19) 12.
47 Van Rompuy, *Europe in the Storm* (n 19) 12.
48 Van Rompuy, *Europe in the Storm* (n 19) 12-13; Ludlow, 'Van Rompuy Saves the Day' (n 25) 9-10.
49 Van Rompuy, *Europe in the Storm* (n 19) 13-14.
50 Van Rompuy, *Europe in the Storm* (n 19) 14.

telling of the change in the stability conception underlying the single currency and reads as follows:

> 'All euro area members … have a shared responsibility for the economic and financial stability in the area.'[51]

Contrary to the draft statement of the Eurogroup, the text no longer followed up on this sentence by putting fiscal consolidation and financial support on the same level.[52] The obligation of each member state to conduct sound national policies was now mentioned separately at the very beginning of the statement. The implication of the currency union's changed stability conception, on the contrary, featured in the statement's final two sentences:

> 'Euro area Member States will take determined and coordinated action, if needed, to safeguard financial stability in the euro area as a whole. The Greek government has not requested any financial support.'[53]

To Merkel, this separation between fiscal consolidation and financial support was essential.[54] It signalled that the one having to take responsibility for the Greek misery was Greece itself. Things could only be different if its problems spread beyond its own borders and threatened the currency union at large. In that case, the members of the currency union could step in to safeguard financial stability by granting financial support. Although the statement indicated that Greece had not lodged a request for such support, by merely identifying this as a possibility the members of the currency union implicitly recognised that they would display such positive solidarity if the situation called for it. Or to put it in the words of Van Rompuy: 'Without spelling out that the other EU countries would lend money to Greece, we did touch on the limits of the no-bailout clause by stating that if a Greek bankruptcy threatened the financial stability of the whole Eurozone, member states would take action'.[55]

Those who had expected euro area leaders to put billions on the table may have been disillusioned with the statement. The truth is, however, that it was of fundamental importance. Political leaders – not only those in the euro area, all of them – had initiated a fundamental change of the Founding Contract between their states. They had jointly committed themselves to a currency

51 Statement by the Heads of State or Government of the European Union, Brussels, 11 February 2010.
52 See also Ludlow, 'Van Rompuy Saves the Day' (n 25) 11.
53 Statement by the Heads of State or Government of the European Union, Brussels, 11 February 2010.
54 Quentin Peel, 'Stability not solidarity at root of response to debt crisis' *Financial Times* (19 March 2010); Ludlow, 'Van Rompuy Saves the Day' (n 25) 11-12; Bastasin (n 22) 155-157.
55 Van Rompuy, *Europe in the Storm* (n 19) 13.

union that is very different from the one that had been introduced almost two decades earlier with the Treaty of Maastricht. A currency union that is not only geared to price stability, but that also attributes great importance to financial stability, up to the extent that it calls for financial assistance to safeguard it. In the weeks and months ahead they would specify the change in the Contract, to which the member states would eventually subscribe not just in their executive capacity, but in full. The positive solidarity that was bound to follow would therefore not only be factual in nature. Members of the currency union had a political obligation to show it too.

2.2 Specifying the change

The statement issued on 11 February not only signified a change in the set-up of the currency union; it also showed who could initiate such a change and give it further shape in the months ahead. A change that touches on the very core of the Founding Contract between the member states can only be brought about by their political leaders. In other words: it is '*Chefsache*'.[56] Only the heads of state and government had the authority to decide on the fate of Greece and the currency union at large.[57] Certainly, ministers of finance dealt extensively with these matters in the Council and the Eurogroup, just as civil servants did in the Economic and Financial Committee (EFC), the Eurogroup Working Group (EWG) and the Commission's DG ECFIN.[58] Yet, the principal decisions could only be taken by the 'chiefs'.[59]

The crisis, therefore, put into perspective the system of decision making in the economic and monetary union and the debate about the necessity of a *gouvernement économique*. Germany had argued against such a government at the time of the conclusion of the Treaty of Maastricht out of fear that too

56 Luuk van Middelaar, 'The Return of Politics: The European Union after the crises in the eurozone and Ukraine' (2015) 54 JCMS 495, 498.

57 See in this regard Uwe Puetter, 'Europe's deliberative intergovernmentalism: the role of the Council and the European Council in EU economic governance' (2012) 19 Journal of European Public Policy 161, 171: 'Only the "heads" themselves were in a position to make credible pledges of financial support, could agree joint positions for global coordination, and were able to finalize statements on a common strategy for domestic responses'. See also Alicia Hinarejos, *The Euro Area Crisis in Constitutional Perspective* (OUP 2015) 91: 'The problems and potential solutions to the crisis were of such political significance and sensitivity that it would have been unthinkable for the Heads of State and Government not to have taken a leading role in the quest for recovery; it was furthermore crucial to calm down markets and private investors, and this could only be done by showing the involvement of the national executives at the highest level'.

58 See also Peter Ludlow, 'In the Last Resort: The European Council and the euro crisis, Spring 2010' (Eurocomment Briefing Note Vol 7, No 7/8) 10-11.

59 For an analysis of how the position of the Eurogroup has been affected by the crisis and the involvement of the heads of state or government see Dermot Hodson, *Governing the Euro Area in Good Times and in Bad* (OUP 2011) 46ff.

great an involvement of political leaders could negatively affect the Bank's ability to strive for price stability.[60] And it had been relatively successful in making that plea. Whereas the French had aimed to have the European Council in charge of streamlining economic and monetary policy, the TFEU only attributes the institution a task in relation to the coordination of economic policies and even there the Council plays a greater role. The crisis, however, revealed a blind spot in this system.[61] It may function in 'normal' times, yet it falls short when decisions are required that strike at the heart of the currency union's foundations; decisions that change the rules of the game. In such situations the involvement of the heads of state and government is unavoidable.

At the beginning of 2010, Germany had come to terms with that reality as well.[62] Looking ahead at the crucial European Council meeting at the French-German summit on 4 February, Merkel said that the political leaders would perceive themselves in the European Council as a 'true economic government' (*Wirtschaftsregierung*).[63] Admittedly, in Merkel's eyes this government should comprise all twenty-seven leaders and not, as France preferred, only those in the currency union; Germany still perceived this as too great

60 See text to n 237 (ch 3).

61 See in this respect also Van Middelaar (n 56) 501-502 (pointing attention to the re-emergence of the notion of 'government' in European discourse and stressing in this regard that 'politics is the authoritative form in which society copes with the unknown, with historic change'). As discussed already in the prologue to this study, many legal scholars depict the rise of the European Council as indicative of *constitutional* change. See eg Mark Dawson and Floris De Witte, 'Constitutional Balance in the EU after the Euro-Crisis' (2013) 76 MLR 817, 828ff (arguing that the European Council's importance is indicative of a change in the Union's 'institutional balance', which in turn signifies a more broader change in its 'constitutional balance'); Edoardo Chiti and Pedro Gustavo Teixeira, 'The Constitutional Implications of the European Responses to the Financial and Public Debt Crisis' (2013) 50 CML Rev 683, 685-690 (arguing that this 'new form of intergovernmentalism' has 'redefined' the Union's institutional balance); Federico Fabbrini, *Economic Governance in Europe: Comparative Paradoxes and Constitutional Challenges* (OUP 2016) 115ff (assessing the 'increasing intergovernmentalisation of the decision-making process, with the rise of the European Council as the forum for high politics' in the light of constitutional change). For a different view see Bruno De Witte, 'Euro Crisis Responses and the EU Legal Order: Increased Institutional Variation or Constitutional Mutation?' (2015) 11 EuConst 434, 450 (arguing that the 'leading role taken by the European Council during the euro crisis was not an institutional novelty but corresponded precisely to the role which the European Council was expected to play under existing (pre-crisis) constitutional arrangements'). This study agrees with the latter position, taking the view that the actions of the European Council during the crisis are not indicative of a change of its institutional position but rather *confirm* or *evidence* its place in the Union's constitutional set-up. For greater analysis of this place and the consequences of the European Council's actions for other constitutional actors see the conclusion to this study.

62 Ludlow, 'Van Rompuy Saves the Day' (n 25) 8, 16-17.

63 Quoted in Lutz Meier, 'Merkel beugt sich Sarkozys Willen' *Financial Times Deutschland* (5 February 2010) (translation by the author).

a threat to the independence of the European Central Bank.[64] Yet, the shift in the German perspective on how the currency union should be governed was nonetheless remarkable and, as will become clear later on, would develop even further as the crisis progressed.[65]

Paradoxically, then, the political actors whose involvement the treaty drafters had sought to curtail so as to safeguard the single currency's focus on stability, now found themselves at the centre of decision making, being called upon to rescue that very currency. And Merkel, as the leader of the currency union's most powerful state that would have to contribute most to any assistance operation, had the greatest say of them all.

The decision of 11 February meant a departure – in principle – from the no-bailout clause. Its severity, however, would depend on the specifics of any assistance operation.[66] During subsequent negotiations the German chancellor tried to make the departure as limited as possible since the prospect of a constitutional challenge was still hanging over her like the sword of Damocles. In fact, the professors who had challenged the transition to the third stage of monetary union in 1998 now threatened to go to Karlsruhe again if their government consented to assistance for Greece:

> 'There is no shortage of proposals to help the Greeks, including assistance from other eurozone governments – a move that would contravene the "no-bailout" rule in the Maastricht treaty. There is, sadly, only one way to escape this vicious circle. The Greeks will have to leave the euro, recreate the drachma and re-enter the still-existing exchange rate mechanism of the European Monetary System, the so-called ERM-II, from which they departed in 2001 ... .we would like to state clearly that, should governments provide assistance to Greece in a manner that contravenes the no-bailout rule, we would have no hesitation in lodging a new lawsuit at the constitutional court to enjoin Germany to depart from monetary union.'[67]

Three issues were of particular interest to the German government, all of them having to do with the desire to deviate as little as possible from the no-bailout clause.[68] The first flowed directly from the statement of 11 February. It had been careful in distinguishing Greece's interest strictly speaking from that of the currency union as a whole. Only when the latter's financial stability was at stake could the former receive support. To further underline the fact that

64 See Ben Hall, 'French press home need for governance', *Financial Times* (18 February 2010).

65 See text to n 94 (ch 6) (discussing the legal formalisation of the 'Euro Summit').

66 For an analysis of how the German government 'steered a middle course' between 'ordo-liberal' and 'Keynesian' policies by trying to put an 'ordoliberal stamp' on the assistance operations see Rainer Hillebrand, 'Germany and its Eurozone Crisis Policy' (2015) 33 German Politics and Society 6, 17.

67 Wilhelm Hankel and others, 'A euro exit is the only way out for Greece' *Financial Times* (26 March 2010). See also text to n 7 (ch 4).

68 See also Ludlow, 'In the Last Resort' (n 58) 13-21.

the currency union at large was the beneficiary rather than Greece as such, finance minister Schäuble stressed that assistance had to be accompanied by 'strict conditions and a prohibitive price tag …'.[69] The discipline expected from the markets but not achieved at a preventive stage, should now be achieved through policy conditionality and non-subsidised lending rates.

The other two implications had to do with the timing of assistance. In order to leave the no-bailout clause intact as much as possible, assistance should only be considered as '*ultima ratio*';[70] if indispensable to safeguard financial stability. Or to put it in Schäuble's words again: '[A]id must be the last resort'.[71] To further underline the *ultima ratio*-nature of assistance, the German government also demanded the involvement of the IMF.[72] This third demand was perhaps the most controversial one. At first, the German government had been divided over the issue itself. Schäuble was adamantly against such involvement as it would indicate the currency union's inability to handle its own affairs.[73] France, the Commission and the European Central Bank held similar views.[74] The IMF was the destination states like Zimbabwe or Venezuela turned to for help, not a member of the world's second largest economy.[75] 'If the IMF steps in', the Bank's Executive Board member Lorenzo Bini Smaghi reasoned, 'the image of the euro would be that of a currency that is able to survive only with the external support of an international organization … resorting to the IMF can be detrimental to the stability of the euro'.[76] In addition to this fear of a loss of reputation, the Bank was also afraid that the economists from Washington would 'impose' a reform programme on Athens that would frustrate its monetary policy.[77] Chancellor Merkel, however, assessed the situation differently. Although hesitant at first, she gradually

69 Wolfgang Schäuble, 'Why Europe's monetary union faces its biggest crisis' *Financial Times* (12 March 2010). See also Gerrit Wiesmann and Ralph Atkins, 'Schäuble calls for tough EMF sanctions' *Financial Times* (12 March 2010).

70 Ludlow, 'In the Last Resort' (n 58) 14; Bastasin (n 22) 158-159.

71 Schäuble (n 69).

72 Ludlow, 'In the Last Resort' (n 58) 19.

73 According to Schäuble: 'The acceptance of financial assistance from the IMF would, in my opinion, amount to an admission that the eurozone countries cannot solve their own problems with their own efforts'. See quote in Quentin Peel, 'First big step towards more integrated eurozone' *Financial Times* (8 March 2010).

74 Gerrit Wiesmann and Quentin Peel, 'Germany warms to giving IMF a role in any Greek debt rescue' *Financial Times* (19 March 2010); Ludlow, 'In the Last Resort' (n 58) 19-20; Lynn (n 20) 142-144; Bastasin (n 22) 168.

75 Lynn (n 20) 142-143.

76 Quoted in Ralph Atkins, 'ECB takes on Merkel over Greece' *Financial Times (FT.Com)* (24 March 2010). See also Trichet's statement at the ECB's press conference of 4 March 2010: 'Let me add that I do not believe that it would be appropriate to introduce the IMF as a supplier of help through standby arrangements or through any such kind of help'. See 'Introductory statement to the press conference (with Q&A)' (ECB, 4 March 2010).

77 Ludlow, 'In the Last Resort' (n 58) 19. See also Bastasin (n 22) 161.

became receptive to the idea.[78] Besides the fact that the organisation's expertise, which had already been alluded to in the statement of 11 February, would be helpful in devising a plan to bring the Greek economy back to a sustainable path, its involvement would also underline the last resort character of any rescue action, thereby easing pressure on the no-bailout clause.[79]

The occasion that was to bring further clarity on the Greek assistance operation was the European Council meeting of 25 March 2010. Contrary to the meeting on 11 February, the statement of which had been prepared mostly by Van Rompuy, this time Merkel took the lead on the negotiations.[80] In the weeks before the meeting, her aides turned to their traditional interlocutors at the Élysée to put together a statement for the upcoming European Council meeting that would reflect Germany's negotiating stance. The core of that stance was concisely worded by Merkel herself on the day of the meeting when she had to appear in the *Bundestag* to give a full outline of the government's position on a possible rescue of Greece. She first appealed to the fundamental commitment of 11 February:

> 'I think I can say that on 11 February, in an hour of fundamental economic and political challenges, Europe has proven itself as equally committed and considerate…'[81]

Then she explained how her government wanted to make this commitment concrete in relation to Greece:

> 'Today and tomorrow it is about specifying the decisions of the summit of 11 February ... the Federal Government will advocate in the council that, in a case of emergency, a combination of IMF aid and bilateral assistance should be guaranteed. Yet this is – I will say this again – ultima ratio. I will do my very best to make sure that such a decision – IMF and bilateral assistance – will succeed.'[82]

The French-German text, finalised by Merkel and Sarkozy themselves just hours before the start of the meeting, was first given to Van Rompuy and Papandreou and then presented with only slight changes to the other leaders of the currency union who gathered informally between the European Coun-

78 Quentin Peel and Nikki Tait, 'Germany warms to IMF bail-out for Greece', *Financial Times (FT.Com)* (18 March 2010); Bastasin (n 22) 145.

79 Quentin Peel, 'Merkel raises defence shields' *Financial Times* (25 March 2010); Ludlow, 'In the Last Resort' (n 58) 19; Lynn (n 20) 143-144.

80 Ludlow, 'In the Last Resort' (n 58) 17-18; Bastasin (n 22) 166.

81 Regierungserklärung von Bundeskanzlerin Merkel zum Europäischen Rat am 25. und 26. Marz, Berlin, 25 March 2010 (translation by the author).

82 Regierungserklärung von Bundeskanzlerin Merkel zum Europäischen Rat am 25. und 26. Marz, Berlin, 25 March 2010 (translation by the author).

cil's first working session and dinner.[83] Although several of them criticised the manner in which the text had been prepared, feeling they had been presented with a '*fait accompli*',[84] the document passed almost unchanged.[85] As a result, it greatly reflected the German view. The statement first referred to the decision of 11 February to safeguard financial stability and then stated that euro area states stood 'ready' to support Greece through bilateral loans on the basis of their respective share in the European Central Bank's capital key alongside the IMF.[86] France had secured, however, that the 'majority' of the support would have to be provided by the members of the currency union.[87] The statement also made clear that this support had 'to be considered *ultima ratio*', meaning that it could only be granted if needed to safeguard financial stability and when financing could no longer be obtained sufficiently on the markets.[88] If that scenario were to materialise, the discipline that the markets were supposed to but could no longer exert, would have to be replaced by public discipline through 'non-concessional' interest rates and, most importantly, 'strong' policy conditionality.[89] Only if Greece complied with this conditionality, which the Commission and the Bank had to verify, could euro area states unanimously decide to make disbursements under the loan. As a result, any positive solidarity of other states would have to be matched by Greece itself with negative solidarity in the form of budgetary cuts and economic reforms.

2.3 The 'Greek' facility

With their deal of 25 March, the leaders of the currency union specified their joint commitment to safeguard financial stability by detailing how their states would display positive solidarity in pursuit of this purpose. Yet, as Greece had not yet lodged an official request for assistance, the statement still spoke

83 Ludlow, 'In the Last Resort' (n 58) 18; Bastasin (n 22) 167.
84 Quentin Peel, Ben Hall and Stanley Pignal, 'Deal shows Merkel has staked out a strong role' *Financial Times* (27 March 2010). According to a Finnish official, quoted in the article: 'We are happy with the contents, but we don't want the way this deal was reached to become a precedent'.
85 Ludlow, 'In the Last Resort' (n 58) 18.
86 Statement by the Heads of State and Government of the Euro Area, Brussels, 25 March 2010.
87 Ludlow, 'In the Last Resort' (n 58) 20; Bastasin (n 22) 167.
88 Statement by the Heads of State and Government of the Euro Area, Brussels, 25 March 2010.
89 Statement by the Heads of State and Government of the Euro Area, Brussels, 25 March 2010.

about assistance in hypothetical terms.[90] It was clear to everyone, however, that assistance was unavoidable. In their statement, the leaders had still praised Greece for its 'ambitious and decisive action' that should allow it 'to regain the full confidence of the markets'.[91] But the markets were not impressed. A week after the meeting Greece managed to raise € 5bn in the markets, yet the interest it had to pay on its 7-year bond was still alarming: 5.9%, 325 basis points above similar German *Bunds*.[92] And at the beginning of April panic had fully returned as yields on 10-year bonds rose to 7.5%, the highest rate since Greece had entered the currency union in 2001.[93] It forced Papandreou on 8 April to call José Zapatero, the Spanish prime minister who held the Council presidency, and request him to convoke the euro area ministers of finance with a view to activating financial support.[94] Zapatero then turned to Sarkozy and Van Rompuy. The first supported the plan for a meeting, yet the latter withheld approval.[95] It seems he realised that Merkel, who was on a formal trip to the United States, would not give her consent without a specific, detailed plan for the assistance and Greece's adjustment efforts.[96]

The chancellor did indicate, however, that she had no objections to a gathering of the Eurogroup in order to further specify the plan for assistance, thereby paving the way for concrete action at the highest political level at a later stage.[97] And that is exactly what happened. In a video conference on 11 April the Eurogroup adopted a statement further detailing assistance for Greece.[98] The statement made clear that the 'non-concessional interest rate' on the bilateral loans would be set at 'around 5%'.[99] It also indicated that these loans would comprise a 'three-year period', with € 30bn to be provided in the first year, and that they would be 'centrally pooled' by the Commission. Most importantly, the Eurogroup tasked the Commission to immediately start working, in liaison with the Bank, on a programme for Greece setting out the latter's exact financing needs and reform efforts. That same day President Van

90 The statement of the 25 of March stipulated in this regard: 'The Greek government has not requested any financial support. Consequently, today no decision has been taken to activate…the mechanism'. See Statement by the Heads of State and Government of the Euro Area, Brussels, 25 March 2010.

91 Statement by the Heads of State and Government of the Euro Area, Brussels, 25 March 2010.

92 Kerin Hope, David Oakley and Jennifer Hughes, 'Greeks attract €5bn with new bond' *Financial Times* (30 March 2010).

93 Anousha Sakoui, 'Greek sovereign debt yields near year-highs' *Financial Times (FT.Com)* (8 April 2010).

94 Ludlow, 'In the Last Resort' (n 58) 24; Bastasin (n 22) 171

95 Ludlow, 'In the Last Resort' (n 58) 24; Bastasin (n 22) 171.

96 Ludlow, 'In the Last Resort' (n 58) 24; Bastasin (n 22) 171-172.

97 Ludlow, 'In the Last Resort' (n 58) 25.

98 Eurogroup statement on the support to Greece by Euro area Member States, Brussels, 11 April 2010.

99 Carlo Bastasin observes in this regard that the rate of 5% was actually considerably less than market rates (around 200 bps). See Bastasin (n 22) 173.

Rompuy issued a declaration in which he welcomed the statement and confirmed its consistency with the decisions that the heads of state or government had taken on 11 February and 25 March.[100]

On 23 April 2010 Prime Minister Papandreou subsequently let the world know his state could no longer withstand market pressure and formally asked his partners for help.[101] Little more than a week later, on 2 May 2010, the Eurogroup announced that it had unanimously decided to activate a three-year assistance programme for Greece worth € 110bn.[102] Of this amount € 30bn had to come from the IMF, whilst the greatest part – € 80bn – would be provided by euro area states through a system of bilateral loans, called 'Greek Loan Facility', to be coordinated by the Commission.[103] This facility rested on two legal instruments.[104] The first concerned an intercreditor agreement, concluded among the states granting assistance.[105] It governed essential aspects of their financial relationship, such as the mandate for the Commission to administer the pooled loans, the obligation of each state to contribute to the total amount of assistance in line with the capital subscription key of the Bank and the procedure for disbursements.[106] The second was a loan facility agreement between the euro area lenders and Greece regulating the assistance operation itself.[107] It set out in particular the requirement that disbursements of assistance could only be made if the lending states were of the opinion that Greece complied with the conditions attached to the assistance that were laid

100 Statement by President Van Rompuy on the Eurogroup agreement on Greece, Brussels, 11 April 2010.

101 See Joint statement by the European Commission, European Central Bank and Presidency of the Eurogroup on Greece, Brussels, 23 April 2010. See also text to n 79 (prologue).

102 Statement by the Eurogroup, Brussels, 2 May 2010.

103 On 5 May 2010 the representatives of the governments of the Member States agreed that the members of the euro area could task the Commission to administer the loan facility. See the Decision of the Representatives of the Governments of the 27 Member States of 5 May 2010 in Council document 9417/10. For more information on the permissibility of using Union institutions in intergovernmental initiatives see references in n 14 (ch 7).

104 See also Alberto De Gregorio Merino, 'Legal Developments in the Economic and Monetary Union During the Debt Crisis: The Mechanisms of Financial Assistance' (2012) 49 CML Rev 1613, 1616-1618.

105 Intercreditor agreement between the creditor euro area Member States, 8 May 2010 (Intercreditor Agreement). The agreement can be consulted at <www.irishstatutebook.ie/2010/en/act/pub/0007/sched1.html>, accessed 16 April 2017.

106 See in particular points 1(1), 2(3) and 4 Intercreditor Agreement.

107 Loan Facility Agreement between the euro area lenders, Greece, and the Bank of Greece acting as agent of the latter, 8 May 2010 (Loan Facility Agreement). The agreement can be consulted at <www.irishstatutebook.ie/2010/en/act/pub/0007/sched2.html> accessed 16 April 2017. It should be mentioned that Germany was not a partner to this agreement. Instead, *Kredietanstalt für Wiederaufbau* (KfW), a financial institution established under public law, acted as lender on behalf of Germany. See Recital 14 Loan Facility Agreement. See also De Gregorio Merino (n 104) 1617.

down in a Council decision based on Articles 126(9) and 136(1) TFEU,[108] and were further specified in a Memorandum of Understanding (MoU).[109]

Taken by the currency union's ministers of finance, the decision to activate assistance for Greece was in principle only binding on states in their *executive capacity*.[110] This was also recognised by the announcement of the Eurogroup, which stated that in some member states 'parliamentary approval' was needed before the assistance could be disbursed.[111] The onus therefore fell on governments to channel the facility through their parliaments. They all did so, except for the Slovakian government. Slovakia had worked hard to join the currency union only in 2009 and was reluctant to rescue its Hellenic partner that was more prosperous, but managed less efficiently. In August 2010 its newly-elected parliament therefore rejected participation in the assistance operation.[112] Prime Minister Iveta Radičová even defended the move by saying that her state would not support those that 'behaved irresponsibly, who did not behave according to the treaty and according to the stability pact'.[113] Yet, she failed to take responsibility for the group herself by not defending assistance for Greece and disregarding the political obligation Slovakia had incurred in its executive capacity earlier in May.

'It is a breach of the commitment undertaken by Slovakia in the Eurogroup', Economic and Monetary Affairs Commissioner Rehn said after the parliamentary vote.[114] The other members of the currency union were therefore quick to rebuke the state for its failure to respect this commitment to which they were reciprocally bound. 'All member states have committed themselves

108 Council Decision 2010/320/EU of 10 May 2010 addressed to Greece with a view to reinforcing and deepening fiscal surveillance and giving notice to Greece to take measures for the deficit reduction judged necessary to remedy the situation of excessive deficit [2010] OJ L245/6, as last amended by Council Decision 2011/257/EU of 7 March 2011 [2011] OJ L110/26. In the interests of clarity the Council has subsequently adopted a new decision setting out the policy conditionality on 12 July 2011, repealing the previous one. See Council Decision 2011/734/EU of 12 July 2011 addressed to Greece with a view to reinforcing and deepening fiscal surveillance and giving notice to Greece to take measures for the deficit reduction judged necessary to remedy the situation of excessive deficit (recast) [2011] OJ L 296/38, last amended by Council Decision 2013/6/EU of 4 December 2012 [2013] OJ L4/40. Note, however, that as of the entry into force of the 'Two-Pack', the issues surrounding conditionality are in principle governed by Reg 472/2013. See text to n 341 (ch 5).

109 Point 3(5)(c) Loan Facility Agreement. See also De Gregorio Merino (n 104) 1617.

110 For the difference between states acting in their *executive capacity* and *in full* see text to n 131 (ch 2).

111 Statement by the Eurogroup, Brussels, 2 May 2010.

112 See Jan Cienski, Stanley Pignal and Gerrit Wiesmann, 'Slovakia under fire over bail-out' *Financial Times* (13 August 2010).

113 Quoted in Jan Cienski, 'Slovakian leader defends Greece stance' *Financial Times (FT.Com)* (5 October 2010).

114 Quoted in Cienski, Pignal and Wiesmann, 'Slovakia under fire over bail-out' (n 112).

politically to assistance for Greece', Merkel's spokesman told the press.[115] 'Every member relies on solidarity; solidarity is not a one way street'.[116]

Within a year Slovakia would again be confronted with its commitment to safeguard financial stability, at a time when the stakes were even higher. And this time it would bow, dramatically.[117] At issue was not a rescue fund for Greece, but one for the currency union at large.

3 Saving the currency union

3.1 The call for a crisis fund

When the Eurogroup announced the assistance package for Greece on 2 May 2010, the key players were quick to reassure the public that they had prevented the crisis from spreading further.[118] IMF Managing Director Dominique Strauss Kahn, for example, said the move was necessary given the 'significant risks of spill over to other countries' but nonetheless 'exceptional'.[119] In reality, however, contagion risk was omnipresent. Merkel's insistence on the *ultima ratio* nature of assistance was understandable from her perspective, yet it had also slowed down the rescue of Greece.[120] The resulting uncertainty had fuelled market panic, as a result of which other debt-stricken states like Portugal and Ireland fell prey to the markets as well. As the euro 'plunged' against the dollar and stock markets around the world went down, there was fear that only two years after the collapse of Lehmann the world would witness another global financial crisis.[121] On 7 May 2010, only five days after the Eurogroup had decided to help out Greece, the euro area leaders therefore convened yet again to put in place an even greater rescue mechanism for the currency union at large.

The gathering at the highest political level had already been announced by Van Rompuy at a press conference of the EU-Japan summit on 28 April 2010.[122] The meeting would provide the leaders with the opportunity to

115 Quoted in Cienski, Pignal and Wiesmann, 'Slovakia under fire over bail-out' (n 112).
116 Quoted in Cienski, Pignal and Wiesmann, 'Slovakia under fire over bail-out' (n 112). For this initial lack of solidarity shown by Slovakia see also Amtenbrink (n 10) 183.
117 See text to n 203 (ch 5).
118 See also text to n 83 (prologue).
119 Quoted in Kerin Hope, Nikki Tait and Quentin Peel, 'Eurozone agrees Greek bailout' *Financial Times* (3 May 2010).
120 See also Ludlow, 'In the Last Resort' (n 58) 27, 50; Bastasin (n 22) 184.
121 Peter Garnham, 'Euro suffers violent price action' *Financial Times (FT.Com)* (7 May 2010); Barber, Peel and Demos, 'Markets tumble on European debt fears' (n 11); Bastasin (n 22) 185.
122 Kerin Hope, 'Van Rompuy quells Greek restructuring fears' *Financial Times (FT.Com)* (28 April 2010).

endorse the Eurogroup's decision on Greece whilst at the same time allowing them to discuss ways to strengthen the single currency in the long term. When Van Rompuy made the announcement, however, he refrained from mentioning a specific date, instead saying that the meeting would take place 'around 10 May'.[123] The choice for 10 May was inspired by the German ballot box. Since Merkel's CDU faced tough elections in Nordrhein-Westfalen on 9 May, the meeting would ideally take place afterwards so as to avoid that any decisions the leaders might take would have an impact on the electoral vote.[124]

Soon, however, it became clear that the meeting could not wait until the 10th. With markets getting more stressed by the day, Van Rompuy had to request Merkel whether she would agree to bring the meeting forward to Friday 7 May.[125] This would allow ministers of finance sufficient time to work out any decisions of the heads of state and government over the weekend, before the markets started trading again on Monday. The chancellor agreed. It was also clear by now that the meeting would not predominantly be about Greece nor long term plans. Leaders had to pacify markets instantly and defend the single currency by all means.[126] Telling is a letter of Thomas Wieser, the president of the Economic and Financial Committee (EFC), which he sent on 6 May to the president of the Eurogroup, Jean-Claude Juncker. In the letter he expressed his great concern about 'market trends' over the preceding days and argued that 'the issue of market pricing of sovereign risk' had to be 'addressed rapidly' so as to 'avoid the development of further instability'.[127] What is more, the members of the currency union had to 'express their willingness to take all necessary measures to protect the integrity and stability of the euro'.[128] Similar calls for action also came from outside the currency union.[129] In the morning of 7 May, prior to the crucial meeting, G-7 finance ministers and central bank governors held a teleconference to discuss the situation.[130] At an even higher level, the president of the United States called Merkel to share his concerns. According to Obama they 'agreed on the importance of a strong policy response by the affected countries and a strong financial response from the international community'.[131] The scene was set for a weekend that would decide the fate of the currency union.

123 Hope, 'Van Rompuy quells Greek restructuring fears' (n 122).
124 Ludlow, 'In the Last Resort' (n 58) 29; Bastasin (n 22) 183.
125 Ludlow, 'In the Last Resort' (n 58) 29; Bastasin (n 22) 184.
126 Ludlow, 'In the Last Resort' (n 58) 29.
127 Quoted in Ludlow, 'In the Last Resort' (n 58) 29.
128 Quoted in Ludlow, 'In the Last Resort' (n 58) 29. See also Bastasin (n 22) 191.
129 Bastasin (n 22) 191-192.
130 Bob Davis and John Hilsenrath, 'U.S. Presses Europe to Contain Greek Fallout' *The Wall Street Journal* (8 May 2010); Lynn (n 20) 155.
131 Quoted in Davis and Hilsenrath, 'U.S. Presses Europe to Contain Greek Fallout' (n 130).

Prior to the meeting in Brussels there was a series of 'bilaterals' in which key players such as Trichet, Sarkozy, Merkel, Barroso and Van Rompuy searched for common ground as there was not yet 'a eurozone consensus on how to proceed', an official later recalled.[132] These encounters went on for so long that the meeting itself – a working dinner – had to be postponed for two hours, which again gave some of the less prominent leaders the feeling they were being sidestepped.[133]

After the Greek Prime Minister Papandreou had finally opened the meeting by discussing the dire situation of his state, Central Bank President Trichet took the floor.[134] As will be shown in the next chapter, Trichet's role during the meeting is intriguing for various reasons.[135] For now, it suffices to state that Trichet tried to dispel any illusions that those sitting at the table might still have had about the nature of the crisis.[136] He showed them a chart demonstrating how interest rates for bonds of peripheral states were reaching dangerously high levels and impressed on their minds that whatever misery would fall upon these states would threaten the currency union at large. 'This isn't only a problem for one country', he allegedly said, 'it's several countries, it's Europe.'[137] His words impressed all leaders, even those of large states. An ambassador recalls how the president of France appeared 'stunned': 'Sarkozy was white with shock. I've never seen him so pale'.[138] Trichet subsequently gave national leaders a tongue-lashing for their failure to observe fiscal discipline during the preceding years and for which they now had to pay the price: 'We have done what we had to do. It is you, the member states, who have failed in your duty'.[139] The central banker ended with a dramatic call for action: 'Live up to your responsibility!'[140]

'It was Trichet's alarming speech that woke up all the participants in the meeting', one official later said.[141] 'Until then there was no real readiness to contemplate a package that was commensurate with the challenge'.[142] Yet, even though all leaders were now convinced of the necessity to live up to their commitment to safeguard financial stability, there was still a great difference in opinion on how to proceed. Sarkozy called for quick, drastic action and

132 Quoted in Ben Hall, Quentin Peel and Ralph Atkins, 'Twelve hours that tested the limits of the Union' *Financial Times* (11 May 2010). On the 'bilaterals' see also Ludlow, 'In the Last Resort' (n 58) 30; Lynn (20) 158; Bastasin (n 22) 193.
133 Ludlow, 'In the Last Resort' (n 58) 30. See also Bastasin (n 22) 193.
134 Ludlow, 'In the Last Resort' (n 58) 31; Lynn (n 20) 160-161; Bastasin (n 22) 193-194.
135 See text to n 28 (ch 6).
136 Tony Barber, 'Dinner on the edge of the abyss' *Financial Times* (11 October 2010).
137 Quoted in Barber, 'Dinner on the edge of the abyss' (n 136).
138 Quoted in Barber, 'Dinner on the edge of the abyss' (n 136).
139 Quoted in Ludlow, 'In the Last Resort' (n 58) 31.
140 Quoted in Bastasin (n 22) 194.
141 Quoted in Ben Hall, Quentin Peel and Ralph Atkins, 'The day that tested the limits of the Union' *Financial Times* (11 May 2010).
142 Quoted in Hall, Peel and Atkins, 'The day that tested the limits of the Union' (n 141).

pushed for a loan mechanism under the control of the Commission that would 'not oblige any of us to seek parliamentary approval at home'.[143] To Merkel, on the contrary, such approval was essential. She regarded it as a means to ensure conformity with the German constitution.[144] Whereas some of the assistance could perhaps be given shape on the basis of the Union Treaties and be brought under the aegis of the Commission, she insisted that a significant part should be placed under the control of national finance ministers and parliaments.[145]

The heads of state and government eventually settled for the option to leave it to the finance ministers to come up with a precise plan. They issued a statement in which they reaffirmed their commitment to ensure the stability of the currency union and called on the Commission to submit a proposal for a crisis mechanism to an 'extraordinary ECOFIN meeting' on Sunday 9 May.[146]

At the end of that meeting, however, the currency union would end up having not one such mechanism, but two. Both would put Union law under strain, each in their own way. The first because it aimed to accommodate the shift towards positive solidarity within the confines of the original stability framework in the Union Treaties, the second because it went outside it.

3.2 The mechanism

The Commission did not start thinking about a crisis mechanism until only after the political leaders had requested it to devise one. In the preceding weeks, its lawyers had racked their brains over such a mechanism and had reached the conclusion that it could be given shape on the basis of the current Treaties. Central to their thought was Article 122(2) TFEU, the provision that allows the Union to grant assistance to a member state in the case of exceptional difficulties beyond its control.[147] This Article, the Commission reasoned, provided the Union with the possibility to establish a rescue mechanism that would not fall foul of the no-bail out clause in Article 125 TFEU. In fact, its President Barroso was convinced of the legal solidity of this option. Asked about the possibility of establishing a crisis mechanism, he stated:

> 'I want to clarify this absolutely. We have checked this issue from a legal point of view and….no-bailout does not mean no help. On the contrary, there are many provisions in the Treaty; I could also quote Article 122 where there is a specific solidarity clause saying that where a member state is in difficulties the Council may, on a proposal from the Commission, grant financial assistance. So, it's com-

143 Quoted in Ludlow, 'In the Last Resort' (n 58) 31.
144 Ludlow, 'In the Last Resort' (n 58) 32, 34; Bastasin (n 22) 195.
145 Ludlow, 'In the Last Resort' (n 58) 32, 34; Bastasin (n 22) 195, 197.
146 Statement of the Heads of State or Government of the euro area, Brussels, 7 May 2010.
147 See text to n 291 (ch 3).

> pletely wrong and misleading to say that because of the "no-bailout" clause there cannot be help to some member states. It's quite the opposite. The Treaty design stipulates this.'[148]

However, resorting to Article 122(2) TFEU was far from easy, both politically and legally. Politically, it met with resistance from the United Kingdom. Just days earlier, on 6 May, the Conservative Party led by David Cameron had won the parliamentary elections.[149] Although the outgoing Labour government was still in charge of the negotiations, Finance Minister Alistair Darling informed his negotiating partners over the weekend that he could not sign up to a large-scale assistance mechanism on the basis of Article 122(2) TFEU.[150] Given that this provision lets the Council decide on the basis of a qualified majority of votes,[151] he was afraid that his state would be drawn into massive euro area assistance operations against its will.[152]

On Sunday 9 May the Commission nonetheless tabled a proposal on the basis of Article 122(2) TFEU for a Regulation establishing a 'European Financial Stabilisation Mechanism' ('EFSM' or 'mechanism') in which it had tried to accommodate British concerns.[153] The proposal stipulated that the Union could grant financial assistance 'in the form of a loan or of a credit line' to a euro area member state and it empowered the Commission 'to contract borrowings on the capital markets' for this purpose.[154] However, the total outstanding amount of assistance the Union could provide in this way could not exceed 'the margin' available under its own 'resources ceiling for payment appropriations', which meant that only €60bn could be mobilised in this way.[155] Any assistance above that ceiling should 'benefit from the joint and pro-rata guarantee' of euro area states, thereby excluding the United Kingdom from any further financial involvement.[156]

Bringing together Union and member state assistance in one Union law instrument, as the Commission proposed, is legally problematic. Article 122(2) TFEU allows the Union to grant assistance but it does not speak about member states. It is therefore highly questionable whether it provides a legal basis for a Regulation obliging member states to contribute to an assistance operation.

148 Quoted in 'Interview Transcript: José Manuel Barroso' *Financial Times (FT.Com)* (23 March 2010).

149 Bastasin (n 22) 189.

150 Tony Barber and Ben Hall, 'EU to expand emergency fund by at least €60 bn' *Financial Times (FT.Com)* (9 May 2010); Peel and Atkins, 'Twelve hours that tested the limits of the Union' (n 132); Lynn (n 20) 173.

151 See Art 122(2) TFEU read in combination with Art 16(3) TEU.

152 Barber and Hall, 'EU to expand emergency fund' (n 150).

153 Commission, 'Proposal of 9 May 2010 for a Council Regulation establishing a European Financial Stabilisation Mechanism' COM (2010) 2010 final (EFSM proposal).

154 Arts 1 and 2(1) EFSM Proposal.

155 Art 2(2) EFSM Proposal.

156 Art 3(1) EFSM Proposal.

It is true that the predecessor to the current balance of payments assistance facility, which was laid down in Council Regulation 1969/88, adopted a similar approach.[157] However, Article 143(2) TFEU (ex Art 119 EC), the Treaty provision that governs such assistance,[158] specifically mentions the possibility for the Council to oblige states to contribute to such aid. As no such possibility is mentioned by Article 122(2) TFEU, the same technique cannot be used for assistance granted under this provision.

However, the Commission's proposal would never have to be legally challenged on these grounds as it met with resistance in the Council for other reasons. Germany's Interior Minister Thomas de Maizière, acting as substitute for Finance Minister Schäuble who had turned ill upon arrival in Brussels, indicated that a great aid scheme under Union law was unacceptable to his government.[159] The day before, on Saturday 8 May, Merkel had confirmed to Sarkozy by telephone that she would support a rescue fund totalling €500bn.[160] Strauss Kahn, moreover, had already confirmed to the leaders of the currency union that the 'IMF would contribute half of whatever figure the Europeans agreed', making the total size of the rescue fund reach €750bn.[161] Yet, Merkel had instructed De Maizière that the assistance that the member states had to provide – €440 bn – should not be placed under the control by the Union in case such a set-up would not stand up before the *Bundesverfassungsgericht*.[162] She made clear that this money should, as had happened with Greece, be provided through bilateral loans.[163]

In the end, the Council decided to only use Article 122(2) TFEU and the Regulation based on it for the Union's contribution of €60bn.[164] Contrary

157 See Arts 1(3) and 3(3) of Council Regulation (EC) 1969/88 of 24 June 1988 establishing a single facility providing medium-term financial assistance for Member States' balances of payments [1988] OJ L178/1. The current balance of payments assistance facility, laid down in Council Regulation 332/2002, no longer contains the possibility to oblige member states to grant assistance. It only allows the Union to grant assistance with a view to which the Commission can contract borrowings on the capital markets or with financial institutions. See Recital 9 and Art 1(2) of Council Regulation (EC) 332/2002 of 18 February 2002 establishing a facility providing medium-term financial assistance for Member States' balance of payments [2002] OJ L 53/1, as last amended by Council Regulation 431/2009 of 18 May 2009 [2009] OJ L 128/1 (Reg 332/2002).

158 Note that Art 143 TFEU does not provide the legal basis for Reg 332/2002, which is based on Art 352 TFEU. See also n 459 (ch 3).

159 Barber, 'Dinner on the edge of the abyss' (n 136); Lynn (n 20) 166-167, 169.

160 Bastasin (n 22) 198.

161 Barber, 'Dinner on the edge of the abyss' (n 136).

162 Barber, 'Dinner on the edge of the abyss' (n 136). See also Ludlow, 'In the Last Resort' (n 58) 36-37; Bastasin (n 22) 199.

163 Barber, 'Dinner on the edge of the abyss' (n 136). See also See also Ludlow, 'In the Last Resort' (n 58) 36-37; Lynn (n 20) 172; Bastasin (n 22) 199.

164 Conclusions Ecofin Council meeting, Brussels, 9-10 May 2010, 9602/10; Art 2(2) of Council Regulation (EU) 407/2010 of 11 May 2010 establishing a European financial stabilisation mechanism [2010] OJ L 118/1 (Reg 407/2010).

to the Commission's proposal, Article 1 of the Regulation makes it clear that with a view to preserving financial stability the mechanism can be used to grant assistance to any member state – not just those in the currency union – that 'is experiencing, or is seriously threatened with, a severe economic or financial disturbance caused by exceptional occurrences beyond its control'. Such assistance, which may take the form of a loan or credit line,[165] can be granted by the Council acting by a qualified majority on the basis of a Commission proposal.[166]

The Council decision granting assistance must contain, amongst others, the general economic policy conditions accompanying the support as well as the approval of the adjustment programme that the beneficiary state has prepared to meet these conditions.[167] It is for the Commission to negotiate, and subsequently conclude, a memorandum of understanding (MoU) with the recipient state detailing the general policy conditions attached to the assistance.[168] Disbursements of a loan take place in instalments and are subject to the Commission's positive assessment of compliance by the beneficiary state with the policy conditions and its adjustment programme.[169]

The Union's contribution of € 60bn was important, yet it paled before the € 440bn that the members of the currency union decided to provide. In line with Germany's wishes their contribution would not be part of the Union mechanism, but Merkel's plan to provide the assistance through bilateral loans would not see the light of day either.

3.3 The facility

For a long time during the Council meeting of 9 May, it was uncertain whether ministers of finance would manage to agree on a rescue fund. Some ministers preferred the original Commission proposal as it envisaged making available the funds in excess of the Union's ceiling of € 60bn by making use of state guarantees.[170] Contrary to Germany's preference for bilateral loans, this

165 Art 2(1) Reg 407/2010.
166 Art 3(2) Reg 407/2010.
167 Arts 3(3) and 3(4) Reg 407/2010. Note, however, that as of the entry into force of the 'Two-Pack', the issues surrounding conditionality are in principle governed by Reg 472/2013. See text to n 341 (ch 5). As a result, the decisions on conditionality based on Reg 472/2013 now contain a 'cross-reference' to the decisions taken on the basis of Reg 407/2010.
168 Art 3(5) Reg 407/2010. Art 3(6) stipulates that the Commission has to 'reexamine' the policy conditionality at least every six months and discuss with the state in question any changes that it needs to make to its adjustment programme. Art 3(7) states that the Council has to approve of any changes to the conditions and adjustment programme.
169 Art 4 Reg 407/2010. For the procedure governing the release of funds under a credit line see Art 5 Reg 407/2010.
170 Ludlow, 'In the Last Resort' (n 58) 36-37; Bastasin (n 22) 199.

assistance option would not put further pressure on national debt burdens. Ministers also indicated they were not itching to go to their parliaments to ask for approval of such a move so shortly after the Greek operation.[171] However, De Maizière stuck to his position. Having the Union provide assistance on the basis of state guarantees would come close to a 'Eurobond', at least in the eyes of the German public.[172] Yet time was running out. With no solution in sight, De Maizière eventually suggested that the other member states should opt for a 'common fund', while his state would separately provide assistance through a bilateral loan.[173] But a fund without the participation of Germany was a 'no-go' for the others as it would seriously weaken its credibility.[174] De Maizière phoned Merkel to discuss how to proceed. The chancellor instructed him: 'Stay firm. We still have two hours to negotiate'.[175]

When the markets were about to open in Sydney, the finance ministers realised they would miss their deadline. The French Minister Christine Lagarde then indicated they had to 'forget about Sydney' and do everything possible to issue a statement before the important Tokyo market started trading.[176] 'I did sense the pressure', she recalls, 'I was looking at my watch'.[177] Salvation finally came from Maarten Verwey, at the time Director of Foreign Financial Relations at the Dutch Ministry of Finance.[178] He suggested creating a 'Special Purpose Vehicle' (SPV) with the capability to raise funds in the markets using government guarantees. The German government could live with this solution. It still made use of government guarantees, yet it would be of an intergovernmental nature and it would not be based on Union law.[179] Euro area finance ministers therefore settled for Verwey's suggestion and committed themselves to provide assistance through such a vehicle that would expire after three years.[180] The decision was taken by these ministers 'meeting within

171 Barber, 'Dinner on the edge of the abyss' (n 136); Bastasin (n 22) 199.

172 Ludlow, 'In the Last Resort' (n 58) 37. See also Lynn (n 20) 169; Barber, 'Dinner on the edge of the abyss' (n 136); Bastasin (n 22) 199. For a more general analysis of how Germany's ordoliberal mindset stood in the way of the adoption of 'eurobonds' during the crisis see Matthias Matthijs and Kathleen McNamara, 'The Euro Crisis' Theory Effect: Northern Saints, Southern Sinners, and the Demise of the Eurobond' (2015) 37 Journal of European Integration 229.

173 Bastasin (n 22) 199-200.

174 Bastasin (n 22) 200.

175 Quoted in Bastasin (n 22) 200.

176 Quoted in Neil Irwin, *The Alchemists: Three Central Bankers and a World on Fire* (Penguin Books 2014) 230. Irwin tells that the ministers of finance eventually reached a compromise at 3:15 am. As a result, 'They missed the Japanese market deadline as well, but apparently the sense that European leaders were furiously working toward a deal was enough to assuage the markets'. See also Lynn (n 20) 172.

177 Quoted in Barber, 'Dinner on the edge of the abyss' (n 136).

178 Barber, 'Dinner on the edge of the abyss' (n 136); Bastasin (n 22) 200.

179 Ludlow, 'In the Last Resort' (n 58) 37; Barber, 'Dinner on the edge of the abyss' (n 136).

180 Decision of the Representatives of the Governments of the Euro Area Member States Meeting Within the Council of the European Union, Brussels, 10 May 2010, 9614/10.

the Council', which is a formula often used for intergovernmental cooperation initiatives outside the framework of Union law.[181] It indicates that it is not the Council that acts,[182] but the member states jointly exercising their sovereign rights, as a result of which the decision forms an agreement governed by international law.[183]

The vehicle itself, called European Financial Stability Facility ('EFSF' or 'facility'), forms a public limited liability company ('société anonyme') incorporated under Luxembourg law.[184] Its legal basis therefore lies outside Union law, in its articles of association.[185] Most of the essential provisions governing the facility's assistance operations, however, are not laid down in these articles but in a 'Framework Agreement' concluded on 8 June 2010 between the facility and the members of the currency union in their capacity as its shareholders.[186] This agreement, which is governed by English law,[187] regulates the guarantees each participating state has to provide, calculated on the basis of its subscription to the capital key of the European Central Bank,[188] with a view to ensuring the facility's effective lending capacity of €440bn.[189] It

181 Koen Lenaerts and Piet Van Nuffel, *European Union Law* (Sweet & Maxwell 2011) 929-931.

182 Note, however, that for an act not to be a Council decision it is not enough to simply denominate it as a 'decision of the Member States'. According to the Court it is decisive 'whether, having regard to its content and all the circumstances in which it was adopted, the act in question is not in reality a decision of the Council'. See Joined Cases C-181/91 & C-248/91 *Parliament v Council* [1993] EU:C:1993:271, paras 12-14.

183 Henry G Schermers, 'Besluiten van de vertegenwoordigers der Lid-staten; Gemeenschapsrecht?' (1966) 14 SEW 545, 549-550; Vestert Borger, 'De eurocrisis als katalysator voor het Europese noodfonds en het toekomstig permanent stabilisatiemechanisme' (2011) 59 SEW 207, 209. For a more extensive analysis of the decision's legal character see Daniel Thym, 'Euro-rettungsschirm: zwischenstaatliche Rechtskonstruktion und verfassungsrechtliche Kontrolle' (2011) 22 EuZW 167, 168.

184 For detailed analysis see also De Gregorio Merino (n 104) 1619-1621.

185 The articles of association, last amended on 23 April 2014, are available at <www.esm.europa.eu/sites/default/files/efsf_status_coordonnes_23avrl2014.pdf> accessed 17 April 2017.

186 EFSF Framework Agreement between the euro area Member States and the EFSF (consolidated version incorporating the amendments agreed on during the summits of the euro area heads of state or government on 11 March 2011 and 21 July 2011) <www.efsf.europa.eu/about/legal-documents/index.htm>, accessed 17 April 2017 (EFSF Framework Agreement).

187 Point 16(1) EFSF Framework Agreement.

188 See Points 2(3)-(7) and Annex 2 EFSF Framework Agreement. Points 2(7) and 10(5)(f) make clear that a state requesting financial assistance may ask its partners to unanimously accept that it no longer issues guarantees or incurs liabilities as a guarantor in relation to any further debt issuances by the EFSF. All states having received assistance from the EFSF – Ireland, Greece and Portugal – are such 'stepping-out' guarantors.

189 Initially the total amount of guarantees equalled €440bn, as a result of which the facility's effective lending capacity was much lower. Given that only a few states benefit from the highest credit rating (AAA), the facility itself could only issue bonds with a similarly high rating – which was considered essential at the time – to the extent they were guaranteed

also determines that the facility shall be 'liquidated' on the earliest date possible after 30 June 2013,[190] the deadline for launching new assistance operations.[191]

Even though the facility differed from the first intergovernmental assistance vehicle for Greece in terms of its legal set-up, the conditions and procedure under which it could grant support were similar and reflected the change in the Contract initiated on 11 February 2010 and its subsequent specification by the deal of 25 March. Assistance could only be granted if needed to safeguard financial stability and had to be subject to strong conditionality.[192] Moreover, it required the unanimous approval of the granting states, both at the time of its launch and when specific disbursements had to be made.[193] Where the facility did differ from its 'Greek' predecessor was on the point of assistance instruments. It is here that the significance of normative solidarity is also most clearly evident. Understanding how and why requires examination of the meeting between the leaders of the currency union of 21 July 2011.

3.4 The search for 'flexibility'

Initially, the EFSF could only grant assistance through loans, just like the 'Greek' vehicle. But as the crisis took on ever-greater proportions, calls to strengthen its firepower and set of instruments increased, especially after Eurogroup and ECOFIN ministers had decided to grant Ireland € 85bn in financial assistance on 28 November 2010.[194] A first attempt at strengthening the facility came at the meeting of euro area heads of state and government of 11 March 2011.

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by these states (approximately €250bn). With a view to extending the effective lending capacity to the envisaged amount of €440bn, euro area heads of state or government therefore decided on 11 March 2011 to raise the total guarantee commitments to €780bn. See Conclusions of the Heads of State or Government of the euro area, Brussels, 11 March 2011, para 5; Recital 2 and Annex 1 EFSF Framework Agreement. See also De Gregorio Merino (n 104) 1620. See also text to n 195 (ch 5).

190 Point 11(2) EFSF Framework Agreement.

191 Points 2(5)(b) and 2(11) EFSF Framework Agreement.

192 Recital 1 and Point 2(1)(a) EFSF Framework Agreement. The latter provision states that the conditionality had to be laid down in an MoU to be negotiated by the Commission. No separate MoU was required in case the beneficiary state also received assistance from the EFSM. The provision also required the MoU's consistency with a decision on conditionality that the Council could take under Art 136(1) TFEU. Note, however, that as of the entry into force of the 'Two-Pack', the issues surrounding conditionality are in principle governed by Union law, in particular Reg 472/2013. See text to n 341 (ch 5).

193 Points 10(5)(a)-(b)EFSF Framework Agreement.

194 Statement of the Eurogroup and ECOFIN ministers, Brussels, 28 November 2010. The breakdown of the assistance was as follows: EFSM (€22.5bn), EFSF (€22.5bn), IMF (€22.5bn), the UK (€3.8bn), Sweden (€0.6bn), Denmark (€0.4bn). €17.5bn was provided by Ireland itself through a Treasury cash buffer and investments of the National Pension Reserve Fund.

There, they decided to make the facility's lending capacity 'fully effective' by raising the amount of guarantees underpinning it from € 440bn to € 780bn.[195] They also gave it the possibility to intervene on the primary market for government debt.[196] Yet, when Portugal also had to give in to the markets on 17 May 2011, receiving assistance worth € 78bn,[197] and Greece's assistance package appeared clearly insufficient, it was obvious that more had to be done. On 11 July the Eurogroup therefore announced that it stood ready to adopt 'further measures' to deal with the risk of contagion, in particular by 'enhancing the flexibility' of the facility, 'lengthening the maturities' of loans and 'lowering' their interest rates.[198] It refrained, however, from providing details about these measures, nor did it set out a specific time path for taking them. These difficult decisions had to be taken at the highest political level, at the meeting of Union institutions and euro area leaders of 21 July 2011. After that meeting, the Slovakian Prime Minister Radičová would again be confronted with her political obligation to safeguard financial stability.

The agreement of 21 July was broad, covering a range of issues that were listed in a long, technical statement.[199] At the very beginning, leaders reaffirmed their commitment to do whatever was needed to maintain financial stability in the currency union. With a view to that aim, Greece would receive a second support package from the facility in combination with a 'voluntary contribution' from the private sector.[200] In addition, and together with Portugal and Ireland, it also got a lengthening of the maturities of its loans as well as a reduction of the interest rate it had to pay.[201] What matters most for present

195 Conclusions of the Heads of State or Government of the euro area, Brussels, 11 March 2011, para 5. An increase of guarantees was needed as without such an increase the EFSF could not use the full €440bn if it wanted to qualify for a Triple-A status with credit rating agencies. See Recital 2 EFSF Framework Agreement. See also n 189 (ch 5).

196 Conclusions of the Heads of State or Government of the euro area, Brussels, 11 March 2011, para 5. The decision on primary market intervention would also apply to the (future) ESM.

197 Press release, 'Council approves aid to Portugal, sets conditions' (Brussels, 17 May 2011). Contributions to the overall amount of assistance were as follows: EFSM (€26bn), EFSF (€26bn), IMF (€26bn).

198 Statement by the Eurogroup, 11 July 2011.

199 Statement by the Heads of State or Government of the euro area and EU institutions, Brussels, 21 July 2011.

200 Statement by the Heads of State or Government of the euro area and EU institutions, Brussels, 21 July 2011, paras 2, 6-7. Note, however, that formal approval of the second aid package was only given after the 'haircut' on bonds in the hands of private creditors had been effectuated in March 2012. The emphasis on the 'voluntary' nature of the private sector contribution was a demand of the ECB, which still feared the contagious effects and stability risks of involving private investors in assistance operations. See Irwin (n 176) 313-315. See also text to n 296 (ch 5).

201 Statement by the Heads of State or Government of the euro area and EU institutions, Brussels, 21 July 2011, paras 3, 10. It should be noted that Greece had already received an interest rate reduction and an extension of the maturity for its loans at the summit of the currency union's leaders of 11 March 2011. See Conclusions of the Heads of State or

purposes, however, is that leaders also decided to increase the 'flexibility' of the EFSF by equipping it with more instruments.[202] The facility should be able to act on the basis of a precautionary programme so as to support member states with sound economic conditions before they experience funding difficulties in the market. It would also have the power to recapitalise banks through loans to governments and intervene on the secondary market for government bonds.

The statement indicated that the necessary procedures for the implementation of these decisions would be initiated 'as soon as possible'.[203] But this was easier said than done. The increase in guarantees supporting the facility, which leaders had agreed on in March, as well as its 'flexibilisation' required amendments to the facility's Framework Agreement and were therefore dependent on national approval. Slovakia postponed taking a decision for months, until it was one of only a few states left.[204] One of the governing coalition parties, the Freedom and Solidarity Party (SaS), was adamantly against the amendments. Its leader Richard Sulik argued that 'The whole idea of the euro bailout is wrong. It tries to solve the debt crisis with more debt'.[205] What is more, he considered the EFSF to be 'the biggest swindle against Slovak and European taxpayers'.[206] Prime Minister Radičová consequently again found herself in a fix. A year earlier she had ignored her political obligation to safeguard financial stability by refusing to take part in the Greek loan facility.[207] This time, however, the consequences of such a move would be much greater as it would put on the line the viability of a rescue fund for the currency union at large. At last, a way out of her predicament was offered by the centre-left opposition leader Robert Fico, but the sacrifice Radičová would have to make was great.[208] In return for his support, Fico demanded that she would call for early elections which his SMER Party was likely to win.

Government of the euro area, Brussels, 11 March 2011, para 5.

202 Statement by the Heads of State or Government of the euro area and EU institutions, Brussels, 21 July 2011, paras 8-9. The decision to increase the set of instruments also applied to the (future) ESM. The ESM Treaty, which had initially been concluded on 11 July 2011, therefore had to be redrafted. It was signed for a second time on 2 February 2012. See also text to n 328 (ch 5).

203 Statement by the Heads of State or Government of the euro area and EU institutions, Brussels, 21 July 2011, para 8.

204 Jan Cienski, 'Slovakia stuck on eurozone rescue fund' *Financial Times (FT.Com)* (4 October 2011).

205 Quoted in Cienski, 'Slovakia stuck on eurozone rescue fund' (n 204).

206 Quoted in Leos Rousek, Gordon Fairclough and Marcus Walker, 'EU bailout fault lines exposed in Slovakia' *The Wall Street Journal Online* (12 October 2011).

207 See text to n 110 (ch 5).

208 Jan Cienski, 'Slovaks strike deal to ratify deal' *Financial Times* (13 October 2011).

On 13 October 2011 Radičová took responsibility for the currency union by acting on her obligation.[209] She accepted Fico's offer and secured parliamentary approval. Slovakia no longer supported the facility's flexibilisation only in its executive capacity, but in full. After the vote in parliament Finance Minister Mikloš expressed his relief: 'The price is high, but I'm glad that Slovakia stood up to its commitments in the end and we are not blocking the euro zone from having this tool at its disposal to contain the crisis'.[210]

Following this display of solidarity, which Van Rompuy calls 'one of the most courageous decisions' he has ever witnessed 'around the Council table',[211] Radičová stayed on as prime minister until the elections in March 2012, which she lost to Fico.

4 Incorporating the shift in the Treaties

4.1 The chiefs back at the steering wheel

The weekend of 7-9 May 2010 became a watershed. The currency union's set-up used to be dominated by the overriding goal of price stability, symbolised most forcefully by the no-bailout clause in Article 125 TFEU. Now, however, it contained two rescue funds – the EFSM and the EFSF – that could be used to safeguard financial stability. 'It is an enormous change',[212] the French Minister for European Affairs Pierre Lellouche argued, comparing the shift towards positive solidarity with NATO's defence scheme: 'The €440bn mechanism is nothing less than the importation of NATO's mutual defense clause applied to the eurozone. When one member state is under attack the others are obliged to come to its defence'.[213] 'It is expressly forbidden in the treaties by the famous no-bailout clause',[214] he reasoned. '*De facto*, we have changed the treaty'.[215]

209 Cienski, 'Slovaks strike deal to ratify deal' (n 208).
210 Quoted in Martin Santa and Jan Lopatka, 'Slovak EFSF approval completes ratification process' *Reuters* (13 October 2011).
211 Van Rompuy, *Europe in the Storm* (n 19) 36.
212 Quoted in Ben Hall, 'EU bail-out scheme alters bloc treaties, says France' *Financial Times* (28 May 2010). See also Lynn (n 20) 177.
213 Quoted in Hall, 'EU bail-out scheme alters bloc treaties, says France' (n 212).
214 Quoted in Hall, 'EU bail-out scheme alters bloc treaties, says France' (n 212).
215 Quoted in Hall, 'EU bail-out scheme alters bloc treaties, says France' (n 212). See in this respect also Willem T Eijsbouts and Thomas Beukers, 'The EU and Constitutional Change: A Research Proposal' (2010) 6 EuConst 335. In 2010, when the rescue facilities were established or initiated, they already argued: 'It is possible to view these mechanism as mere accessories to the monetary union rules. But they are probably better understood as modest though fundamental innovations'.

For Merkel that was precisely the problem. Already at the beginning of March her Finance Minister Schäuble had tabled a proposal for a 'European Monetary Fund', arguing that the rules on economic policy were 'incomplete' and left the currency union 'unprepared for extremely severe situations….that demand a comprehensive intervention to avert greater systemic risks'.[216] Whilst Merkel had supported the initiative in principle, she had also made it clear that such a fund would require treaty amendment: 'Without treaty change we cannot found such a fund'.[217] But in the weeks that followed, the chancellor had been overtaken by events. Market panic had reached such heights that treaty amendment – a long and dreadful process – was not an option.[218] The necessity to safeguard financial stability had forced her to commit to the establishment of a rescue fund with the Union Treaties left untouched. Admittedly, the EFSF had been given shape outside these Treaties, but that did not matter legally. Due to the supremacy of Union law, the reach of the no-bailout extends even to such intergovernmental action. The tension between what Union law demanded of the members of the currency union and the positive solidarity they had committed to politically could not have been higher.

Although in May 2010 Merkel had had no option but to consent to the establishment of the EFSF, she had demanded that the fund would be of a 'temporary nature'.[219] The expiration deadline of 30 June 2013 ensured her call for treaty amendment still had a natural urgency. Theoretically, of course, nothing prevented the member states in the currency union from prolonging the facility's functionality beyond the horizon of June 2013, but in her concern about a constitutional challenge in Karlsruhe Merkel made it absolutely clear this was not an option: 'I have said time and again that the rescue fund will end in 2013 and will definitely not simply be extended ... we need a crisis mechanism that is lasting, but different'.[220]

Thinking about a permanent crisis mechanism had already started early 2010.[221] At its meeting in March the European Council had asked its President Van Rompuy to establish a task force to present measures 'for an improved crisis resolution framework and better budgetary discipline…'.[222] The task

216 Schäuble (n 69).
217 Quoted in Quentin Peel, Ben Hall and Tony Barber, 'EMF plan needs new EU Treaty, says Merkel' *Financial Times* (9 March 2010).
218 Bastasin (n 22) 168.
219 Bastasin (n 22) 198. See also Lynn (n 20) 173.
220 Quoted in Quentin Peel and others, 'Germany confident of "crisis resolution" deal' *Financial Times (FT.Com)* (19 October 2010). See also Peter Ludlow, 'The Euro Crisis Once Again: The European Council of 28-29 October 2010 (Eurocomment Briefing Note Vol 8, No 3, December 2010) 9-10; Bastasin (n 22) 222.
221 Ludlow, 'The Euro Crisis Once Again' (n 220) 7.
222 European Council, Conclusions, Brussels, 25-26 March 2010, para 7.

force, which besides Van Rompuy consisted of Eurogroup President Juncker, Economic and Monetary Affairs Commissioner Rehn, Central Bank President Trichet and all national finance ministers, further defined its mandate when it met for the first time on 21 May 2010 by identifying four spearheads of reform: 'greater budgetary discipline', 'means to reduce divergences in competitiveness', an institutional upgrade of economic governance, and 'an effective crisis mechanism'.[223]

On each of these four fronts the task force, which presented its final report on 21 October 2010, laid the foundations for important reforms.[224] Many of these reforms were put in place by the European Parliament and the Council in November 2011 when they adopted the so-called 'Six-Pack'– a set of legislative measures consisting of five Regulations and one Directive – on the basis of either Article 121(6) or 126(14) TFEU, at times in combination with Article 136(1) TFEU when the reforms specifically targeted the states in the currency union.[225] Concerning budgetary discipline, for example, the task force advised *inter alia* to 'operationalise' the reference value for public debt of 60% of GDP and to put in place a 'wider range of sanctions' for euro area states.[226] These sanctions should also be applied 'with a higher degree of automaticity' and not only in the corrective arm of the Stability and Growth Pact, as used to be the case, but also preventively.[227]

223 Remarks by Herman Van Rompuy, President of the European Council, following the first meeting of the Task Force on Economic Governance, Brussels, 21 May 2010. The heads of state and government had already alluded to these priorities two weeks earlier, in their statement of 7 May. See Statement of the Heads of State or Government of the euro area, Brussels, 7 May, para 3.

224 Report of the Task Force to the European Council, *Strengthening Economic Governance in the EU* (Brussels, 21 October 2010) (Task Force Report on Economic Governance).

225 Regulation (EU) 1173/2011 of the European Parliament and the Council of 16 November 2011 on the effective enforcement of budgetary surveillance in the euro area [2011] OJ L 306/1 (Reg 1173/2011); Regulation (EU) 1174/2011 of the European Parliament and the Council of 16 November 2011 on enforcement measures to correct and address macroeconomic imbalances in the euro area [2011] OJ L 306/8 (Reg 1174/2011); Regulation (EU) 1175/2011 of the European Parliament and the Council of 16 November 2011 amending Council Regulation 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies [2011] OJ L 306/12 (Reg 1175/2011); Regulation (EU) 1176/2011 of the European Parliament and the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances [2011] OJ L 306/25 (Reg 1176/2011); Council Regulation (EU) 1177/2011 of 8 November 2011 amending Regulation 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure [2011] OJ L 306/33 (Reg 1177/2011); Directive (EU) 2011/85 of 8 November 2011 on requirements for budgetary frameworks of the Member States [2011] OJ L 306/122 (Dir 2011/85). Pointing out already at an early stage of the crisis that Art 136(1) TFEU should form the starting point for reforms to the currency union was Stefaan Van den Bogaert, '"Ich bin ein Europäer": Een uitweg uit de monetaire crisis?' (Inaugural Lecture Leiden University, 10 September 2010) 9.

226 Task Force Report on Economic Governance (n 224) point 1 (executive summary).

227 Task Force Report on Economic Governance (n 224) paras 5-31.

Parliament and Council followed these recommendations by amending the Pact.[228] As to debt, Article 2(1a) of its corrective arm – Regulation 1467/97 – now stipulates that it is excessive if it exceeds the reference value of 60% of GDP and 'the differential' with respect to this value has not decreased with at least 5% on average over the last three years. Sanctions, moreover, can no longer only be applied in the context of the corrective arm, but already once a euro area state significantly deviates from its adjustment path towards its medium-term objective and has 'failed to take action' in response to a Council recommendation on the basis of Article 121(4) TFEU demanding it to address this situation.[229] Their imposition has also become more automatic through the introduction of 'reverse qualified majority' voting. It means that the Council no longer has to actively vote in favour of sanctions in order to have them imposed on a member state; a decision to impose sanctions is now deemed to be adopted by the Council *unless* it decides within ten days of the adoption by the Commission of a recommendation concerning the sanction to reject this recommendation.[230]

On the front of macro-economic imbalances and competitiveness, the task force has provided crucial input too.[231] Its call for a 'surveillance mechanism' to address these issues was answered by Parliament and Council through the establishment of a 'macro-economic imbalances procedure'.[232] This procedure aims to identify potential risks for imbalances early on and to address excessive ones, not in the least through the imposition of sanctions if they occur in states belonging to the currency union.[233] Institutionally, one of the task force's recommendations concerned the introduction of a 'European Semester', a 'cycle of reinforced *ex ante* policy coordination' covering 'all elements of economic surveillance'.[234] Streamlining surveillance at Union level at the beginning of every year should allow national policy makers to take better note of the European 'dimension' to budgets and reform programmes when these have to be drafted later in the year.[235] The Semester was launched for the first

228 See in particular Reg 1175/2011; Reg 1177/2011; Reg 1173/2011. Formally speaking the latter Reg does not form part of the Pact, which according to the preambles of Regs 1466/97 and 1467/97 (as last amended by Regs 1175/2011 and 1177/2011) only consists of these two Regs and the European Council Resolution of 17 June 1997. Nonetheless, Reg 1173/2011 cannot be seen separately from the Pact.

229 Art 4(1) Reg 1173/2011 read in combination with Art 6(2) Reg 1466/97, as amended by Reg 1175/2011.

230 See Arts 4(2), 5(2) and 6(2) Reg 1173/2011.

231 Task Force Report on Economic Governance (n 224) paras 32-42.

232 Reg 1174/2011 and Reg 1176/2011.

233 Under the macro-economic imbalances procedure sanctions are also adopted by the Council on the basis of a reversed qualified majority. See Arts 3(3) and 5 Reg 1174/2011.

234 Task Force Report on Economic Governance (n 224) paras 42-45.

235 Task Force Report on Economic Governance (n 224) para 44.

time on 1 January 2011 and received legislative recognition through the adoption of the Six-Pack.[236]

By far the most delicate issue on the task force's agenda, however, was the establishment of a crisis mechanism. As it questioned the function and place of the no-bailout clause in the single currency's legal set-up, it was not something that could be addressed by Council and Parliament through secondary legislation. Striking at the very heart of the stability conception to which the member states had committed themselves two decades earlier, it could only be decided at the highest level: It was *Chefsache*, once again.

4.2 A stroll on the shores of Deauville

When the European Council had established the task force in March 2010, Merkel had ensured that treaty amendment was explicitly on the agenda as far as the crisis mechanism was concerned.[237] The task force had to explore 'all legal options to reinforce the legal framework', the conclusions stated.[238] But if the mechanism was shaped along German lines, treaty amendment would not just be an option; it would be a legal necessity. In his proposal for a European Monetary Fund, Schäuble had made it clear that the granting of emergency liquidity should 'never be taken for granted' and that in principle it should 'still be possible for a state to go bankrupt',[239] thereby implicitly indicating there was a need for rules on private debt restructuring.[240] Moreover, the granting of assistance would have to go hand in hand with greater means to enforce fiscal prudence.[241] Similar to the possibility to deprive a member state of its voting rights in the Council when it seriously and consistently breaches the values in Article 2 TEU,[242] the voting rights of euro area states had to be 'suspended for a year' if they 'intentionally breached' the budgetary rules.[243] It should ultimately even be possible to expel them from the currency union.[244] Whereas the involvement of the private sector could possibly still be given shape on the basis of the current Treaties, the voting sanctions could clearly not as they went far beyond the limited set of sanctions listed in Article 126(11) TFEU.

Other leaders, however, were not eager to engage in treaty amendment just months after the entry into force of the Lisbon Treaty in December 2009.

236 See Art 2-a Reg 1466/97, as amended by Reg 1175/2011.
237 Ludlow, 'The Euro Crisis Once Again' (n 220) 7; Bastasin (n 22) 208.
238 European Council, Conclusions, Brussels, 25-26 March 2010, para. 7.
239 Schäuble (n 69).
240 Bastasin (n 22) 145, 163.
241 Schäuble (n 69).
242 Art 7(3) TEU.
243 Schäuble (n 69).
244 Schäuble (n 69).

They either feared the prospect of having to organise a referendum on the change, bringing back the memory of the fiasco of the European Constitution in 2005, or simply lacked the political strength to steer the amendment through their parliaments.[245] When Van Rompuy visited Merkel in Berlin just days before the task force's final session on 18 October, he therefore told her that it would be difficult to get the other heads of state or government behind the idea of treaty amendment. He added, however, that her odds would be higher if she managed to have Sarkozy support the cause.[246]

By the time Van Rompuy visited Berlin, the German government had already started to intensify consultations with the French as it realised that its chances at treaty amendment were slim without the backing of the Élysée.[247] The French government, meanwhile, had its own concerns about the direction in which the deliberations within the task force were heading. In September, the Commission had anticipated the latter's final report by introducing its proposals for the 'six-pack' legislation mentioned above,[248] and the envisaged changes to the Stability and Growth Pact were not to the French government's liking.[249] The possibility to sanction member states in the currency union already at a preventive stage and the greater automaticity in imposing such sanctions due to 'reverse majority voting' made the prospect of having to face financial penalties much more real. Worrying too was the fact that the proposals left little room for states to escape sanctions once their budgets were judged to be 'off-track'. Under the Pact's corrective arm, for example, sanctions in the form of non-interest bearing deposits were to be imposed the moment the Council established an excessive deficit on the basis of Article 126(6) TFEU.[250] A fine, moreover, was already to be introduced by the Council if no effective action had been taken within, at most, six months after the Council had established the existence of an excessive deficit on the basis of Article 126(6) TFEU.[251]

245 To put it in the words of Eniko Gyori, the Hungarian minister for European affairs: 'Nobody wants to reopen Pandora's box unless they want to destroy the European Union'. See quote in Quentin Peel and Peter Spiegel, 'Merkel demands rewrite of EU treaties' *Financial Times* (28 October 2010).

246 Ludlow, 'The Euro Crisis Once Again' (n 220) 11.

247 Ludlow, 'The Euro Crisis Once Again' (n 220) 10; Bastasin (n 22) 220-221.

248 Commission Press Release, 'EU economic governance: the Commission delivers a comprehensive package of legislative measures' (Brussels, 29 September 2010). See also text to n 225 (ch 5).

249 Ludlow, 'The Euro Crisis Once Again' (n 220) 9; Bastasin (n 22) 221-222.

250 Art 4(1) Commission, 'Proposal of 29 September 2010 for a Regulation of the European Parliament and of the Council on the effective enforcement of budgetary surveillance in the euro area' COM (2010) 524 final.

251 Art 1(3) Commission, 'Proposal of 29 September 2010 for a Council Regulation amending Regulation (EC) 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure' COM (2010) 522 final; Art 5(1) COM (2010) 524 final.

Given that France and Germany both had an interest in influencing the work of the task force, a compromise between the two member states was not far away. In the weeks before the task force's final session there were intensive negotiations between Paris and Berlin to find a solution that would satisfy both. They came to a close in the French town of Deauville, on 18 October. That day Merkel and Sarkozy were to meet the Russian President Medvedev in the context of a trilateral security summit.[252] However, they had decided to discuss the future of the currency union between the two of them prior to the summit. During a stroll on the beach the deal was struck.[253] In a joint declaration issued the same day the two leaders set out the contours of their compromise.[254] Concerning budgetary discipline, the imposition of sanctions should become 'more automatic', yet with due respect to 'the role of different institutions and the institutional balance'.[255] 'Acting by QMV', the Council should be empowered to 'impose progressively' sanctions in the form of interest-bearing deposits under the Pact's preventive arm in case of significant deviations of the adjustment path towards the medium-term budgetary objectives.[256] Under the Pact's corrective arm, moreover, there should be 'automatic' sanctions for states that were found by the Council, again 'acting by QMV', to have failed to implement the required corrective measures within six months after the establishment of an excessive deficit.[257]

In return for these concessions to the French, Merkel got them back her desired treaty amendment. Such an amendment was 'needed', the declaration read, for the establishment of a 'robust crisis resolution framework'.[258] It would allow for 'adequate participation of private creditors' and also make it possible to suspend the voting rights of member states 'in case of a serious violation of basic principles of economic and monetary union…'.[259] The amendment was to be adopted and ratified by the member states 'in due time before 2013', so as to have the permanent crisis mechanism up and running when the EFSF ceased to function mid-2013.[260]

The declaration landed like a bombshell in Luxembourg where the task force simultaneously held its final meeting.[261] Conscious of the negotiations taking

252 Ben Hall and Quentin Peel, 'Paris and Berlin seek "reset" with Moscow' *Financial Times* (18 October 2010); Ludlow, 'The Euro Crisis Once Again' (n 220) 11; Bastasin (n 22) 222.
253 Bastasin (n 22) 224.
254 Franco-German declaration, Deauville, 18 October 2010.
255 Franco-German declaration, Deauville, 18 October 2010.
256 Franco-German declaration, Deauville, 18 October 2010.
257 Franco-German declaration, Deauville, 18 October 2010.
258 Franco-German declaration, Deauville, 18 October 2010.
259 Franco-German declaration, Deauville, 18 October 2010.
260 Franco-German declaration, Deauville, 18 October 2010.
261 For extensive discussion of what happened in Luxembourg see Ludlow, 'The Euro Crisis Once Again' (n 220) 11-13; Bastasin (n 22) 219-225. The following discussion is based on these sources.

place between their chiefs in Deauville, Finance Ministers Schäuble and Lagarde had decided not to show up on the occasion. However, upon arrival in Luxembourg the Finnish, Swedish and Dutch finance ministers, as well as Central Bank President Trichet and Commissioner Rehn, were still confident that the Commission's proposals to tighten budgetary rules would be endorsed by the task force. But their mood quickly deteriorated when Jörg Asmussen, Germany's state secretary for financial affairs doing the honours for Schäuble, indicated that his government would side with the French view on the Stability and Growth Pact. President Van Rompuy was immediately aware of the window of opportunity presented by the German change of mind.[262] With the two most important states now in favour of softening the changes to the Pact, and with those still supporting the original Commission proposals clearly in a minority position, he pushed for a report with a somewhat softer tone on fiscal prudence. At the same time the report kept open the possibility of treaty amendment. It stated that the setting up of a crisis resolution framework required 'further work'.[263] As it could lead to treaty amendment, the issue should be left to the European Council.[264]

Coming out of the meeting, stability hawks were furious about what had happened. 'Some states have got cold feet',[265] Dutch Finance Minister Jan Kees de Jager told the press. Central Bank President Trichet even demanded that that his 'discontent' was recorded in an annex to the report. 'The president of the ECB does not subscribe to all elements of this report', it read.[266] Not helpful either for assessing the report on its merits was the fact that it was only published three days later, on 21 October.[267] Having only the French-German Deauville declaration to work with, much of the media pictured the deal as if Merkel had fallen to the knees of Sarkozy.[268] The reality is, however, that her concessions were minor.[269] The declaration stated that the Council would 'act by QMV' when imposing sanctions, but it left unmentioned that the Commission's plan to have the voting rule applied on a reversed basis was still on the table. That Merkel did not insist on having fully automatic sanctions, as some of her political rivals in Germany said she should have done,[270] is understandable. As had already been clear when Waigel pleaded

262 Ludlow, 'The Euro Crisis Once Again' (n 220) 12; Bastasin (n 22) 223.
263 Task Force Report on Economic Governance (n 224) para 57.
264 Task Force Report on Economic Governance (n 224) para 57.
265 Quoted in Peter Ehrlich and Lutz Meier, 'Merkel schont Defizitsünder' *Financial Times Deutschland* (19 October 2010) (translation by the author).
266 Task Force Report on Economic Governance (n 224) Annex 1.
267 Ludlow, 'The Euro Crisis Once Again' (n 220) 14.
268 See eg Ehrlich and Meier, 'Merkel schont Defizitsünder' (n 265); Marcus Walker and Charles Forelle, 'Merkel Cedes Ground in Pact on Debt Rules' *The Wall Street Journal Online* (21 October 2010).
269 Ludlow, 'The Euro Crisis Once Again' (n 220) 12-13; Bastasin (n 22) 223.
270 Quentin Peel, Gerrit Wiesmann and Joshua Chaffin, 'Rift in Germany over EU budget accord' *Financial Times* (22 October 2010).

for automatic sanctions in 1995,[271] this would require treaty amendment. Since Articles 126(11) and (13) TFEU make clear that sanctions can only be imposed on the basis of a vote in the Council, having them applied automatically is currently impossible.[272]

The only real point which the French managed to secure concerned the 'timing' of sanctions.[273] In its proposal the Commission required a euro area state to lodge an interest-bearing deposit the moment the Council issues a recommendation in accordance with Article 121(4) TFEU to take adjustment measures in case it significantly deviates from its medium-term objective.[274] The task force recommended imposing this sanction only after the state concerned has been given the opportunity to take such measures within a period of at most five months from the Council recommendation.[275] Yet, even on the point of timing the French government did not get everything it wanted. Whereas the Deauville declaration stated that under the Pact's corrective arm a state should be required to pay a fine if it failed to take corrective measures within six months after the Council had established the existence of an excessive deficit on the basis of Article 126(6) TFEU, the task force kept open the possibility to shorten the period to three months if this was 'warranted by the situation'.[276]

The German chancellor, on the contrary, returned home from Deauville having secured what she wanted. A permanent crisis mechanism for the currency union – including her desired treaty amendment to make that possible – had the backing of France and it was on the agenda for the European Council meeting of 28-29 October 2010.

271 See text to n 1 and n 314 (ch 3).

272 In fact, the reversed qualified majority voting rule already puts the law under strain. For analysis see Rainer Palmstorfer, 'The Reverse Majority Voting under the "Six-Pack": A Bad Turn for the Union?' 20 ELJ (2014) 186 (arguing it violates the Treaties); Thomas Beukers, 'The Eurozone Crisis and the Legitimacy of Differentiated Integration' in Bruno De Witte, Adrienne Héritier and Alexander H Trechsel (eds), *The Euro Crisis and the State of European Democracy* (EUI 2013) 14 (arguing that reverse majority voting is compatible with the Treaties as it only applies to new 'steps', not to existing ones under the excessive deficit procedure); René Smits, 'Correspondence' (2012) 49 CML Rev 827, 829 (defending reverse majority voting on the basis that any other reading would make Art 136 TFEU 'rather futile').

273 Ludlow, 'The Euro Crisis Once Again' (n 220) 12.

274 Art 3(1) COM (2010) 524 final.

275 Task Force Report on Economic Governance (n 224) para 21. This arrangement has also found its way in to the final version of the Pact. See Arts 6(2) Reg 1466/97 and 4(1) Reg 1173/2011.

276 Task Force Report on Economic Governance (n 224) para 22. This arrangement has also found its way into the final version of the Pact. See Arts 3(4) and 4(1) of Reg 1467/97 and 6(1) Reg 1173/2011.

4.3 Scaling back ambitions

That treaty amendment was on the agenda of the European Council did not mean it was a done deal. The events at Deauville had upset other member states, in particular those in northern Europe that had favoured tougher changes to the Pact. 'We're more or less used to Germany and France cooking things up', one diplomat said, 'but this was really flagrant'.[277] Apart from the dissatisfaction about what had happened in Deauville, there were also real concerns about the political feasibility of treaty change, both as to timing and scope.[278] Merkel wanted the permanent crisis mechanism to be in place before the EFSF would lose its capacity to engage in any new assistance operations on 30 June 2013.[279] With little more than two years left, and judging from past amendment procedures, it would be a race against the clock to have the amendment ratified by all member states in time. Moreover, some heads of state or government still indicated they would have great difficulty in selling treaty change in their domestic political arenas. In particular the United Kingdom's newly-elected Prime Minister David Cameron pointed out his predicament: 'The stability of the eurozone is important for us. But we would not accept anything that involves a transfer of power from Westminster to Brussels'.[280] In the run-up to the European Council meeting Van Rompuy therefore reminded Merkel that even though the deal of Deauville had increased her chances at treaty amendment, the reform would have to be limited in ambition and concise in nature for it to succeed.[281]

Meanwhile, the Council's legal service was busy tackling the question of how such a limited reform could be given shape legally. The idea that eventually triumphed is said to have come from Jean-Claude Piris, the head of the Council legal service who had just left office but was still involved in its business.[282] He suggested resorting to the simplified treaty revision procedure in Article 48(6) TEU. This procedure, which ought to be less time consuming than the ordinary one due to the fact that it does not require an intergovernmental conference or convention,[283] allows the European Council to adopt a decision amending all or part of the provisions of Part III of the TFEU. The decision enters into force as soon as it is approved by the member states in accordance with their national constitutional requirements. Piris thought the

277 Quoted in Joshua Chaffin and Peter Spiegel, 'Franco-German pact divides EU', *Financial Times* (25 October 2010).

278 Ludlow, 'The Euro Crisis Once Again' (n 220) 15-16.

279 See also text to n 191 and n 219 (ch 5).

280 Quoted in Peel and others, 'Germany confident of "crisis resolution" deal' (n 220).

281 Ludlow, 'The Euro Crisis Once Again' (n 220) 16-17.

282 Ludlow, 'The Euro Crisis Once Again' (n 220) 17.

283 See for a more extensive comparison of the ordinary and simplified revision procedures Bruno De Witte, 'Treaty Revision Procedures after Lisbon' in Andrea Biondi, Piet Eeckhout and Stefanie Ripley (eds), *EU law after Lisbon* (OUP 2012) 117ff.

procedure could be used to insert a limited provision into the TFEU, no longer than two or perhaps three sentences, making clear that the members of the currency union could conclude a separate treaty to establish a rescue mechanism.[284]

Merkel was captivated by the idea, but also realised it would force her to scale down her ambitions.[285] Given that Article 48(6) TEU indicates that the simplified procedure may not be used to *increase* the competences of the Union, she would have to let go of depriving member states of their voting rights within the Council in case of serious violations of the budgetary rules. Yet, in the days prior to the meeting the chancellor did not put all her cards on the table.[286] She stuck to the voting-rights plan and, conscious of the fact that the issue of treaty amendment would lose momentum if the task force's recommendations would be implemented in a piecemeal fashion, insisted that the European Council could only approve of the task force's report in its entirety. When she spoke to the *Bundestag* the day before the meeting, she said:

> 'Tomorrow and the day after tomorrow, at the summit of European Heads of State and Government, I will insist that President Van Rompuy receives a precise mandate of the European Council on the basis of which he can, in close consultation with the members of the European Council, develop a proposal for the necessary, strictly limited Treaty changes and concrete options for a durable, robust crisis resolution framework and present them to the European Council in March 2011 at the latest. I say on behalf of the Federal Government and our country as a whole without ambiguity: to me, the consent to the report of the Van Rompuy-Task Force and the precise mandate of Herman Van Rompuy are inseparable. They form a package.'[287]

The strategy paid off. In its conclusions the European Council endorsed the task force's report in its entirety.[288] The conclusions then stated that the heads of state and government had agreed 'on the need for Member States to establish a permanent mechanism to safeguard financial stability of the euro area as a whole' and that they had invited President Van Rompuy 'to undertake consultations with the members of the European Council on a *limited* treaty change *to that effect*, not modifying Article 125 (no-bailout clause)'.[289] Although there was therefore no specific mention yet that such a limited amendment should be realised through the simplified revision procedure in Article 48(6) TEU, the conclusions were already hinting at this strategy by

284 Ludlow, 'The Euro Crisis Once Again' (n 220) 17.
285 Ludlow, 'The Euro Crisis Once Again' (n 220) 17.
286 Ludlow, 'The Euro Crisis Once Again' (n 220) 15.
287 Regierungserklärung von Bundeskanzlerin Merkel zum EU-Gipfel in Brüssel und zum Gipfel der G20-Staaten in Seoul, Berlin, 27 October 2010 (translation by the author).
288 European Council, Conclusions, Brussels, 28-29 October 2010, para 1.
289 European Council, Conclusions, Brussels, 28-29 October 2010, para 2 (emphasis added).

indicating that the *heads of state* had come to terms with the fact that *states* needed to establish a permanent mechanism for the currency union. As this precluded any increase of Union competences, the route to Article 48(6) TEU was open. Besides treaty amendment, the European Council also announced that the Commission would start working on 'the general features' of the mechanism, including '*the role of the private sector*'.[290] A final decision on the amendment and the features of the mechanism would be taken at the next meeting in December so as to leave enough time for the ratification process to be finalised no later than mid-2013.

Whereas Merkel managed to find support for treaty change as well as private sector involvement, her plan to suspend voting rights met with great resistance. 'It is incompatible with the idea of a limited treaty change', Commission President Barroso argued upon arrival at the meeting, 'and frankly speaking it is not realistic'.[291] Papandreou too argued that he was 'opposed to any discussion about the removal of voting rights'.[292] The chancellor therefore let go of it, at least for the moment.[293] It would not be covered by the amendment, yet the European Council conclusions did state that President Van Rompuy still 'intended' to examine 'the issue of the right of euro area members to participate in decision making in EMU-related procedures in the case of a permanent threat to the stability of the euro area as a whole'.[294]

'I am, on the whole, quite satisfied', Merkel told the press after the meeting.[295] The same was not true for Central Bank President Trichet. He had attended the meeting and had warned the members of the European Council of the risks of involving the private sector in the functioning of the permanent crisis mechanism.[296] Such involvement would not further the cause of securing financial stability. On the contrary, offering investors the prospect of having to participate in a debt restructuring at a time in which the markets were already in disarray would do more harm than good to the single currency. But markets were not the only factor national leaders had to take into account, as Merkel civilly explained: 'The president of the European Central Bank looks at everything to calm the markets….We support him on this but we also look

290 European Council, Conclusions, Brussels, 28-29 October 2010, para 2 (emphasis added).
291 Quoted in Joshua Chaffin and Peter Spiegel, 'EU leaders rebuff Merkel plan' *Financial Times* (29 October 2010).
292 Quoted in Chaffin and Spiegel, 'EU leaders rebuff Merkel plan' (n 291).
293 According to an anonymous observer the issue of voting rights was 'essentially just a bargaining chip on Germany's part to get what they really want'. See 'EU leaders to give green light to tweak treaty' *EUobserver* (28 October 2010) <euobserver.com/institutional/31154> accessed 14 April 2017. See also Schimmelfennig (n 6) 187.
294 European Council, Conclusions, Brussels, 28-29 October 2010, para 2.
295 Quoted in Joshua Chaffin, Peter Spiegel and Quentin Peel, 'Merkel's horse trading secures fragile triumph' *Financial Times* (30 October 2010).
296 Peter Spiegel, 'Trichet warns on bail-out risk' *Financial Times* (30 October 2010); Ludlow, 'The Euro Crisis Once Again' (n 220) 20-23; Bastasin (n 22) 225-226.

at our people and their very legitimate belief they should not bear the cost'.[297] Yet, there was more to the involvement of the private sector than just trying to appease public opinion. The demand that investors should bear part of the burden also reflected the oppositional dimension to the solidary behaviour of member states, united as they were by the prospect that if one of them fell prey to the markets others would follow, and the realisation that they were bound together by a common destiny.[298]

But Trichet was right. The call for private sector involvement was ill-timed and terrified markets. Soon politicians found themselves busy doing damage control.[299] In a declaration issued on 12 November the ministers of finance of France, Germany, Italy, Spain and the United Kingdom indicated that 'Whatever the debate about the future permanent crisis resolution mechanism, and the potential for private sector-involvement, we are clear that this does not apply to any outstanding debt and any programmes under current instruments'.[300] On 28 November the Eurogroup followed up on that promise when it adopted a statement setting out the main features of the permanent mechanism.[301] Any private sector involvement would be 'fully consistent with IMF policies'.[302] To 'facilitate' such a process standardised collective action clauses (CACs), making it possible to force creditors to participate in a debt restructuring if a majority of bond holders decides so, would be included in 'all new euro area government bonds, starting in June 2013'.[303] Before that date the private sector arrangements would have no effect.[304]

But the clarification came too late for Ireland. Already under pressure from the markets because of its ailing banking sector and gravely deteriorated fiscal position, the uncertainty surrounding private sector involvement was the last drop that made the cup run over. On the very same day that the Eurogroup issued its statement, ministers of finance also announced that Ireland would receive € 85 billion in financial assistance.[305] Later in the crisis, political leaders would even backtrack on their promise not to involve the private sector

297 Quoted in Spiegel, 'Trichet warns on bail-out risk' (n 296).

298 On 'oppositional solidarity' see also text to n 35 (ch 1).

299 Ralph Atkins and others, 'A punt too far' *Financial Times* (20 November 2010); Peter Ludlow, 'Doing Whatever is Required? The European Council of 16-17 December 2010 (Eurocomment Briefing Note Vol 8, No 4, March 2011) 10; Bastasin (n 22) 227.

300 The relevant part of the statement can be found in Peter Spiegel and David Oakley, 'EU ministers move to calm bond markets' *Financial Times (FT.Com)* (12 November 2010).

301 Eurogroup statement, Brussels, 28 November 2010.

302 Eurogroup statement, Brussels, 28 November 2010. This meant in particular that any restructuring of debt would only be considered if a member state were considered 'insolvent' on the basis of an analysis of the sustainability of its debt.

303 Eurogroup statement, Brussels, 28 November 2010.

304 This arrangement eventually found its way into the ESM Treaty, although the deadline for including CACs in government bonds was brought forward to 1 January 2013. See Recitals 11-12 and Art 12(3) ESM Treaty.

305 Statement by the Eurogroup and ECOFIN ministers, Brussels, 28 November 2010. See also text to n 194 (ch 5).

before 2013 and in relation to outstanding debt. Although they were at pains to stress that the Greek situation was 'exceptional and unique', the involvement of private creditors in the second aid package for Greece, decided on at the summit of 21 July 2011 and expanded at the one of 26 October,[306] was effectuated in March 2012, partly through the retroactive inclusion of collective action clauses in Greek government bonds.[307]

4.4 The permanent mechanism

The draft treaty amendment that had been devised under the guidance of Van Rompuy and which the Belgian government presented to the European Council at its meeting of 16 and 17 December 2010 was indeed limited. On paper, that is. Making use of the simplified amendment procedure in Article 48(6) TEU, the proposal suggested the European Council would adopt a decision inserting a third paragraph into Article 136 TFEU, which deals specifically with the members of the currency union. It read:

> 'The Member States whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the euro area as a whole. The granting of any required financial assistance under the mechanism will be made subject to strict conditionality.'[308]

Consisting of only two sentences, the amendment sought to align the Treaties with the transformation of the single currency's stability conception which had been set in motion through the change in the Founding Contract that had been initiated in February 2010. Carefully crafted, it set out the two most important conditions that the heads of state and government had attached to the shift in solidarity in the preceding months. The first was that assistance could only be granted if it was 'subject to strict conditionality'. The second reflected Merkel's insistence that financial support had to be *ultima ratio*. Although the amendment did not literally use this Latin term, the requirement that the permanent mechanism could only be activated 'if indispensable to safeguard the stability of the euro area as a whole' made equally clear that assistance had to be a last resort.[309]

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306 Statement by the Heads of State or Government of the euro area and EU institutions, Brussels, 21 July 2011, paras 5-7; Euro Summit statement, Brussels, 26 October 2011, paras 10-16.

307 See also text to n 200 (ch 5).

308 European Council, Conclusions, Brussels, 16-17 December 2010, Annex 1.

309 Peter Ludlow states in this regard that in the run-up to the European Council meeting the German government had pushed for the Latin phrase to be incorporated in the amendment, but that this met with resistance from other governments. Considering that the notion of 'indispensability' conveyed the same message, Merkel eventually consented to the proposal. See Ludlow, 'Doing Whatever is Required?' (n 299) 14, 18.

At least as interesting as the text of the amendment itself, was the preamble to the proposed Decision. In May 2010 the United Kingdom's outgoing Labour government had consented to the use of Article 122(2) TFEU to establish the EFSM.[310] In the eyes of Eurosceptic Conservatives, however, this had been a major mistake, making British taxpayers cough up money – via the Union's budget – for rescuing a currency union they had deliberately decided to stay out of.[311] Certainly, only weeks earlier they had participated in the rescue of Ireland with a bilateral loan, but given the strong financial ties to the Irish economy this had been done out of self-interest. According to Finance Minister George Osborne the separate loan reflected that 'we are not part of the euro….but Ireland is our closest economic neighbour'.[312] Yet, now that treaty amendment was on the table Prime Minister Cameron sought to exclude a recurrence of the events in May.

In the run-up to the European Council meeting it became clear, however, that other governments were not keen on expanding the scope of the amendment beyond the absolute minimum to cater for British concerns.[313] A compromise was eventually found by stating in the conclusions as well as in the preamble to the draft Decision that the European Council had agreed that since the permanent mechanism was 'designed to safeguard the financial stability of the euro area as a whole, Article 122(2) of the TFEU will no longer be needed for such purposes'.[314] When Cameron defended his bargain in the House of Commons a few days after the meeting, on 20 December, he argued:

> 'Britain is not in the euro and we are not going to join the euro, and that is why we should not have any liability for bailing out the eurozone when the new permanent arrangements come into effect in 2013. In the current emergency arrangements established under article 122 of the treaty, we do have such a liability. That was a decision taken by the previous Government, and it is a decision that we disagreed with at the time. We are stuck with it for the duration of the emergency mechanism, but I have been determined to ensure that when the permanent mechanism starts, Britain's liability should end, and that is exactly what we agreed at the European Council ... Both the Council conclusions and the decision that introduces the treaty change state in black and white the clear and unanimous agreement that from 2013 Britain will not be dragged into bailing out the eurozone.'[315]

The picture painted by Cameron was far too positive, for two reasons in particular. The first concerned the fact that the compromise on Article 122(2)

310 See text to n 147 (ch 5).
311 Ludlow, 'Doing Whatever is Required?' (n 299) 2, 15.
312 Quoted in George Parker, 'UK to lend €7bn to Ireland' *Financial Times (FT.Com)* (22 November 2010).
313 Ludlow, 'Doing Whatever is Required?' (n 299) 15.
314 European Council, Conclusions, Brussels, 16-17 December 2010, para 1 and Annex 1.
315 HC Deb 20 December 2010, cols 1187-88.

TFEU had been included in the draft decision's preamble, not its operative part. It had therefore no legally binding force. Second, even politically the agreement was less solid than Cameron made it believe. During the European Council meeting Commission President Barroso had turned against the compromise as he had realised that the consequence would be that any future assistance operation would be entirely intergovernmental, minimising the influence of his own institution and that of the European Parliament.[316] After setting out that the European Council had agreed that Article 122(2) TFEU '*will no longer be needed* for such purposes', the conclusions and the preamble to the draft decision therefore continued by saying the heads of state and government – not the Commission president (!) – had agreed that it '*should not be used* for such purposes'.[317] This specification may have seemed insignificant at the time, but this was not so. As it kept ambiguous the use of Article 122(2) TFEU for euro area rescue operations, it left open the possibility to resort to the provision if needed. And as chapter 7 will show, that is exactly what would happen in the summer of 2015.[318]

In line with Article 48(6) TEU, after the European Council had approved of the draft decision it was subsequently presented to the Bank, the Commission and the Parliament for an opinion.[319] All three opinions are interesting from a legal perspective, yet for now it suffices to single out the one from the Bank.[320] Earlier, on 28 October, the European Council had argued that the envisaged amendment should not alter the scope of the no-bailout clause.[321] That statement formed the culmination of intense negotiations in which especially the German chancellor had insisted on treaty amendment so as to avoid the permanent mechanism falling foul before the *Bundesverfassungsgericht*, whilst at the same time trying to stay as close as possible to the single

316 Ludlow, 'Doing Whatever is Required?' (n 299) 15, 19. Note, however, that under the intergovernmental construct that was eventually chosen, the ESM, the Commission has actually retained considerable influence due to its heavy involvement in its operation. See also text to n 348 (ch 5).

317 European Council, Conclusions, Brussels, 16-17 December 2010, para. 1 and Annex 1 (emphasis added).

318 See text to n 162 (ch 7).

319 Opinion of 17 March 2011 of the European Central Bank on a Draft European Council Decision Amending Article 136 of the Treaty on the Functioning of the European Union with regard to a stability mechanism for member states whose currency is the euro [2011] OJ C 140/8 (ECB Opinion on Article 136(3) TFEU); Commission, 'Opinion of 15 February 2011 on the Draft European Council Decision amending Article 136 of the Treaty on the Functioning of the European Union with regard to a stability mechanism for member states whose currency is the euro' COM(2011)70 final; Resolution of the European Parliament of 23 March 2011 on the Draft European Council Decision amending Article 136 of the Treaty on the Functioning of the European Union with regard to a stability mechanism for member states whose currency is the euro [2011] OJ C 247 E/22 (European Parliament Resolution on Article 136(3) TFEU).

320 For a discussion of the opinion of the European Parliament see text to n 359 (ch 5).

321 See text to n 289 (ch 5).

currency's original stability set-up; too great a departure from it could equally incur the wrath of Karlsruhe. By stressing that the no-bailout clause would not be changed by Article 136(3) TFEU, the statement also seemed to want to avoid any doubts about the legality of already existing assistance funds, in particular the 'Greek' facility and the EFSF. At the same time, however, the European Council thereby denied the change in the Contract that had been initiated on 11 February. Legally, this begged the question why the Treaty should be amended in the first place. Even Karlsruhe would surely not require a treaty amendment only to make explicit that which had always been possible. Nonetheless, in its opinion the Bank followed the European Council's line of reasoning as it argued that Article 136(3) TFEU only 'helps to explain, and thereby confirms, the scope of Article 125 TFEU…'.[322]

Having received the opinions, the European Council adopted the Decision, numbered 2011/199, at its meeting of 25 March 2011.[323] Within just months it had managed to agree on treaty change. Nonetheless, Article 48(6) TEU determines that such a decision will only enter into force after all member states have approved it in line with their constitutional requirements. The Decision itself set a target date for the completion of these national approval procedures: 1 January 2013.[324] But with each state having the ability to throw a spanner in the works, it proved to be an overtly ambitious date. For more than two years, the Czech Republic failed to give the Decision its blessing. Both chambers of its parliament approved the Decision, yet its Eurosceptic President Václav Klaus refused to sign it, considering the permanent mechanism for which the Decision sought to clear the way 'horrifying and absurd'.[325] The Czech position only changed when Klaus was replaced as president by Miloš Zeman in March 2013. Less than a month later, on 3 April 2013, he signed the Decision, which subsequently entered into force on 1 May.[326]

Now, Article 136(3) TFEU itself does not provide the legal basis for the permanent crisis mechanism. It could not have done so without making it impossible to use the simplified revision procedure in Article 48(6) TEU, which excludes its use in case of an increase in Union competences. Article 136(3) TFEU takes account of that limit by making clear that the member states in the

322 ECB Opinion on Article 136(3) TFEU, para 5.

323 European Council Decision 2011/199/EU of 25 March 2011 amending Article 136 of the Treaty on the Functioning of the European Union with regard to a stability mechanism for Member States whose currency is the euro [2011] OJ L 91/1 (European Council Decision 2011/199). See also European Council, Conclusions, Brussels, 25-26 March 2011, para 16.

324 Art 2 European Council Decision 2011/199.

325 Quoted in Tomas Dumbrovsky, *Constitutional Change Through Euro Crisis Law: "Czech Republic"* (EUI, February 2014) (references omitted).

326 Art 2 European Council Decision 2011/199 stipulates that failing the deadline of 1 January 2013, it would enter into force on the first day of the month following receipt by the Secretary General of the Council of the last of the notifications of approval. The Czech Notification was received on 23 April 2013.

currency union can establish a permanent mechanism, not the Union itself. Parallel to the amendment of the TFEU, the members of the currency union therefore also worked on a separate treaty to establish the permanent fund, called European Stability Mechanism (ESM).[327] The Treaty was initially signed on 11 July 2011, but soon it had to be revised due to the modifications that the political leaders had decided on at their summits of 21 July and 9 December 2011.[328] A second version of the Treaty was therefore signed on 2 February 2012.[329]

As with the amendment of the TFEU, the ratification process was far from easy. On 9 December 2011 the leaders in the currency union had decided to bring forward the deadline for the Treaty's entry into force to July 2012.[330] Article 48(1) of the Treaty makes clear, however, that it will only enter into force when it has been ratified by states representing at least 90% of the total subscriptions to the ESM's capital stock, which are determined in line with the capital key of the European Central Bank.[331] This meant that ratification difficulties in large states like Italy, France and Germany – each having a capital contribution exceeding 10% – could prevent the ESM from becoming operational. And they materialised in Germany where opponents challenged the Treaty before the *Bundesverfassungsgericht*. In chapter 7 this challenge will receive careful attention,[332] for now it suffices to point out that on 12 Septem-

327 See also European Council conclusions of 16-17 December 2010, para 3.

328 The updates to the ESM Treaty concerned new assistance instruments, more flexible pricing, a link with the fiscal compact, a new emergency voting procedure, private sector involvement and the timing of capital contributions. See also text to n 199 (ch 5) and text to n 93 (ch 6).

329 Treaty establishing the European Stability Mechanism, Brussels, 2 February 2012. Some argue that the ESM's intergovernmental nature is simply the result of what historical institutionalists call 'path-dependence'. Once the EFSF was established it limited subsequent options for reform, as a result of which its permanent successor (the ESM) became intergovernmental as well. See Gocaj and Meunier (n 15) 248-250; Bruno De Witte, *Using International Law In the Euro Crisis: Causes and Consequences* (Arena Working Paper No 4, June 2013) 7. Others like Christopher Bickerton, Dermot Hodson and Uwe Puetter argue that the ESM genuinely evidences a greater willingness to support (intergovernmental) '*de novo* bodies' instead of endowing 'traditional supranational institutions' with greater powers. See Christopher J Bickerton, Dermot Hodson and Uwe Puetter, 'The New Intergovernmentalism: European Integration in the Post-Maastricht Era' (2015) 53 JCMS 703, 713-714.

330 Statement by the euro area Heads of State or Government, Brussels, 9 December 2011. On 30 March 2012 the Eurogroup decided that the EFSF would continue to fund the existing programmes for Portugal, Ireland and Greece, as a result of which the combined lending capacity of the EFSF and ESM became €700bn. See Statement of the Eurogroup, Brussels, 30 March 2012.

331 See Art 11 and Annex I ESM Treaty. Note, however, that the contribution key in Annex I contains a temporary correction to take into account the economic condition of certain states. It shall expire twelve years after the adoption of the euro by the ESM member concerned. See Art 42(1) ESM Treaty. New members of the ESM may also qualify for a temporary correction under Art 42(2) ESM Treaty.

332 See text to n 200 (ch 7).

ber 2012 the German constitutional court refused to issue a temporary injunction preventing Germany from ratifying the Treaty,[333] provided it was ensured that Germany's payment obligations would not exceed the amount of € 190bn that was specifically mentioned in the Treaty.[334] Moreover, none of the provisions on the inviolability of documents, professional secrecy and immunities of persons should bar detailed information of the *Bundestag*.[335] On 27 September, the contracting states provided this assurance through the adoption of an interpretative declaration.[336] That same day Germany deposited its instrument of ratification, thereby enabling the Treaty's entry into force.

Given that the ESM has its legal basis in a separate treaty, it forms an international organisation under international law with its seat in Luxembourg.[337] Contrary to the EFSF, it does not raise funds on the back of state guarantees but instead functions on the basis of capital stock worth € 700bn, which is divided into 'paid-in shares' and 'callable shares' and which should ensure a maximum lending capacity of € 500bn.[338] Similar to the EFSF, the ESM can support states using several instruments, ranging from 'ordinary' loans, precautionary assistance, intervention on primary and secondary bond markets, to the (indirect) recapitalisation of financial institutions.[339] In line with the change in the Contract initiated on 11 February 2010, such support can only be granted if it is indispensable to safeguard financial stability and subject to strict conditionality.[340] This conditionality is laid down in a Memorandum of Understanding that is concluded between the ESM and the recipient state. Since the entry into force of the 'Two-Pack' – two Union Regulations that further strengthen economic and budgetary surveillance for states in the currency union[341] – the requirement of conditionality is also laid down in

333 BVerfG, Case 2 BvR 1390/12 of 12 September 2012.
334 See Art 8(5) and Annex II ESM Treaty.
335 See Arts 32(5), 34 and 35(1) ESM Treaty.
336 Declaration on the European Stability Mechanism, Brussels, 27 September 2012.
337 Arts 1(1) and 31 ESM Treaty.
338 Art 8(1)-(2) and Recital 6 ESM Treaty.
339 Arts 14-19 ESM Treaty. For an in-depth analysis of the ESM instrument of indirect recapitalization see Vestert Borger, 'The European Stability Mechanism: a crisis tool operating at two junctures' in Matthias Haentjens and Bob Wessels (eds), *Research Handbook on Crisis Management in the Banking Sector* (Edward Elgar 2015) 150ff. Since December 2014 the ESM also has the ability to grant direct recapitalization assistance. See also text to n 165 (ch 6).
340 Arts 3 and 12(1) ESM Treaty.
341 Regulation (EU) 472/2013 of the European Parliament and the Council of 21 May 2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability [2013] OJ L 140/1 (Reg 472/2013); Regulation (EU) 473/2013 of the European Parliament and the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area [2013] OJ L 140/11 (Reg 473/2013).

Union law itself. A state requesting financial assistance from the ESM needs to prepare a macroeconomic adjustment programme that requires approval by the Council.[342]

All major decisions of the ESM, such as those on the granting of assistance or capital calls, require, in principle, the mutual agreement of the Board of Governors,[343] which is composed of the finance ministers of participating states and thus *de facto* equals the Eurogroup.[344] Below the governors is the Board of Directors, to which each governor may appoint one director.[345] The directors need to ensure that the ESM is run in accordance with its founding treaty and bylaws and they may also exercise those powers that have been delegated to them by the Board of Governors.[346] Meetings of the Board of Directors are chaired by the ESM's managing director, who may also participate in those of the governors.[347]

342 Arts 6(1)-(2) Reg 472/2013. The requirement to prepare an adjustment programme also applies to states receiving assistance from the EFSM, EFSF, IMF or any (third) state. Art 7(12) makes clear that states do not have to prepare an adjustment programme if they receive precautionary financial assistance, loans for the recapitalisation of financial institutions, or benefit from other new ESM instruments not requiring an adjustment programme. The Council will, however, still have to approve 'the main policy requirements' that are included in the conditionality attached to assistance. Moreover, Art 2(3) indicates that states receiving precautionary assistance will be subject to 'enhanced surveillance'. In line with Arts 2(5) and 7(12) the Commission has published two lists of instruments: one on instruments not requiring a macroeconomic adjustment programme and one on instruments qualifying as precautionary assistance. See Commission Communication of 16 October 2013 from the Commission concerning two lists of financial assistance instruments under Regulation (EU) 472/2013 [2013] OJ C 300/1.

343 Art 5(6) ESM Treaty. Note, however, that Art 4(4) ESM Treaty allows decisions to grant and implement assistance to be taken on the basis of an 'emergency voting procedure'. In that case a decision requires a qualified majority of 85% of the votes cast. Decisions that require a normal qualified majority are set out in Art 5(7) ESM Treaty. Art 4 ESM Treaty determines how voting rules (unanimity, qualified majority, simple majority) should be applied.

344 Art 5(1) ESM Treaty. Each state shall also appoint an alternate governor, who can act on the governor's behalf when he is not present. Art 5(2) ESM Treaty states that the Board of Governors may decide to be presided by the president of the Eurogroup or to elect another chairperson from among its members. The economic and monetary affairs commissioner as well as the ECB president may participate as observers in meetings of the Board of Governors. The same applies to representatives of states outside the currency union that participate in assistance operations alongside the ESM on an *ad hoc* basis. See Arts 5(3)-(4) ESM Treaty.

345 Art 6(1) ESM Treaty. Governors may also appoint one alternate director which may act on the director's behalf when he is not present. The economic and monetary affairs commissioner as well as the ECB president may appoint one observer. The same applies to representatives of states outside the currency union that participate in assistance operations alongside the ESM on an *ad hoc* basis. See Arts 6(2)-(3) ESM Treaty.

346 Arts 5(6)(m), 6(5) and 6(6) ESM Treaty.

347 Art 7 ESM Treaty.

Union institutions are heavily involved in the functioning of the ESM as well.[348] The contracting states have empowered the Court to decide any dispute on the interpretation or application of the ESM Treaty which arises between the ESM and one of its members or between such members and which cannot be definitively settled by the Board of Governors.[349] The Commission and the Bank are closely involved too. In liaison with the Bank, the Commission has to assess the existence of risks to financial stability as well as a state's debt sustainability and financing needs if the ESM receives a request for assistance.[350] Moreover, it has to negotiate with the recipient state, and again in liaison with the Bank, the Memorandum of Understanding detailing the conditionality attached to assistance.[351] Once such a Memorandum has been approved by the Board of Governors the Commission also has to sign it on behalf of the ESM and subsequently monitor a state's compliance with it in liaison with the Bank.[352]

5 Conclusion

The importance of what happened on 11 February 2010 is impossible to overestimate. In a period of extreme uncertainty and market turmoil, and without a toolbox to deal with the situation, political leaders initiated a change in the Union's Founding Contract by jointly committing themselves to safeguarding financial stability. In so doing, they laid the basis for a transformation of the currency union's set-up, characterised by a widening of its stability conception. This, in turn, led to a shift in solidarity among the member states, a shift that put huge pressure on the law which needed time and action to adjust.

The panic and uncertainty that characterised the crisis during its first years may have subsided, but over time the solidarity that the members of the currency union will be asked to display in support of their currency is likely to evolve further. Two possible changes should be singled out. The first would result from a further shift towards positive solidarity, putting even greater pressure on the no-bailout clause. Over the past years, several reports have

348 In so doing, the ESM continues a practice that had already started with the EFSF. On 20 June 2011 the representatives of the governments of the Member States authorized the Contracting Parties to request the Commission and the ECB to perform the tasks provided for in the Treaty. See Decision of the Representatives of the Governments of the Member States of the European Union, Brussels, 20 June 2011, 12114/11; Recital 10 ESM Treaty. A similar request was made in relation to the EFSF on 10 May 2010. See Decision of the Representatives of the Governments of the 27 EU Member States, 10 May 2010, Brussels, 9614/10.

349 Recital 16 and Art 37(3) ESM Treaty.

350 Art 13(1) ESM Treaty.

351 Art 13(3) ESM Treaty.

352 Arts 13(4) and 13(7) ESM Treaty.

been published that investigate possibilities to strengthen the single currency's architecture. One of them has been prepared under the guidance of former European Council President Van Rompuy and was published in December 2012. Entitled 'Towards a Genuine Economic and Monetary Union', it calls for the creation of an 'insurance mechanism' in the medium term.[353] Contrary to the ESM, it should not serve as a crisis tool but as a 'shock absorber' that improves the currency union's 'resilience' by 'cushioning' adverse economic events that cannot be handled by states on their own.[354] Over time, it should be linked to a 'fiscal capacity' for the currency union based on 'common debt issuance'.[355] An even more recent report – published in June 2015 and written by Commission President Juncker in close cooperation with his peers at the European Council, the Parliament, the Bank and the Eurogroup – repeats the call.[356] If and to the extent that such debt issuance would be based on the joint and several liability of states,[357] it would lead to an even greater degree of positive solidarity between them. Indeed, under the ESM a state's liability does not go beyond its portion of the authorised capital stock.[358]

The second change is more fundamental as it would require a further modification of the single currency's stability conception. On 11 February 2010 leaders committed themselves to securing the currency union's financial stability, a commitment that eventually led to the establishment of the ESM. Yet, what would happen if assistance needs to be given to secure *political* stability? In its opinion on the European Council Decision introducing Article 136(3) into the TFEU, the European Parliament touched on the question. It stressed that the ESM involved all member states taking part in the single currency, even those 'whose economy may be seen as not "indispensable" for the purposes of safeguarding the euro area as a whole'.[359] During the last years of the crisis the issue has become increasingly relevant, especially in the context of the Cypriot rescue package of € 10bn in March 2013 and the

353 Herman Van Rompuy, 'Towards a Genuine Economic and Monetary Union' (Brussels, 5 December 2012) 9-12 (Towards a Genuine EMU Report December 2012).

354 Towards a Genuine EMU Report December 2012 (n 353) 11-12

355 Towards a Genuine EMU Report December 2012 (n 353) 12.

356 Jean-Claude Juncker, 'Completing Europe's Economic and Monetary Union' (European Commission, June 2015) 14-15. For a more general analysis of the report see Stefaan Van den Bogaert and Armin Cuyvers, 'Of Carrots and Sticks: What Direction to Take for Economic and Monetary Union?' in Bernard Steunenberg, Wim Voermans and Stefaan Van den Bogaert (eds), *Fit for the Future?: Reflections from Leiden on the Functioning of the EU* (Eleven International Publishing 2016) 133-139.

357 Common debt issuance does not necessarily require joint and several liability. In its Green paper on 'stability bonds', published in November 2011, the Commission discusses several options for the joint issuance of debt, one of which does not require joint and several guarantees. See Commission, 'Green paper of 23 November 2011 on the feasibility of introducing Stability Bonds' COM (2011) 818 final.

358 Art 8(5) ESM Treaty. The question whether a state's liability under the ESM is indeed limited to this portion has been subject to further scrutiny by the *BVerfG*. See text to n 332 (ch 5).

359 Point 6 European Parliament Resolution on Article 136 TFEU.

third assistance programme for Greece of € 86 billion in August 2015. Admittedly, these assistance operations were still carried out with the purpose of maintaining financial stability. And the concern for financial stability is indeed still a very real one, even though the height of the crisis is over. Yet, the need to secure political stability has increasingly come to the fore.

Greece's case is telling. When leaders were discussing the third aid package for Greece in July 2015, they had become increasingly sceptical of the operation. Earlier that month, on 5 July, the Greek people had rejected the policy conditionality attached to the disbursement of the final tranche of the second loan package in a referendum called by the newly-elected Prime Minister Tsipras.[360] A growing body of opinion was saying that it would therefore perhaps be best for the state to return to the Drachma, especially now that the currency union was better capable of withstanding shocks. But European Council President Tusk reminded the public of the consequences of having a failed state at the Union's external borders: 'Our inability to find agreement may lead to the bankruptcy of Greece and the insolvency of its banking system. And for sure, it will be most painful for the Greek people. I have no doubt that this will affect all Europe also in the geopolitical sense. If someone has any illusion that it will not be so, they are naive'.[361]

Tusk's appeal to political stability was not the first. Ever since the start of the crisis, leaders have referred to it in order to justify assistance operations. Merkel has probably done it most forcefully when she appeared in the *Bundestag* on 19 May 2010 to defend her consent to a rescue fund for the currency union at large: 'If the euro falls, Europe falls' (*Scheitert der euro, dann scheitert Europa*).[362] But a joint commitment of similar importance as the one of 11 February 2010 to financial stability is still lacking, at least on paper. Not to mention its penetration into the law.

360 Henry Foy and Stefan Wagstyl, 'Greece's eurozone future in doubt after decisive No victory' *Financial Times (FT.Com)* (6 July 2015).

361 Remarks by President Donald Tusk after the Euro Summit of 7 July 2015 on Greece, Brussels, 7 July 2015.

362 Regierungserklärung von Bundeskanzlerin Merkel zu den Euro-Stabilisierungsmassnahmen, Berlin, 19 May 2010.

6 Contractual change and Central Bank action

1 INTRODUCTION

Not only the member states should be given credit for the survival of the single currency. The European Central Bank deserves credit too. Throughout the crisis it resorted to 'unconventional' measures that have proven crucial for the stability of the currency union, whether it concerns 'enhanced credit support' for banks or purchases of government bonds. This has also given rise to new analyses of the Banks's role and position. An interesting one is given by Thomas Beukers.[1] Contrary to conventional studies concentrating on central bank *independence*,[2] he studies the Bank's actions from the perspective of central bank *intervention*. Due to the crisis, he argues, the relationship between the Bank and the member states has changed profoundly. Control over measures such as the easing of collateral requirements for banks,[3] emergency liquidity support (ELA),[4] or government bond purchases puts the Bank in a powerful position, enabling it to exercise considerable influence over the policies carried out by states, 'individually' and 'collectively'.[5] By making implementation of these measures (*de facto*) 'conditional' on economic and institutional reforms, it can 'pressure' them into a particular 'course of action'.[6]

▪ This chapter contains and/or builds on previously published work by the author. See especially Vestert Borger and Armin Cuyvers, 'Het Verdrag inzake Stabiliteit, Coördinatie en Bestuur in de Economische en Monetaire Unie: de juridische en constitutionele complicaties van de eurocrisis' (2012) 60 SEW 370; Vestert Borger, 'The European Stability Mechanism: a crisis tool operating at two junctures' in Matthias Haentjens and Bob Wessels (eds), *Research Handbook on Crisis Management in the Banking Sector* (Edward Elgar 2015) 150; Vestert Borger, 'Outright Monetary Transactions and the Stability Mandate of the ECB: *Gauweiler*' (2016) 53 CML Rev 139.

1 Thomas Beukers, 'The New ECB and its Relationship with the Eurozone Member States: Between Central Bank Independence and Central Bank Intervention (2013) 50 CML Rev 1579.

2 See text to n 162 (ch 3).

3 See also text to n 41 (prologue).

4 See text to n 306 (ch 4).

5 Beukers (n 1) 1604.

6 Beukers (n 1) 1604. Illustrative is the example of the ECB's control of ELA support in the case of Cyprus, discussed in ch 4 (see text to n 310). For a different view see Frank Schimmelfennig, 'Liberal intergovernmentalism and the euro area crisis' (2015) 22 Journal of European Public Policy 177, 188: '[T]he ECB has, of course, made a major contribution to

The claim that the crisis has led to greater intervention by the Bank in the policies of member states is undoubtedly true. Some scholars, however, go into overdrive, claiming that the Bank has been 'calling the shots',[7] or that it has risen to power due to the 'collective abdication of Eurozone governments'.[8] Careful scrutiny of its actions, in particular its government bond purchases, tells a different, more nuanced story. One that shows that these purchases are intrinsically linked to the normative solidarity displayed by the member states.

Since the Bank's mandate and constitutional position ultimately rest on the Founding Contract between the member states, it could not intervene in bond markets without a prior change in this Contract through which states committed themselves to a different currency union based on a broader stability conception. Only such a contractual change, and confirmation of it through concrete action, could provide the necessary political cover for bond purchases that pushed the boundaries of the Bank's original mandate. At the same time, it was precisely the prospect of bond market intervention that allowed the Bank to hold the members of the currency union to their commitment to safeguard financial stability. Although it is therefore certainly correct to say that the Bank could pressure states into 'collective action',[9] it was also dependent on this very action for the implementation of its own bond purchases.

This chapter takes a closer look at this interplay between the member states and the Bank. It exists of three parts. The first deals with the bond programme that the Bank implemented at an early stage of the crisis, in May 2010. The launch of this 'Securities Markets Programme' (SMP) was unprecedented. Never before in its existence had the Bank carried out targeted, outright purchases of government bonds, and for good reason. Even though the purchases took place on the secondary market, and not on the primary one which Article 123 TFEU explicitly declares forbidden territory,[10] in the eyes of many they nonetheless amounted to the sort of monetary financing this provision prohibits. The Bank therefore only 'crossed the Rubicon' after the member states had confirmed the change in Contract that they had initiated on 11

mitigating the crisis and buying governments time to find agreement – but it does not seem to have had a noteworthy agenda setting-role in institutional reform'.

7 Kathleen McNamara, 'Banking on Legitimacy: The ECB and the Euro Zone Crisis' (2012) 13 Georgetown Journal of International Affairs 143, 148.

8 Henning Deters, 'Deliberative Supranationalism in the Euro Crisis? The European Central Bank and the European Council in Times of Conflict' in Christian Joerges and Carola Glinksi (eds), *The European Crisis and the Transformation of Transnational Governance* (Hart Publishing 2014) 261.

9 See Beukers (n 1) 1601.

10 See also text to n 274 (ch 3).

February 2010 through the establishment of an assistance fund for the currency union at large.[11]

The second part focuses on the period following the launch of the Securities Markets Programme. Although the programme helped ease tensions for a while, it did not definitely dispel market panic. Calls for more drastic central bank intervention therefore increased, especially when Spain and Italy came under siege in the markets in the summer of 2011. Yet, to answer these calls the Bank needed further confirmation that the member states were willing to act on their commitment to financial stability. A first attempt at providing such confirmation took place in December 2011, when political leaders decided to conclude the Treaty on Stability, Coordination and Governance. However, as this Treaty largely focused on fiscal discipline, and therefore rather suited the currency union's old stability conception instead of its new one, it did not provide the kind of confirmation the Bank needed. Although it would intensify its liquidity provision to the banking sector, it therefore did not step up its bond market intervention.

Only when the currency union's leaders broadened their focus beyond immediate rescue measures to the long-term implications of their commitment to financial stability, and this leads to the third part of the chapter, could the Bank intensify its bond purchases. Their decision in June 2012 to establish a Single Supervisory Mechanism for banks, in combination with the possibility to directly recapitalise them through the ESM, paved the way for the Bank to introduce its second, more far-reaching bond programme, called 'Outright Monetary Transactions'. But even with political confirmation of the changed Founding Contract in place, the Bank's move would remain highly controversial, not least within its own Governing Council. Conservative central bankers, in particular those from Germany, would resist it and defend a position in line with the mandate that the treaty drafters had given them more than two decades ago.

2 Crossing the Rubicon

In January 2010 the president of the European Central Bank, Jean-Claude Trichet, was already aware of the dangers posed by Greece's financial misery. He feared the state's departure from the currency union and the contagious effects it would have on other members. Questioned about the possibility of exit at the Bank's monthly press conference of January 2010 he therefore refused to comment on 'absurd hypotheses'.[12] But when he was subsequently

11 By portraying the launch of the SMP as 'crossing the Rubicon' this study follows Neil Irwin, *The Alchemists: Three Central Bankers and a World on Fire* (Penguin Books 2014) 229.

12 'Introductory statement to the press conference (with Q&A)' (ECB, 14 January 2010). See also text to n 27 (ch 5).

asked whether this implied that the Bank was willing to help out Greece he stuck to the stability paradigm set out in the Treaties. 'No government, no state can expect any special treatment from us', he stated.[13] Moreover, the whole question was beside the point. A state was already helped simply by being a member of the currency union as the euro's credibility had ensured an 'easy means of financing' its current account deficit over the preceding years.[14] 'The problem', Trichet argued, 'is thus not one of "help". The problem is one of doing the job, of taking the appropriate decisions'.[15] In other words, Greece would have to pursue a ferocious strategy of fiscal consolidation so as to comply with the requirements of the Stability and Growth Pact as soon as possible. A month later, at the press conference on 4 February, not much had changed. Respecting the fiscal goals set out in the Treaties and the Pact was essential. Not just for Greece, for all others too.[16]

But after the change in the Contract had been initiated on 11 February Trichet's stance changed. When asked again about Greece leaving the currency union at the beginning of March 2010, he still called it an 'absurd hypothesis'.[17] Yet, he no longer excluded the possibility of financial assistance. Although not explicitly mentioning the possibility, he considered the statement of 11 February to be 'very important' and as 'committing the Heads of State or Government in case we would have to safeguard financial stability in the euro area as a whole'.[18] Trichet's wording created the impression he still thought that the political leaders had only committed their states to act in support of financial stability. Yet, he knew that in the new stability community they were creating, the Bank would have to play a role too.

For a long time in the spring of 2010 Trichet maintained the position that the Bank would not attempt to alleviate market pressure on distressed states by intervening in sovereign bond markets. Signs of a change in position only appeared as late as 6 May 2010, just days before the currency union's ministers of finance would put in place their €500bn rescue fund, when he told his audience at a press conference that the Governing Council 'did not discuss this option' at its monthly meeting held in Lisbon.[19] By saying that the issue had not been on the agenda, Trichet made clear that the Governing Council had not taken any decision on bond market intervention. Yet, his remarks also

13 'Introductory statement to the press conference (with Q&A)' (ECB, 14 January 2010).
14 'Introductory statement to the press conference (with Q&A)' (ECB, 14 January 2010).
15 'Introductory statement to the press conference (with Q&A)' (ECB, 14 January 2010).
16 'Introductory statement to the press conference (with Q&A)' (ECB, 4 February 2010).
17 'Introductory statement to the press conference (with Q&A)' (ECB, 4 March 2010): 'I have already said that leaving the euro area is an absurd hypothesis, and I confirm that'.
18 'Introductory statement to the press conference (with Q&A)' (ECB, 4 March 2010).
19 'Introductory statement to the press conference (with Q&A)' (ECB, 6 May 2010). See also Carlo Bastasin, *Saving Europe: Anatomy of a Dream* (Brookings Institution Press 2015) 187.

kept open the possibility that it would do so at a later time. And that time would arrive sooner than he had probably expected himself.

On the evening of 6 May the members of the Governing Council gathered with their spouses for dinner at a fancy estate close to Lisbon, the *Palácio de Bacalhoa*.[20] All of a sudden the officials' phones went off. The Dow Jones witnessed its sharpest 'intraday loss' ever.[21] Later it would become known that the fall was due to a technical failure, but at that moment the central bankers thought the panic was the result of Trichet's hesitance to clearly speak out in favour of bond market intervention at the press conference earlier that day.[22] Trichet instantly called for a meeting in the estate's cellar to discuss with his colleagues what to do.[23] To everyone's surprise it was the president of the *Bundesbank*, Axel Weber, who urged the Governing Council to act: 'We must be clear: the ECB must buy Greek government bonds!'[24] The head of the currency union's most staunch supporter of monetary orthodoxy now advocated a move away from the prohibition on monetary financing in Article 123 TFEU, blurring the dividing line between fiscal and monetary policy.[25]

Realising the importance of having the *Bundesbank* president on board, Trichet acted swiftly: 'Fine, then the decision is made'.[26] It was agreed that the Executive Board would put together a proposal the following day so as to allow the Governing Council to take a formal decision on the bond purchases as soon as possible.[27]

When the currency union's political leaders convened the next day to decide on a crisis fund they had no knowledge of what had happened in Lisbon.[28] Whereas they all realised that they needed the Bank in their effort to safeguard financial stability, they had different ways of conveying that message to Trichet, who was also present at the meeting. An old divide along the lines of central bank independence showed up. Southern leaders, led by Sarkozy, openly urged Trichet to buy government bonds. 'Come on, come on, stop

20 Accounts of what happened during that dinner can be found in Irwin (n 11) 219-223; Bastasin (n 19) 187-189.

21 Bastasin (n 19) 187 on the 'flash crash': 'At 2:42 p.m. New York time (8:42 p.m. in Lisbon), with the Down Jones down more than 300 points for the day, the equity markets began to fall rapidly, dropping more than 600 points in five minutes for an almost 1,000 point loss by 2:47 p.m. It was the largest intraday loss in the history of Wall Street'.

22 Bastasin (n 19) 187-188.

23 Bastasin (n 19) 188.

24 Quoted in Bastasin (n 19) 188.

25 Irwin (n 11) 221 (making clear in this regard that 'Some in the room interpreted his comments as an explicit backing, while others saw it more as a kind of theoretical, academic musing as to the possibility, with no endorsement implied').

26 Quoted in Bastasin (n 19) 188.

27 Bastasin (n 19) 188.

28 For a discussion of this meeting of political leaders see also text to n 132 (ch 5).

hesitating!', the French president shouted at him.[29] Those with deeper held convictions about the virtues of central bank independence defended the central bank president. Chancellor Merkel, backed by Dutch Prime Minister Balkenende and his Finnish colleague Vanhanen, argued that the attacks on the Bank had to cease.[30] She pointed out that the Bank had a 'very good record' and that leaders had to 'trust' it.[31] Trichet himself defended his turf ferociously: 'We do not need and we will not ask for your permission. We have a very good track record and you must trust us. If you try to apply pressure, the ECB Council will react negatively with disastrous consequences'.[32] As a result, the leaders refrained from mentioning any specific central bank measures in their statement, instead stating that they fully supported 'the ECB in its action to ensure the stability of the euro area'.[33]

Trichet's stance was understandable given the need to protect the independence of the Bank. But there was an even deeper, more profound dimension to it. The heads of state and government had not yet reached a deal on a crisis mechanism for the currency union at large. By keeping them dangling as to bond market intervention, Trichet could pressure them to act on their joint commitment to safeguard financial stability in the currency union.[34] Economists may simply explain this 'wait-and-see' approach by the need to avoid moral hazard, in particular the risk that leaders would leave it entirely to the Bank to rescue the currency union.[35] Although certainly true, the explanation for the Bank's stance reaches much deeper. It needed leaders to confirm in practice the change in Contract they had initiated on 11 February, as only such confirmation would provide it with the necessary political cover for unprecedented central bank action.

Weber's surprising conversion was short-lived. Only hours after the meeting in Lisbon, whilst flying back to Frankfurt, the *Bundesbank* president wrote an e-mail to his colleagues in the Governing Council about the envisaged bond purchases.[36] Perhaps the sense of urgency that had caused him to back the move a day earlier lost out to his academic monetary beliefs, perhaps he felt that he would not be able to defend it before his colleagues in Frankfurt.[37] What matters is that he withdrew his support of the purchases.[38] But it was

29 Quoted in Tony Barber, 'Dinner on the edge of the abyss' *Financial Times* (11 October 2010).
30 Barber, 'Dinner on the edge of the abyss' (n 29).
31 Quoted in Peter Ludlow, 'In the Last Resort: The European Council and the euro crisis, Spring 2010' (Eurocomment Briefing Note Vol 7, No 7/8) 32.
32 Quoted in Ludlow, 'In the Last Resort' (n 31) 32.
33 Statement of the Heads of State or Government in the euro area, Brussels, 7 May 2010.
34 On the ECB's ability to pressure states into collective action see also Beukers (n 1) 1601.
35 On moral hazard see text to n 277 (ch 4).
36 Irwin (n 11) 221-222.
37 Irwin (n 11) 221-222.
38 Irwin (n 11) 222; Bastasin (n 19) 201.

too late. In a teleconference on Sunday 9 May Weber found support among some colleagues, notably Executive Board member Jürgen Stark and Dutch Central Bank President Nout Wellink.[39] The majority, however, stuck to the position they had taken three days earlier in Lisbon and decided to launch the Securities Markets Programme, allowing the Eurosystem to buy government bonds.[40] The decision was made public early in the morning of Monday 10 May, only after the member states in the currency union had acted on their commitment to safeguard financial stability by deciding to establish the European Financial Stability Facility (EFSF).[41]

The bond programme had been designed carefully so as to limit the pressure it would put on the Bank's mandate and the prohibition on monetary financing. It only allowed the Eurosystem to purchase government bonds on the secondary market,[42] not the primary one, which is explicitly ruled out by Article 123 TFEU.[43] Moreover, the purchases were justified by the need to 'restore an appropriate monetary policy transmission', and therefore ultimately price stability.[44] Any liquidity that was 'injected' through the interventions was 'sterilised', which means that it was offset by absorbing measures so as not to affect the 'monetary policy stance' and avoid negative consequences as regards inflation.[45] Most importantly, the purchases were tied to the implicit condition that member states would put their fiscal records straight. In their statement of 7 May the heads of state and government had declared that 'the consolidation of public finances' was 'a priority' for all of them.[46] In an effort to reduce the risk of moral hazard, the Bank stated in the preamble of its Decision that it had 'taken note' of that statement, thereby

39 Matthew Lynn, *Bust: Greece, the Euro and the Sovereign Debt Crisis* (Bloomberg Press 2011) 170-171; Irwin (n 11) 229; Bastasin (n 19) 201.

40 Decision of the European Central Bank of 14 May 2010 establishing a securities markets programme (ECB/2010/5) [2010] OJ L 124/8 (Decision ECB/2010/5).

41 ECB Press Release, 'ECB decides on measures to address severe tensions in financial markets' (ECB, 10 May 2010). There is some discussion whether the announcement of the bond programme not only took place after member states had *decided* to establish the EFSF but also after they had *announced* their decision. Ludlow, 'In the Last Resort' (n 31) 37 argues that the 'ECB made its announcement slightly earlier than ECOFIN'. Irwin (n 11) 230, however, states that the ECB's announcement came shortly after the one of the finance ministers. Bastasin (n 19) 201 also takes this view.

42 Art 1 Decision ECB/2010/5. A reference to that statement was also included in the ECB's press release announcing the bond purchases. See in this respect also Ludlow, 'In the Last Resort' (n 31) 37-38.

43 For a discussion of the prohibition on monetary financing see text to n 274 (ch 3).

44 Recital 3 Decision ECB/2010/5. On the transmission of monetary policy and the problematic nature of high bond yields in this respect see text to n 52 (ch 4).

45 ECB Press Release, 'ECB decides on measures to address severe tensions in financial markets' (ECB, 10 May 2010).

46 Statement of the euro area Heads of State or Government, Brussels, 7 May 2010.

signalling that it might cease its bond market intervention if fiscal consolidation were to fall behind expectations.[47]

It was not enough to appease Weber. Soon after the decision had been taken by the Governing Council he set up a conference call with his colleagues at the *Bundesbank*.[48] Considering the bond purchases to strike at the very heart of the currency union's stability set-up in the Union Treaties, he tabled the question whether the *Bundesbank* should implement the Decision. If they had answered it in the negative, it would have meant the end of the bond programme, the Bank's reputation and perhaps even the currency union at large.[49] But they did not. What Weber did do instead was to give an interview to the German newspaper *Börzenzeitung* the following day.[50] In a highly exceptional move he publicly criticised the decision of the Governing Council. It meant the end of his chances at succeeding Trichet as president of the European Central Bank. In February 2011 he publicly drew his conclusions and announced he would step aside as *Bundesbank* president in April, a year before the end of his term: 'The ECB is the bulwark for stability in Europe….The president has a special position in all this. But if he advocates a minority position on essential questions, the credibility of his office suffers'.[51]

The bond programme helped ease tensions in bond markets for a while, but it did not definitely dispel panic.[52] And the longer the bond purchases continued, the more uncomfortable the European Central Bank became. It had intended the programme to be of a temporary nature, focused on safeguarding the transmission of monetary policy. But as the crisis endured the amount of government bonds on its balance sheet rose sharply – not only as a result of outright purchases, also due to their use as collateral in refinancing operations – raising fears it would have to give in to fiscal policy considerations.[53] Ever since the establishment of the EFSF President Trichet had therefore been urging states to make the fund's operability as 'flexible' as possible, thereby exerting pressure on them to take over the task of intervening in bond markets.[54] When the heads of state and government at first only partially

47 Recital 4 Decision ECB/2010/5.
48 Irwin (n 11) 231.
49 Irwin (n 11) 231-232.
50 Jürgen Schaaf, 'Interview mit Bundesbankpräsident Axel Weber' *Börsen-Zeitung* (11 May 2010). See also Lynn (n 39) 176; Irwin (n 11) 232; Bastasin (n 19) 201.
51 Quoted in Daniel Schäfer, 'Weber says his hawkish views drove decision over ECB presidency' *Financial Times* (14 February 2011). For greater analysis of Weber's resignation see Irwin (n 11) 298-301; Bastasin (n 19) 243-244, 246.
52 For a detailed analysis of the 'impact' of the SMP see European Central Bank, 'The determinants of euro area sovereign bond yield spreads during the crisis' (ECB Monthly Bulletin, May 2014) 78-80.
53 See also Bastasin (n 19) 277.
54 See eg Ralph Atkins, 'Trichet urges greater flexibility on debt crisis' *Financial Times (FT.Com)* (14 December 2010). See also Bastasin (n 19) 247-250.

answered that call in March 2011 by agreeing to allow the facility to intervene in primary but not secondary bond markets, the Bank ceased its purchases.[55] Only at their summit of 21 July 2011, when Spain and Italy had come under siege from the markets, did the national political leaders decide to also allow the facility to buy up bonds on the secondary market.[56]

But it would take time for the facility's reform to become operational; time that the markets were not willing to grant Spain and Italy. The Bank consequently found itself between a rock and a hard place. It was the only actor capable of stabilising bond markets, but in May 2010 it had tied its bond programme to the condition that states would consolidate their budgets and reform their economies. Yet, with Silvio Berlusconi as prime minister Italy had failed to book significant progress on this front. On 4 August 2011 the Governing Council therefore embarked on a risky strategy. It reactivated the bond programme, but only bought Portuguese and Irish securities, thereby signalling that Spain and in particular Italy had to step up their fiscal and reform efforts.[57]

The next day, on 5 August, President Trichet and his future replacement Mario Draghi, then still governor of the Bank of Italy, sent a letter to the Italian government in which they set out in detail what they expected from it.[58] Austerity policy should be more ambitious so as to achieve a 'balanced budget' already in 2013, instead of the initial target year of 2014. The pension system should be reformed 'by making more stringent the eligibility criteria for seniority pensions' and by 'aligning the retirement age for women in the private sector to that established for public employees'. Changes should also be introduced to the regime concerning 'the hiring and dismissal of employees' as well as 'the collective wage bargaining system'. All reforms should be implemented 'as soon as possible', preferably by 'decree laws', followed by parliamentary approval at a later stage. On 6 August, with its back against the wall, the Italian government announced in a hastily arranged press conference that it would step up its austerity policy and reform efforts.[59] The following day the Bank issued a statement in which it 'welcomed', amongst others,

55 Irwin (n 11) 304-305; Bastasin (n 19) 253-254.

56 See also text to n 199 (ch 5).

57 Ralph Atkins, 'ECB resumes bond-buying role' *Financial Times* (5 August 2011); Irwin (n 11) 318; Bastasin (n 19) 288-289.

58 The letter can be found at <www.corriere.it/economia/11_settembre_29/trichet_draghi_inglese_304a5f1e-ea59-11e0-ae06-4da866778017.shtml?refresh_ce-cp> accessed 25 April 2017. A similar letter was sent by Trichet and the Spanish central bank governor to the Spanish government. This one did not become public, however. For more detailed discussion of the ECB's strategy behind the letters see Irwin (n 11) 317-321; Bastasin (n 19) 284-291.

59 Guy Dinmore and others, 'Berlin welcomes Rome's action on economy' *Financial Times* (6 August 2011).

the Italian measures and stated that it was on the basis of these 'assessments' that it would 'actively implement its Securities Markets Programme'.[60]

In the weeks that followed it became clear, however, that the Italian government failed to deliver as the reforms and fiscal cuts were far less ambitious than Trichet and Draghi had demanded in their letter.[61] The Bank had brought itself in an impossible position. Financial stability considerations required it to intervene in bond markets, yet by doing so it risked losing its 'leverage' over Italy's economic policy.[62] To Executive Board member Stark, who had voted against reactivation of the bond programme,[63] it showed the Bank could not be a lender of last resort and reform watchdog at the same time. On 9 September 2011 he resigned from his post, citing 'personal reasons'.[64] Later he would admit that the bond purchases had been the real reason, considering them at odds with the prohibition on monetary financing. 'Without this rule there would be no economic and monetary union', he explained.[65] 'About 90 per cent of the self-proclaimed or actual experts around the world tell the ECB: the only way is to use the "big bazooka" ... But behind that, there is a misunderstanding of the institutional framework that we have here'.[66]

3 Calling for a 'compact'

By the autumn of 2011 it had become evident that the member states in the currency union would not be able to stem market panic on their own. Even if the EFSF were able to intervene in secondary bond markets, its fire power was far too little to stabilise large debt markets like those of Spain and Italy.[67] These two states were 'simultaneously too big to fail and too big to save'.[68] At their summit of 26 October 2011 the heads of state and government had

60 Statement by the President of the ECB, Frankfurt, 7 August 2011. Another measure welcomed by the ECB was the decision of the heads of state and government of the currency union of 21 July 2011 to 'flexibilise' the EFSF (and the future ESM) by allowing it to intervene on secondary markets for government bonds. For an analysis of ECB insistence on bringing that decision about see Bastasin (n 19) 277-282.

61 Irwin (n 11) 321-322; Bastasin (n 19) 302, 305-307.

62 Bastasin (n 19) 302.

63 See ECB President Trichet, 'Introductory statement to the press conference (with Q&A)' (ECB, 4 August 2011): 'We were not unanimous but had an overwhelming majority in our decision on the operation regarding the bond purchase'. See also Irwin (n 11) 320-321; Bastasin (n 19) 289.

64 ECB Press Release, 'Jürgen Stark resigns from his position' (ECB, 9 September 2011). See also Ralph Atkins and Gerrit Wiesmann, 'ECB rocked by Stark resignation' *Financial Times (FT.Com)* (9 September 2011); Irwin (n 11) 322-323; Bastasin (n 19) 326.

65 Quoted in Ralph Atkins, 'Stark admits bond-buying led to ECB resignation' *Financial Times* (18 December 2011).

66 Quoted in Atkins, 'Stark admits bond buying led to ECB resignation' (n 65).

67 Bastasin (n 19) 313.

68 Irwin (n 11) 316.

still tried to enhance the € 440bn fire power of the facility without extending their own guarantees by 'leveraging' its financial resources by a factor of 'up to four or five' through difficult technical constructs,[69] but the markets did not perceive it as a credible strategy.[70] In fact, Italian bond yields were reaching such heights that they forced Berlusconi to resign as prime minister of Italy on 12 November,[71] making way for a 'nonpartisan' caretaker government headed by Mario Monti.[72] In Spain, Prime Minister Zapatero similarly felt forced to call for snap elections on 21 November, which his Socialist Party lost to the centre-right Popular Party.[73] Only the pockets of the European Central Bank seemed deep enough to pacify markets that were increasingly running out of control.

But the *Bundesbank* stuck to its position. Jens Weidmann, who had succeeded Axel Weber as president, argued that he did not consider markets as dysfunctional. And even if they were, he did not see how the European Central Bank could stabilise them by acting as a lender of last resort for states:

> 'The role of the central bank is clearly defined. It is to ensure price stability ... it is clear that the responsibility for financial stability lies with the governments ... The eurosystem is a lender of last resort – for solvent but illiquid banks. It must not be a lender of last resort for sovereigns because this would violate Article 123 of the EU Treaty. I cannot see how you can ensure the stability of a monetary union by violating its legal provisions.'[74]

However, in his first appearance before the European Parliament as president of the European Central Bank, Mario Draghi seemed to provide for an opening.[75] He referred to the fact that the recent changes in government in some member states had not yet been reflected in the markets and called for a new 'fiscal compact', a 'fundamental restatement of the fiscal rules' for the member states in the currency union.[76] He then stated that 'other elements

69 Euro summit statement, Brussels, 26 October 2011, paras 17-22. The first leveraging option was providing 'credit enhancement' to private investors when buying new debt issued by member states. The second was to 'maximise' the EFSF's funding arrangements 'with a combination of resources from private and public financial institutions and investors'.

70 Alex Barker and Gerrit Wiesmann, 'Rescue fund's impact in doubt' *Financial Times* (25 November 2011).

71 Guy Dinmore and Giulia Segreti, 'Berlusconi resigns' *Financial Times (FT.Com)* (12 November 2011).

72 Bastasin (n 19) 338.

73 Víctor Mallet and Miles Johnson, 'Rajoy sweeps to record victory in Spain's elections' *Financial Times* (21 November 2011).

74 Ralph Atkins and Martin Sandbu, 'FT interview transcript: Jens Weidmann' *Financial Times (FT.Com)* (13 November 2011).

75 Irwin (n 11) 350; Bastasin (n 19) 347.

76 Mario Draghi, 'Introductory Statement' (Hearing before the Plenary of the European Parliament on the occasion of the adoption of the Resolution on the ECB's 2010 Annual Report, 1 December 2011).

might follow, but the sequencing matters'.[77] The words were perceived by the outside world as an indication that the Bank was willing to step up its bond purchases if the states in the currency union would move first.[78]

Draghi knew a fiscal compact was in the making. At their October summit, the currency union's political leaders had called on European Council President Van Rompuy to prepare a report on the strengthening of the single currency's economic foundations in collaboration with the presidents of the Commission and the Eurogroup.[79] It should concentrate on economic convergence, budgetary discipline and a general 'deepening' of the economic union, including 'the possibility of limited Treaty changes'.[80] Whereas Van Rompuy was only expected to prepare an interim report for the European Council's December meeting,[81] the uproar in the markets speeded up the process.[82] On 5 December 2011 Merkel and Sarkozy announced at a press conference in Paris that they wanted an enhanced regime of fiscal discipline.[83] Two days later, on 7 December, they specified their plans in a joint letter to Van Rompuy.[84] Their key requirement was that members of the currency union should be obliged to incorporate 'rules on a balanced budget…. into national legislation at constitutional or equivalent level'.[85] The obligation should be 'enshrined' in the Union Treaties, but Merkel and Sarkozy indicated that they were willing to settle for a separate treaty among euro area states if amendment of the Union Treaties would be politically infeasible.[86] Van Rompuy, meanwhile, had presented his own interim report a day earlier, on 6 December. He too aimed for a balanced budget rule, yet he stressed the possibility to achieve it through a change of Protocol No 12 on the excessive deficit procedure.[87] As Article 126(14) TFEU indicates that such a change only requires a unanimous

77 Mario Draghi, 'Introductory Statement' (Hearing before the Plenary of the European Parliament on the occasion of the adoption of the Resolution on the ECB's 2010 Annual Report, 1 December 2011).

78 See eg Ralph Atkins and Hugh Carnegy, 'Draghi hints at more robust ECB response' *Financial Times* (2 December 2011).

79 Euro summit statement, Brussels, 26 October 2011, paras 34-35.

80 Euro summit statement, Brussels, 26 October 2011, paras 34-35.

81 Euro summit statement, Brussels, 26 October 2011, para 35; European Council, Conclusions, Brussels, 23 October 2011, para 7.

82 Peter Ludlow, 'The European Council of 8/9 December 2011' (Eurocomment, 12 January 2012) 7ff.

83 Hugh Carnegy and Richard Milne, 'Deal over eurozone fiscal rules' *Financial Times* (6 December 2011).

84 Joint letter from Nicolas Sarkozy, President of the Republic, and Angela Merkel, Chancellor of Germany, to Herman Van Rompuy, president of the European Council, Paris, 7 December 2011 (Joint letter from Sarkozy and Merkel to Van Rompuy, 7 December 2011).

85 Joint letter from Sarkozy and Merkel to Van Rompuy, 7 December 2011 (n 84).

86 Joint letter from Sarkozy and Merkel to Van Rompuy, 7 December 2011 (n 84).

87 Herman Van Rompuy, *Towards a stronger Economic Union: Interim Report* (Brussels, 6 December 2011), paras 10-12.

Council decision, it made recourse to the arduous and time-consuming treaty amendment procedure in Article 48 TEU redundant.

At the European Council meeting of 8 and 9 December 2011, political leaders decided to introduce the balanced budget rule through treaty law, but not in the way ideally envisaged by Merkel and Sarkozy. Under pressure at home by sceptical Tories, Prime Minister Cameron demanded a '*quid pro quo*' that was unacceptable to his peers.[88] Not only did he insist on a guarantee that integration among the states in the currency union would not affect the internal market and the interest of all member states, he also sought to protect London as a financial centre.[89] There had to be a stop on the reinforcement of European supervision of financial markets, any policy initiatives concerning taxes on banks should require unanimous agreement within the Council and financial institutions of third states based in 'the City' had to escape Union regulation.[90] All guarantees, moreover, should be laid down in primary law.[91] Faced with these excessive demands, the members of the currency union opted for a separate treaty that would also be open to those outside the currency union willing to join.[92]

The Treaty on Stability, Coordination and Governance was negotiated in less than three months and signed by all member states except the United Kingdom and the Czech Republic on 2 March 2012 in Brussels.[93] It entered into force on 1 January 2013.[94] The Treaty provides a legal basis for the Euro Summit,[95] the gathering of euro area heads of state or government which had already been officially recognised by political leaders at their meeting of 26 October 2011,[96] and it strengthens policy coordination.[97] By far its most important provisions, however, relate to the 'fiscal compact',[98] in particular its balanced

88 Ludlow, 'The European Council of 8/9 December 2011' (n 82) 18.
89 Ludlow, 'The European Council of 8/9 December 2011' (n 82) 29-32.
90 Ludlow, 'The European Council of 8/9 December 2011' (n 82) 29-30.
91 Ludlow, 'The European Council of 8/9 December 2011' (n 82) 29.
92 Statement by the euro area Heads of State or Government, Brussels, 9 December 2011.
93 Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, Brussels, 2 March 2012 (TSCG). Croatia, which only joined the EU on 1 July 2013, is also not a party to the Treaty. For in-depth analyses of the Treaty see Vestert Borger and Armin Cuyvers, 'Het Verdrag inzake Stabiliteit, Coördinatie en Bestuur in de Economische en Monetaire Unie: de juridische en constitutionele complicaties van de eurocrisis' (2012) 60 SEW 370; Paul Craig, 'The Stability, Coordination and Governance Treaty: Principle, Politics and Pragmatism' (2012) 37 EL Rev 231; Steve Peers, 'The Stability Treaty: Permanent Austerity or Gesture Politics?' (2012) 8 EuConst 404.
94 Art 14(2) TSCG provides that the Treaty enters into force on 1 January 2013, provided that twelve Contracting Parties whose currency is the euro have deposited their ratification instrument with the General Secretariat of the Council.
95 Art 12 TSCG.
96 Euro Summit statement, Brussels, 26 October 2011, paras 30-33 and Annex I.
97 Arts 9-11 TSCG.
98 Arts 3-8 TSCG.

budget rule. States in the currency union, as well as those Contracting Parties that have not (yet) adopted the single currency but have indicated their 'intention to be bound' by the rule,[99] are in principle required to have a budget that is 'balanced or in surplus'.[100] This means that the annual structural balance should be at its 'country-specific medium-term objective', 'with a lower limit of a structural deficit' of 0.5% of GDP.[101] In case of a significant deviation from this objective or 'the adjustment path towards it, a correction mechanism shall be triggered automatically'.[102] The balanced budget rule, including the correction mechanism,[103] has to be implemented at the national level through 'provisions of binding force and a permanent character, preferably constitutional or are otherwise guaranteed to be fully respected and adhered to throughout the national budgetary process'.[104] Implementation into national legislation had to take place at the latest one year after the entry into force of the Treaty.[105] Failing that deadline, states in the currency union would no longer qualify for financial assistance from the ESM.[106]

Similar to the ESM, the Treaty relies heavily on Union institutions.[107] Implementation of the balanced budget rule and correction mechanism needs to be verified by the Commission.[108] If the latter concludes that a state has not complied with its implementation duties, the matter needs to be brought

99 Art 14(5) TSCG. In the absence of such intention, these Contracting Parties are only bound by Title V of the Treaty prior to their adoption of the single currency. See Art 14(4) TSCG.

100 Art 3(1)(a) TSCG.

101 Art 3(1)(b)TSCG. The lower limit can reach -1% to GDP in case the debt to GDP ratio is significantly below 60% and the risks to long-term sustainability of public finances are low. See Art 3(1)(d) TSCG. Note that the basic lower limit of 0.5% of GDP differs from the one in the preventive arm of the Stability and Growth Pact, which uses a lower limit of -1% to GDP. See Art 2a Reg 1466/97 (as last amended by Reg 1175/2011).

102 Art 3(1)(e) TSCG.

103 Art 3(2) TSCG stipulates that the mechanism needs to comply with common principles to be proposed by the Commission. The latter are laid down in a Communication. See Commission, 'Communication of 20 June 2012 on common principles on national fiscal correction mechanisms' COM (2012) 342 final.

104 Art 3(2) TSCG.

105 Art 3(2) TSCG.

106 Recital 25 TSCG; Recital 5 ESM Treaty.

107 Due to the UK's discontent with the Treaty, and contrary to the ESM Treaty, no authorisation has been given by all member states for the Contracting Parties to involve the Commission. On the necessity of such authorisation see Steve Peers, 'Towards a New Form of EU Law?:The Use of EU Institutions Outside the EU Legal Framework' (2013) 9 EuConst 37, 53-55 (arguing such consent is not required); Paul Craig, '*Pringle* and Use of EU Institutions outside the EU Legal Framework: Foundations, Procedure and Substance' (2013) 9 EuConst 263, 271-273 (arguing such consent is required).

108 The Commission published its assessment on 22 February 2017. It found that all states that are presently party to the TSCG have fulfilled their implementation duties or that they will do so in the near future. See Commission, 'Report of 22 February 2017 presented under Article 8 of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union' C(2017) 1201 final.

before the Court by one or more contracting states.[109] The latter may also bring a case independently from the Commission's assessment when they think another state has not abided by the implementation requirements.[110] The judgment of the Court, whose involvement is based on Article 273 TFEU,[111] shall be binding on the parties. When a contracting state considers that another state has failed to comply with the Court's judgment, it may bring another case and ask for the imposition of financial penalties in line with the criteria established by the Commission in the context of Article 260 TFEU.[112]

On 8 December 2011, just hours before the European Council convened in Brussels, Central Bank President Draghi announced new 'non-standard measures', of which two are particularly interesting.[113] First, there would be two 'longer-term refinancing operations' (LTROs), the first on 21 December and the second on 29 February 2012, with a maturity of three years and at 1% interest, conducted as 'fixed rate tender procedures with full allotment'.[114] Second, there would be a further easing of collateral requirements so as to increase the possibilities for banks to access the operations.[115] Later that day, after the European Council meeting had ended, President Sarkozy 'suggested' that the favourable lending scheme could facilitate 'carry trade', whereby banks use the favourable loans to purchase more profitable government bonds, thereby bringing down their yield levels: 'This means that each state can turn to its banks, which will have liquidity at their disposal'.[116]

The three-year refinancing operations greatly helped to ease the funding constraints of banks, allotting as much as € 1 trillion, and they may have even had a positive impact on government bond rates, at least in the short run.[117] Yet, they did not constitute the kind of action that had been expected. In fact, at the press conference following the Governing Council's meeting of 8 December, Draghi said he was 'kind of surprised' by the expectation that the Bank would step up its bond market interventions if the member states agreed on

109 Art 8(1) TSCG. On 2 March 2012 the Contracting Parties agreed on an arrangement on how to bring a case before the Court in these situations. This arrangement is annexed to the minutes of the signing of the TSCG.

110 Art 8(1) TSCG.

111 See Art 8(3) and Recital 15 TSCG. For an in-depth analysis of the Court's involvement under the TSCG see Borger and Cuyvers (n 93) 384-387.

112 Art 8(2) TSCG and Recital 16 TSCG.

113 See 'Introductory statement to the press conference (with Q&A)' (ECB, 8 December 2011).

114 'Introductory statement to the press conference (with Q&A)' (ECB, 8 December 2011). On the meaning of non-standard measures, in particular refinancing operations at 'fixed rate' and 'full allotment', see text to n 32 (prologue).

115 'Introductory statement to the press conference (with Q&A)' (ECB, 8 December 2011).

116 Quoted in Richard Milne, 'Sarkozy's plan to prop up sovereigns is a worrying sign' *Financial Times* (15 December 2011).

117 See Christiaan Pattipeilohy and others, 'Unconventional monetary policy of the ECB during the financial crisis: An assessment and new evidence (DNB Working Paper No 381, May 2013) 31.

a fiscal compact.[118] The Governing Council had not discussed the issue and did not question the desirability of the prohibition on monetary financing. The currency union's legal set-up, Draghi stated, 'embodies the best tradition of the *Deutsche Bundesbank*, whereby monetary financing has always been prohibited ... We comply with laws; we do not discuss laws. We do not push ...'[119]

But the Bank was pushing.[120] The aim of the balanced budget rule to enhance the 'ownership' of budgetary policy through the incorporation of fiscal limits in national (constitutional) law was a welcome development, yet it also fitted the old stability conception in which fiscal discipline and price stability took centre stage. Safeguarding financial stability required member states to take more measures, of a different nature. Draghi alluded to that on 19 December 2011, little more than a week after leaders had decided to adopt the fiscal treaty, when he appeared before the European Parliament in the context of his quarterly monetary dialogue with this institution. 'I think there is a basic fact here that, if you want confidence to return, trust has to return in the euro area ... ..To achieve that, we have to have in place the proper "compact" which I referred to *at that time* only as far as budgetary matters are concerned….'.[121] At the following monetary dialogue, on 25 April 2012, Draghi further specified how trust could be restored:

> '[I]t is not the time to defend the existing situation. It is the time to project what our future design is going to be; it is the time to give a long-term objective to our vision and to say at the same time what conditions have to be implemented in order for this to become reality. It has been done before; it was done at the time of the Maastricht Treaty; it was done at the time of the euro. People established a path ten or fifteen years in advance and then listed the conditions that ought to be satisfied to reach the end of this path. I think we are in a similar situation.'[122]

Two years earlier, on 11 February 2010, political leaders had initiated a change in the Founding Contract between their states by committing themselves to a different currency union, one that also attaches great importance to financial stability. Since then, their states had tried to safeguard that stability by saving distressed partners from immediate collapse. Now, however, they would have

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118 'Introductory statement to the press conference (with Q&A)' (ECB, 8 December 2011).

119 'Introductory statement to the press conference (with Q&A)' (ECB, 8 December 2011).

120 See also Irwin (n 11) 355; Bastasin (n 19) 380; Peter Ludlow, 'A turning-point in the euro crisis? The informal European Council of 23 May 2012' (Eurocomment No 3, 2012) 7-8; Pierre de Boissieu and others, *National Leaders and the Making of Europe: key episodes in the life of the European Council* (John Harper Publishing 2015) 264.

121 Committee on Economic and Monetary Affairs, 'Text of the Monetary Dialogue with Mario Draghi – president of the ECB' (Brussels, 19 December 2011) 8 (emphasis added).

122 Committee on Economic and Monetary Affairs, 'Text of the Monetary Dialogue with Mario Draghi – president of the ECB' (Brussels, 25 April 2012) 14 (Text of the Monetary Dialogue with Draghi of 25 April 2012).

to sketch the long-term implications of this contractual change. One of them was stressed by Draghi himself:

> 'I see financial stability clearly as a common responsibility in a monetary union. During the crisis we have observed the negative spill-over effects across euro area countries and between the banking sector and its respective sovereign…. Ensuring a well-functioning Economic and Monetary Union implies strengthening banking supervision and resolution at European level'.[123]

4 DOING WHATEVER IT TAKES

Draghi's call for a long-term vision for the set-up of the currency union was voiced by other members of the Bank's Executive Board as well in the spring of 2012.[124] The necessity of the exercise, meanwhile, was borne out by the situation in the markets. After the long-term refinancing operations had brought some peace to them at the beginning of 2012, Italian and Spanish bond yields were again spiralling out of control by spring.[125] Especially Spain's situation showed that more fiscal rigour was not a panacea to the currency union's problems. Having stayed well within the Stability and Growth Pact's deficit and debt limits before the financial crisis, a bursting property bubble and weak banking sector now threatened to tear the state down.[126] It was in this climate that European Council president Van Rompuy decided to convene an informal meeting of the European Council on 23 May 2012.[127] Initially, the idea was to discuss Europe's growth agenda, a topic that had been central to the campaign of the socialist François Hollande for the French presidential elections, which he won on 6 May 2012 by defeating Sarkozy in the second round. With market pressure on the rise, however, Van Rompuy soon realised the meeting also provided an opportunity for a more fundamental exchange of views on the future of the currency union.[128] In his invitation to the participants he therefore concluded by saying 'that there should be no taboos concerning the longer term perspective. It is not too early to think ahead and to reflect on possible more fundamental changes within the EMU. In many ways, the perspective of moving towards a more integrated system

123 Text of the Monetary Dialogue with Draghi of 25 April 2012 (n 122) 7.

124 See eg Speech by Peter Praet, 'Sound money, sound finances, a competitive economy: principles of a European culture of stability' (Symposium on perspectives for a common stability culture in Europe, Berlin, 27 February 2012). Intervention by Jörg Asmussen, 'Key issues about the crisis and the European response' (Centre for Strategic and International Studies, Washington, 20 April 2012). See also De Boissieu and others (n 120) 264.

125 Richard Milne, 'Debt fears return as ECB funds are used up' *Financial Times* (27 April 2012).

126 See also text to n 229 (ch 4).

127 De Boissieu and others (n 120) 264.

128 Ludlow, 'A turning-point in the euro crisis?' (n 120) 3-5.

would increase confidence in the euro and the European economy generally'.[129]

At the meeting all leaders got the chance to voice their ideas about the future direction of the single currency – one by one – as a result of which the gathering took almost five hours.[130] Van Rompuy's press statement after the meeting, on the contrary, was much shorter. Most of it dealt with growth issues, but at the end he spoke about the topic that mattered most. '[W]e held an in-depth discussion on the latest developments in the euro area', Van Rompuy stated, 'during which we also reaffirmed our commitment to safeguard financial stability and integrity'. [131]As there was a 'general consensus' on the need to strengthen the single currency's economic pillar so as to make it 'commensurate' with the monetary one, the members of the European Council had tasked him to report in June, in close cooperation with the presidents of the Commission, the Euro Group and the Bank, on the 'main building blocks and on a working method to achieve this objective'.[132]

In the weeks that followed Spanish bond yields returned to panic levels, putting ever more pressure on Prime Minister Rajoy to request financial assistance from his partners.[133] Yet, Rajoy did everything possible to avoid that scenario. His government had itself embarked on an ambitious path of austerity and he regarded it as a major defeat if it would nonetheless become subject to outside influence by signing up to an adjustment programme.[134] Moreover, the options for assistance were not attractive. Although the assistance was primarily needed to recapitalise ailing banks, the EFSF as well as the future ESM could only grant such recapitalisation support indirectly, that is: by channelling it first to the government in question.[135] Shoring up the banking sector would therefore also lead to an increase in a state's debt burden which could negatively affect its ability to raise capital in the markets. That fear also materialised when the Eurogroup finally indicated on 9 June that the Spanish government was planning to lodge a request for recapitalisation

129 Invitation letter of President Van Rompuy to the informal dinner of the members of the European Council, Brussels, 21 May 2012.
130 See extensively Ludlow, 'A turning-point in the euro crisis?' (n 120) 8-13.
131 Remarks by President of the European Council Herman Van Rompuy following the informal dinner of the members of the European Council, Brussels, 24 May 2012.
132 Remarks by President of the European Council Herman Van Rompuy following the informal dinner of the members of the European Council, Brussels, 24 May 2012.
133 Mary Watkins, 'Spanish bond yields jump to euro-era highs over Germany' *Financial Times* (29 May 2012); Richard Milne, 'Fears grow over Spain as warning lights flash red' *Financial Times* (30 May 2012).
134 Miles Jones and Patrick Jenkins, 'Madrid fails to win support for its improvisation' *Financial Times* (30 May 2012).
135 See Recital 4 EFSF Framework Agreement; Art 15 ESM Treaty.

assistance of as much as € 100bn.[136] Over the next days, Spanish bond yields experienced a steep rise.[137]

With markets becoming ever-more unstable, calls for central bank action rose. 'The only institution which today has the capacity to ensure these conditions of stability and liquidity that we need is the ECB', Rajoy wrote in a letter to Van Rompuy about the future of the currency union.[138] Cameron similarly argued for 'greater monetary activism' when he spoke about the European economy at the G20 summit in Los Cabos, Mexico.[139] At that summit, Prime Minister Monti even urged the Bank to 'automatically' intervene in secondary markets if government bond yields exceeded a certain pre-established limit.[140] The Bank, however, consistently ignored the calls. Taking the view that its bond purchases had provided disincentives for states to engage in austerity and reforms, it refused to reactivate its dormant bond programme. Asked about it in an interview with the *Financial Times*, Executive Board member Benoît Coeuré said that 'The SMP has not been terminated, but it is an instrument of monetary policy. It is not an instrument that can be used to fix fiscal difficulties or to help insolvent banks'.[141] Draghi, meanwhile, was consistently stressing the importance of the report that was being written under the guidance of Van Rompuy. At the Bank's monthly press-conference in June, he even put it on a par with the famous Delors Report that had been so essential to the establishment of the currency union:

> 'In 1988, after several failures in the process to link the exchange rates and to try to coordinate monetary movements, the first step was made towards having a common currency. There was a report, the "Delors Report". That was later changed and finally endorsed by the European Council. The important thing as far as we are concerned today is that this report in a sense spelled out a methodology. There was a road with dates, deadlines and conditions to be satisfied. I think that is part of the efforts of our leaders and we, ourselves have to draw up today.'[142]

The report that Van Rompuy presented ahead of the summit on 26 June 2012, entitled 'Towards a Genuine Economic and Monetary Union', was not a second Delors Report, even though it similarly envisaged a 'stage-based process' for

136 Eurogroup Statement on Spain, 9 June 2012.
137 Mary Watkins, 'Spanish bond yields rise sharply' *Financial Times* (12 June 2012).
138 Quoted in Victor Mallet, 'Rajoy urges battle for euro's survival' *Financial Times (FT. Com)* (13 June 2012).
139 Prime Minister Cameron's speech at the Mexico G20, 18 June 2012.
140 Peter Ludlow, 'Short-term help and long-term conditionality: The European Council of 28-29 June 2012' (Eurocomment No 4, 2012) 6-7. For more detailed analyses of the events at Los Cabos, particularly Monti's proposal, see Peter Spiegel, 'If the euro falls, Europe falls' *Financial Times* (16 May 2014); Bastasin (n 19) 375-378.
141 Ralph Atkins and Michael Steen, 'Transcript: FT interview with Benoît Coeuré' *Financial Times (FT.Com)* (20 June 2012).
142 'Introductory statement to the press conference (with Q&A)' (ECB, 6 June 2012).

strengthening the single currency's 'architecture'.[143] Drafted in only five weeks' time, it could not have been. It was certainly ambitious though, envisaging reforms in four different areas. The first concerned an 'integrated financial framework', which should consist of three central elements: single European banking supervision, a common deposit and insurance framework and a European resolution scheme.[144] The second dealt with an 'integrated budgetary framework' for states in the currency union.[145] Their annual budget balance and debt levels should be subject to 'upper limits'.[146] Issuance of debt beyond these limits 'would have to be justified and receive prior approval'.[147] The Union would also have the power to 'require changes' to budgetary plans if these were to run counter to fiscal rules.[148] At a later stage, the 'issuance of common debt' by the members of the currency union could be a possibility.[149] The third area had to do with 'policy coordination', which should be made 'more enforceable' so as to ensure that national policies could not endanger the currency union's stability.[150] Developments in the above three areas, moreover, should go hand in hand with stronger mechanisms for 'legitimate and accountable joint decision-making'.[151]

The vision set out in the report had a long-term horizon, and President Van Rompuy indicated that he was prepared to present a 'specific and time-bound road map' in December 2012.[152] Leaders were aware, however, that the crisis called for urgent action. On 22 June those of the currency union's four biggest states – Germany, France, Italy and Spain – had met in Rome to discuss the upcoming European Council meeting and Euro Summit on 28 and 29 June.[153] There, Merkel had indicated she was prepared to find ways to better support Spain's ailing banking system, provided that such support went hand in hand with more fundamental long-term reforms.[154] The leaders also decided that

143 Report by President of the European Council Herman Van Rompuy, *Towards a Genuine Economic and Monetary Union* (Brussels, 26 June 2012) (Towards a Genuine EMU Report June 2012).
144 Towards a Genuine EMU Report June 2012 (n 143) 4-5.
145 Towards a Genuine EMU Report June 2012 (n 143) 5-6.
146 Towards a Genuine EMU Report June 2012 (n 143) 5.
147 Towards a Genuine EMU Report June 2012 (n 143) 5.
148 Towards a Genuine EMU Report June 2012 (n 143) 5.
149 Towards a Genuine EMU Report June 2012 (n 143) 5-6.
150 Towards a Genuine EMU Report June 2012 (n 143) 6.
151 Towards a Genuine EMU Report June 2012 (n 143) 6.
152 Towards a Genuine EMU Report June 2012 (n 143) 7. The European Council would eventually also call for the presentation of such proposals in an interim report in October, and a final one by December. See European Council, Conclusions, Brussels, 29 June 2012, para 4.
153 Ludlow, 'Short-term help' (n 140) 8; De Boissieu and others (n 120) 266; Bastasin (n 19) 380.
154 Ludlow, 'Short-term help' (n 140) 8; De Boissieu and others (n 120) 266; Bastasin (n 19) 380.

their finance ministers should further prepare the summit in Paris on 26 June.[155] This meeting in Paris, in which several high ranking officials from Brussels also took part, would prove crucial.[156] Finance Minister Schäuble proposed to enable the future ESM to engage in direct recapitalisation of banks, provided there would be a single supervisory mechanism to monitor these financial institutions.[157]

On 28 June deliberations started late in the afternoon with a European Council meeting, which amongst others was set up to adopt a 'Compact for Jobs and Growth'.[158] At a certain point Van Rompuy indicated that he wanted to inform the press that they had reached an agreement on the compact.[159] Although such practice is unusual, early communication of the agreement mattered to several leaders, in particular Hollande who hoped it would help him gain support at home for the ratification of the Treaty on Stability, Coordination and Governance.[160] However, Monti and Rajoy withheld their consent and made clear that they would block all agenda items until agreement had been reached on short-term solutions for the currency union's woes.[161] 'Italy will not underwrite the agreement unless the Conclusions include specific measures that Italy, but not Italy only, consider indispensable', Monti argued.[162] It forced Van Rompuy to bring forward the Euro Summit, which had only been scheduled for lunch the next day, to right after the European Council meeting.[163]

When the Euro Summit began at 1:19 am, the advisors of the leaders had already been bargaining for more than six hours.[164] A deal was in the making, but several issues still needed to be settled at the highest level, two of which are particularly important. The first concerned direct recapitalisation assistance.[165] With a view to 'break the vicious circle between banks and sovereigns',[166] agreement had already been reached that the ESM would be able to directly recapitalise banks once a single supervisory mechanism was

155 Ludlow, 'Short-term help' (n 140) 9; De Boissieu and others (n 120) 266; Bastasin (n 19) 380.
156 Ludlow, 'Short-term help' (n 140) 9; De Boissieu and others (n 120) 266-267.
157 Ludlow, 'Short-term help' (n 140) 9; De Boissieu and others (n 120) 267; Bastasin (n 19) 380.
158 Detailed accounts of the meetings of the European Council and Euro Summit on 28-29 June can be found in Ludlow, 'Short-term help' (n 140) 9-22; De Boissieu and others (n 120) 267-273.
159 Ludlow, 'Short-term help' (n 140) 10; De Boissieu and others (n 120) 269; Bastasin (n 19) 383.
160 De Boissieu and others (n 120) 269.
161 Ludlow, 'Short-term help' (n 140) 10; De Boissieu and others (n 120) 269; Bastasin (n 19) 383.
162 Quoted in Bastasin (n 19) 383.
163 Ludlow, 'Short-term help' (n 140) 10-11; De Boissieu and others (n 120) 270.
164 De Boissieu and others (n 120) 270.
165 Ludlow, 'Short-term help' (n 140) 20-21; De Boissieu and others (n 120) 271.
166 See Euro summit statement, Brussels, 29 June 2012, point 1.

established. The question was, however, what should be done in the intervening period.[167] Rajoy wanted such support to be immediately available, yet Merkel refused to directly recapitalise ailing banks without having proper European oversight in place. A compromise was eventually reached that the Council would 'consider' the Commission's proposals for a supervisory mechanism 'as a matter of urgency by the end of 2012'.[168]

The second issue dealt with the legal basis for the supervisory mechanism.[169] In line with Van Rompuy's report and Draghi's wish, leaders decided that the summit's conclusions would indicate specifically that Article 127(6) TFEU would serve as a legal basis for the mechanism, so as to reassure markets that the European Central Bank would be at its helm.[170] The only treaty provision dealing with financial stability would now form the basis for one of the fundamental pillars of the reformed currency union.[171]

The deal was momentous. Leaders had tied short-term rescue measures to long-term reforms which extended beyond banking supervision as such.[172] Indeed, in the subsequent period, the agreement on a single supervisory mechanism would form a driving force behind the establishment of the Banking Union's remaining pillars: A single rulebook for financial actors as well as a single resolution mechanism.[173] Within hours of the deal's announcement markets started to 'rebound', causing the largest daily hike in European stocks and Italian and Spanish bond prices that year.[174] When Central Bank President Draghi visited Van Rompuy in his office ahead of the European Council's remaining working session the following morning, he told him: 'Herman, do you realise what you all did last night? This is the game-changer we need.'[175]

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167 Ludlow, 'Short-term help' (n 140) 20-21; De Boissieu and others (n 120) 271.

168 Euro summit statement, Brussels, 29 June 2012, point 1. The single supervisory mechanism would eventually become operative in November 2014. The ESM Board of Governors subsequently adopted a decision on the basis of Art 19 ESM Treaty to add direct recapitalisation assistance to the ESM's set of instruments on 8 December 2014. However, after the entry into force of the Banking Union's other pillars, in particular the Bank Recovery and Resolution Directive and a Single Resolution Fund, the importance of the direct recapitalisation instrument has declined as it may only come into play after the bail-in arrangements for private creditors have proven to be insufficient. See Art 8 of the ESM Guideline on Financial Assistance for the Direct Recapitalization of Financial Institutions.

169 Ludlow, 'Short-term help' (n 140) 21; De Boissieu and others (n 120) 271.

170 Euro summit statement, Brussels, 29 June 2012, point 1.

171 For analysis of this provision see also text to n 300 (ch 4).

172 See also Ludlow, 'Short-term help' (n 140) 25-26; De Boissieu and others (n 120) 272.

173 On 24 November 2015 the Commission has, moreover, tabled a proposal for a European deposit insurance scheme. See Commission, 'Proposal of 24 November 2015 for a Regulation of the European Parliament and of the Council amending Regulation (EC) 806/2014 in order to establish a European deposit insurance scheme', COM (2015) 586 final.

174 Hugh Carnegy, Peter Spiegel and Quentin Peel, 'Markets rebound following EU deal' *Financial Times* (30 June 2012).

175 Quoted in Herman Van Rompuy, *Europe in the Storm: Promise and Prejudice* (Davidsfonds Uitgeverij 2014) 21.

Or as Van Rompuy himself puts it: 'The commitment of political leaders to European banking supervision created the opening *he* [Draghi, ed] needed for his own institution to step up its role in the crisis'.[176]

The Bank did not act immediately. It wanted to keep sufficient distance from what had happened at the summit and it also needed time to reflect on the appropriate strategy, making sure that it would not get itself into the same uncomfortable position it had been under the Securities Markets Programme. But on 26 July, at the Global Investment Conference in London, Draghi made his move: 'When people talk about the fragility of the euro….and perhaps the crisis of the euro, very often non-euro area member states or leaders, underestimate the amount of political capital that is being invested in the euro. And so we view this, and I do not think we are unbiased observers, we think the euro is irreversible'.[177] 'But there is another message I want to tell you', he continued:

> 'Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough.'[178]

Immediately after Draghi had made his pledge, on 27 July, Merkel and Hollande published a joint communiqué in which they restated their 'fundamental commitment to the integrity of the euro area' and, whilst not openly referring to the Bank, stressed that 'The member states and the European institutions – each according to its prerogatives – must fulfil their obligations to this end'.[179] They ended by emphasising 'the need for swift implementation' of the deal arrived at by the leaders in June.[180]

Draghi's words calmed fears about an imminent collapse of the currency union. In the days that followed, Spanish yields on 10-year government bonds, which had risen again to dangerous heights in the weeks following the June summit, dropped below the red line of 7%. Those of Italy witnessed a signi-

176 Van Rompuy, *Europe in the Storm* (n 175) 21. See also De Boissieu and others (n 120) 272-273.

177 Verbatim of the remarks made by Mario Draghi (Global Investment Conference, London, 26 July 2012).

178 Verbatim of the remarks made by Mario Draghi (Global Investment Conference, London, 26 July 2012).

179 Joint communiqué issued by M. François Hollande, President of the Republic, and Mrs Angela Merkel, Chancellor of Germany, 27 July 2012 (Joint communiqué of Hollande and Merkel, 27 July 2012). Note that on the same day German finance minister Schäuble published a statement containing an even more explicit approval of the Bank's actions. It welcomed Draghi's pledge 'to take the necessary measures to secure the euro in the framework of the existing ECB mandate'. See quote in 'German French statement for eurozone integrity' *Deutsche Welle* (27 July 2012), <www.dw.com/en/german-french-statement-for-eurozone-integrity/a-16128287> accessed 25 April 2017. See also Bastasin (n 19) 398.

180 Joint communiqué of Hollande and Merkel, 27 July 2012.

ficant decline too.[181] Interestingly, however, the other members of the Governing Council had no prior knowledge of Draghi's speech.[182] In fact, he himself had only added the 'whatever it takes' pledge to the script at the very last moment.[183] But in the days that followed Draghi's call for decisive action met with broad support from his colleagues, even Jürgen Stark's replacement at the Executive Board, the German Jörg Asmussen.[184] 'People try to violate principles every day', he later explained.[185] 'You have to resist it 99 percent [of the time] and say, "this is not the extraordinary situation"…. You have peace time and you have wartime. In peacetime I'm on the *Bundesbank* line but the situation was very different'.[186]

Only *Bundesbank* President Weidmann remained heavily opposed.[187] Yet, with the overwhelming majority of the Governing Council on his side, Draghi followed up on his pledge at his press conference of 2 August. He indicated that the Eurosystem 'may consider' outright purchases in order to push markets out of a 'bad' equilibrium and fight 'exceptionally high risk premia' which related to 'fears about the reversibility of the euro' and were hampering the singleness and proper transmission of its monetary policy.[188] Later that month Weidmann would go public with his criticism in an interview with *Der Spiegel*: 'The framework has been stretched and, in some cases disregarded ….I was already critical of the sovereign bond purchases that have been made to date….Such a policy is too close to state financing via the money press for me'.[189]

It was to no avail. On 6 September the Governing Council decided on the principal features of its Outright Monetary Transactions, which it published in a press release.[190] Similar to the Securities Markets Programme, which was terminated at the same time, it allows the Eurosystem to purchase government bonds on the secondary market whilst 'sterilising' any injected liquid-

181 Dave Shellock, 'ECB pledge to preserve euro fires up markets' *Financial Times* (28 July 2012).
182 Irwin (n 11) 380; Spiegel, 'If the euro falls, Europe falls' (n 140).
183 As Irwin (n 11) 380 tells, the line was not included in the version of the speech that was given to the reporters at the conference. The ECB therefore subsequently had to publish an updated version on its website under the name 'Verbatim of the remarks made by Mario Draghi'.
184 Irwin (n 11) 381-382; Spiegel, 'If the euro falls, Europe falls' (n 140).
185 Quoted in Spiegel, 'If the euro falls, Europe falls' (n 140).
186 Quoted in Spiegel, 'If the euro falls, Europe falls' (n 140).
187 Irwin (n 11) 382-383; Spiegel, 'If the euro falls, Europe falls' (n 140).
188 'Introductory statement to the press conference (with Q&A)' (ECB, 2 August 2012). As regards the notion of 'multiple equilibria' see text to n 27 (ch 4).
189 Georg Mascolo, Michael Sauga and Anne Seith, 'Bundesbank president on ECB Bond purchases' *Spiegel Online International* (tr Paul Cohen, 29 August 2012). See also Irwin (n 11) 383.
190 ECB Press Release, 'Technical features of Outright Monetary Transactions' (ECB, 6 September 2012).

ity.[191] At the same time, it contains some important modifications that intend to make it much more effective than its predecessor.[192] First, there are no '*ex ante* quantitative limits' on the size of purchases, so as not to play into speculator's hands.[193] Second, purchases are focused on the 'shorter part of the yield curve', specifically on bonds with a maturity varying between one and three years.[194] Third, the Eurosystem ranks '*pari passu*' with private creditors so as not to discourage the latter from investing in bonds of distressed states as well.[195] Fourth, and most important, intervention is specifically tied to conditionality this time.[196] The Eurosystem will only buy up bonds of states that are subject to an ESM or EFSF 'macroeconomic adjustment programme', or a 'precautionary programme', provided they contain the option of primary market purchases.[197] If states do not comply with their programme, the Eurosystem will cease its purchases. Over and above such situations, the Governing Council can decide to stop purchases, just as it can decide to activate or continue them, 'in full discretion' and on the basis of its monetary policy mandate.[198]

Until this very day the bond programme has not been used. In fact, it has not even been transposed into a formal legal act. Its mere announcement sufficed to take away much of the fear that was holding markets in its grip.[199]

When Draghi was asked about the support for the programme within the Governing Council at the Bank's press conference of 6 September, he had to admit the decision lacked unanimity: 'Well, it was not unanimous. There was

191 ECB Press Release, 'Technical features of Outright Monetary Transactions' (ECB, 6 September 2012).

192 See also Philippine Cour-Thimann and Bernhard Winkler, 'The ECB's non-standard monetary policy measures: the role of institutional factors and financial structure' (2012) 28 Oxf Rev Econ Policy 765, 778-779.

193 ECB Press Release, 'Technical features of Outright Monetary Transactions' (ECB, 6 September 2012). Later the ECB would indicate, however, that it does employ limits internally. See Case C-62/14 *Gauweiler* [2015] ECLI:EU:C:2015:400, Opinion of AG Cruz Villalón, para 191.

194 ECB Press Release, 'Technical features of Outright Monetary Transactions' (ECB, 6 September 2012).

195 ECB Press Release, 'Technical features of Outright Monetary Transactions' (ECB, 6 September 2012).

196 To put it in the words of ECB Executive Board member Jörg Asmussen, expressed late August 2012, shortly before the OMT announcement: 'The error with Italy ... must not be repeated'. See quote in James Wilson, 'ECB seeks to ease bond fears' *Financial Times* (28 August 2012).

197 In practice, only ESM adjustment programmes are still of relevance. As of 1 July 2013 the EFSF can no longer enter into new assistance operations. States that received EFSF assistance have successfully exited their programmes or are now subject to (new) ESM programmes.

198 ECB Press Release, 'Technical features of Outright Monetary Transactions' (ECB, 6 September 2012).

199 For a detailed analysis of the OMT announcement's impact on bond yields see Carlo Altavilla, Domenico Giannone and Michele Lenza, 'The financial and macroeconomic effects of OMT announcements' (ECB Working Paper series No 1707, August 2014).

one dissenting view. We do not disclose the details of our work. It is up to you to guess'.[200] The guess was not very hard. Just like Axel Weber had done in relation to the Securities Markets Programme, Weidmann had voted against. Unlike his predecessor, however, he would not resign from office. Instead, he would go on to defend his views before Germany's constitutional court.

5 Conclusion

The intervention of the European Central Bank in government bond markets has been crucial for the currency union's survival. However, those who argue that it has thereby compensated for political inactivity or, worse still, that it has been pulling the strings, misread its actions. The Bank's bond purchases are inextricably linked to the normative solidarity displayed by the member states. Going beyond what many held possible on the basis of its original mandate, not least by conservative voices within the Bank itself, they were dependent on the change in the Founding Contract between the member states that leaders had initiated early 2010, and the subsequent confirmation of that change through concrete action. The establishment of a rescue fund for the currency union at large enabled the Bank to launch the Securities Markets Programme in May 2010, just as the decision to create a Banking Union created the opening it needed to announce its Outright Monetary Transactions in the summer of 2012.

This second programme in particular has proven extremely effective. Grounded in Draghi's pledge to do 'whatever it takes', its mere announcement sufficed to take away much of the panic that had driven markets for more than two years. But Draghi could only make that pledge because the heads of state and government had made it first, on 11 February 2010.

The importance of what happened on that winter day in Brussels can therefore not be overestimated. By initiating a change in the Union's Founding Contract, committing to do whatever it takes to safeguard financial stability, political leaders laid the basis for an unprecedented display of positive solidarity by their states and equally unprecedented bond purchases by the Bank. Together, they evidenced nothing less than a fundamental transformation of the euro. They also put great pressure on its legal set-up, however, which to a great extent still reflected a stability conception from the past. It was only a matter of time before they would be challenged before court.

200 'Introductory statement to the press conference (with Q&A)' (ECB, 6 September 2012).

7 Reconciling the Contract with the Treaties

1 INTRODUCTION

The commitment given by political leaders on 11 February 2010 to safeguard financial stability at all means marked a time of great uncertainty; politically but certainly also legally. It initiated a change in the Union's Founding Contract, a change that would be shaped further in the weeks and months ahead. Throughout that time, however, the law remained unaffected. Those having to act on the change therefore felt curbed by the law. The single currency's legal set-up, put in place by the Treaty of Maastricht, had been designed with a different conception of stability in mind. It was not made for the challenges the currency union was now facing. National governments questioned how far they could go in their display of positive solidarity without running counter to the no-bailout clause. The Commission racked its brain over assistance based on Article 122(2) TFEU. And the European Central Bank, too, found itself in unchartered territory given its carefully circumscribed stability mandate and the prohibition on monetary financing.

The question was therefore not *whether* but *when* the actions to which the change in the Contract had given rise would be put to the test before the Court. In 2012, it first ruled on the shift towards positive solidarity by pronouncing on the legality of the ESM in *Pringle*,[1] before assessing the Bank's bond purchases in *Gauweiler* in 2015.[2] In both cases the Court found itself between a rock and a hard place. It was not in a position to strike down actions that had been crucial to the single currency's survival. Yet, in order to approve of them it had to engage in a Herculean struggle with the law that still largely reflected a stability conception from the past. The conclusion to this study will address the question *why* the Court had to approve of the actions, or more specifically: why it could not disapprove, and show how this ultimately relates to solidar-

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▪ This chapter contains and/or builds on previously published work by the author. See especially Vestert Borger, 'The ESM and the European Court's Predicament in *Pringle*' (2013) 14 GLJ 113; Vestert Borger, 'How the Debt Crisis Exposes the Development of Solidarity in the Euro Area' (2013) 9 EuConst 7; Vestert Borger, 'Outright Monetary Transactions and the Stability Mandate of the ECB: *Gauweiler*' (2016) 53 CML Rev 139.

1 Case C-370/12 *Thomas Pringle v Government of Ireland, Ireland and the Attorney General* [2012] ECLI:EU:C:2012:756 (*Pringle*).

2 Case C-62/14 *Peter Gauweiler and others v Deutscher Bundestag* [2015] ECLI:EU:C:2015:400 (*Gauweiler*).

ity. This current chapter instead focuses on *how* it approved the actions through an analysis of its reasoning. It will show that it managed to get out of its predicament precisely by turning the uncertainty surrounding the single currency's legal set-up to its advantage.

Understanding how the Court could do this requires a distinction between 'clear' and 'hard' cases.[3] Contrary to 'clear' cases, in which the applicability of a rule to a set of facts does not raise any problems, hard cases are characterised by uncertainty about which rule should apply or how it should be interpreted.[4] In such situations a court cannot dispose of a case through mere 'deductive justification', that is: by examining whether the facts of the case can be subsumed under a certain rule.[5] It will first have to determine which rule applies and/or decide on its interpretation. This at the same time complicates and helps a court in its task to dispose of a case. It complicates because a court cannot limit itself to applying a given rule to a set of facts but first needs to interpret this rule. But it also helps as the need for interpretation allows a court a certain freedom to reason in favour of a particular outcome.

To see why a court has such freedom, a further distinction needs to be made between 'first' and 'second-order' justification.[6] In clear cases, first-order (deductive) justification suffices to render judgment, yet in hard cases second-order justification is called for since a court needs to justify the use and interpretation of a certain rule.[7] Given, however, that there is no legal method that exhaustively determines how courts should operate at this level, allowing for a single right answer in each and every case,[8] they possess a certain freedom

3 Neil MacCormick, *Legal Reasoning and Legal Theory* (Clarendon Press 1978) 197; Gunnar Beck, *The Legal Reasoning of the Court of Justice of the EU* (Hart Publishing 2013) 47-48.

4 As Joxerramon Bengoetxea, *The Legal Reasoning of the European Court of Justice: Towards a European Jurisprudence* (Clarendon Press 1993) 183ff explains, the distinction between 'clear' and 'hard' cases is analytical and not 'absolute'. One could say they represent ideal types, forming two extremes of a spectrum, and that in practice a case will be situated somewhere along the spectrum depending on its degree of clarity or hardness. See also MacCormick (n 3) 197ff.

5 The term 'deductive justification' features prominently in MacCormick's theory on legal reasoning. See MacCormick (n 3) 19ff. For discussion and analysis of his theory see eg Eveline T Feteris, *Fundamentals of Legal Argumentation: A Survey of Theories on the Justification of Judicial Decisions* (Kluwer 1999) 73-91; Beck, *The Legal Reasoning of the Court of Justice* (n 3) 119-125.

6 MacCormick (n 3) 100ff.

7 MacCormick (n 3) 101: 'Second-order justification must therefore involve justifying choices; choices between rival possible rulings. And these are choices to be made within the specific context of a functioning legal system…'.

8 See in this regard Dworkin's 'right answer thesis' and his assertion that judges should strive to find the 'single' right answer in each case, aiming to act at the level of a model judge 'Hercules', 'a lawyer of superhuman skill, learning, patience and acumen' who is able to act in line with the best theory of a legal system. See Ronald Dworkin, *Taking Rights Seriously*

to favour one interpretation of the law over others.[9] This is not to say that 'everything goes' when it comes to judicial reasoning. Courts will have to justify their reasoning using accepted 'criteria of interpretation' and show that it fits the existing body of law.[10] Yet, whereas these criteria 'guide' their interpretation, they do not 'determine' their decisions.[11]

Both *Pringle* and *Gauweiler* are 'hard' cases.[12] As much as the meaning of key provisions of the single currency's original set-up were clear to economists, at least the stability hawks amongst them, their *legal* meaning was far from obvious. As with so many rules, they are at times 'vague', 'ambiguous' and 'imprecise', necessitating interpretation.[13] This chapter examines how the Court used the interpretative space at its disposal in both cases to reconcile the change in the Founding Contract with Union law. All the great interpretative challenges it encountered in this regard ultimately turned around the question whether and to what extent the law can accommodate the currency

(Duckworth 1977) 105 (and more generally ch 4 on 'hard cases'). As MacCormick (n 3) 255 points out, however, Dworkin's Hercules can 'construct' such a theory 'only at the far end of an infinite regress of theories. Dworkin has landed his Hercules in Augean stables in which the dung cannot run out, because it is in infinite supply'. See also Beck, *The Legal Reasoning of the Court of Justice* (n 3) 19-20, 23, 118.

9 Some, such as Robert Alexy, argue that not only first-order justification is of a deductive nature, but that this equally applies to (elements of) second-order justification. See generally Robert Alexy, *A Theory of Legal Argumentation: The Theory of Rational Discourse as Theory of Legal Justification* (OUP 1989). For discussion see Feteris (n 5) 90-91, 92-118. Still, as Gunnar Beck explains, the uncertainty that exists at the level of first-order justification resurfaces at the level of second-order justification, not least because there is no 'meta-rule' or method that exhaustively determines which interpretative criteria should govern a certain interpretative question and which criteria take precedence over others in particular situations. See Beck, *The Legal Reasoning of the Court of Justice* (n 3) 129, 133-137.

10 In the words of MacCormick, a court cannot let itself be guided solely by 'consequentialist' considerations, but will have to show its ruling is 'consistent' and 'coherent' with the law that is already in place. See MacCormick (n 3) 108-128. See also text to n 6 (conclusion). For an analysis and overview of the European Court's generally accepted 'criteria of interpretation' see Bengoetxea, *The Legal Reasoning of the European Court of Justice* (n 4) 227-262; Beck, *The Legal Reasoning of the Court of Justice* (n 3) 187-230; Suvi Sankari, *European Court of Justice Legal Reasoning in Context* (Europa Law Publishing) 89-176.

11 See Bengoetxea, *The Legal Reasoning of the European Court of Justice* (n 4) 230.

12 Strictly speaking, one could argue that any case reaching the Court under the preliminary ruling procedure is 'hard' given that on the basis of the *CILFIT* doctrine national courts do not need to refer a question when it is 'materially identical' to one that has already been the object of a preliminary ruling respectively when previous judgments of the Court have 'already dealt with the point of law in question' (*acte éclairé*) or when there is no 'reasonable doubt as to the manner in which the question raised is to be resolved' (*acte clair*). See Case 283/81 *CILFIT* [1982] ECLI:EU:C:1982:335, paras 12-20. However, this does not necessarily mean that they will also be hard for the Court. See Joxerramon Bengoetxea, 'Book Review Essay: Text and Telos in the European Court of Justice – Four Recent Takes on the Legal Reasoning of the ECJ' (2015) 11 EuConst 184, 189.

13 For a discussion of such sources of (linguistic) vagueness see Beck, *The Legal Reasoning of the Court of Justice* (n 3) 52ff.

union's new stability conception, characterised by the need to protect financial stability. Its reasoning is imbued by that need.

Following the sequence in which the cases were brought before the Court, this chapter will first discuss *Pringle* before turning its attention to *Gauweiler*. It will show that just as in practice central bank intervention had been dependent on prior action by the member states, so too the Court's review in both cases was inextricably linked; its interpretation of the no-bailout clause and 136(3) TFEU had a great bearing on its reading of the mandate of the Bank and the prohibition on monetary financing. Most of the Court's reasoning on these issues is sound or, where it is strained, could have been justified through the use of different arguments. At one point in its reading of the no-bailout clause, however, the Court encounters the limits of what can be justified through legal reasoning alone.

Finally, a remark about the scope of analysis. Both *Pringle* and *Gauweiler* are rich judgments, touching on a host of interesting legal issues. *Pringle*, for example, sheds light on whether and to what extent the member states can make use of Union institutions when cooperating outside the Union legal order.[14] *Gauweiler*, in its turn, raises interesting questions concerning the Court's ability to review central bank decisions the content of which has only been published in a press release and has not yet been incorporated in a formal legal act.[15] It also provides insight into the relation between the *Bundesverfassungsgericht* and the Court and the hierarchy between them.[16] Exciting as they are, and notwithstanding the many interesting commentaries on them in the literature, this chapter will only discuss them if and to the extent necessary for the analysis of how the Court dealt with the core provisions of the single currency's original stability set-up in its attempt to reconcile the Founding Contract with the Treaties.

14 See on this issue Bruno De Witte and Thomas Beukers, 'The Court of Justice approves the creation of the European Stability Mechanism outside the Union legal order: *Pringle*' (2013) 50 CML Rev 805, 843-847; Stanislav Adam and Francisco Javier Mena Parras, 'The European Stability Mechanism through the Legal Meanderings of the Union's Constitutionalism: Comment on *Pringle*' (2013) 38 EL Rev 848, 861-864; Steve Peers, 'Towards a New Form of EU Law?: The Use of EU Institutions Outside the EU Legal Framework' (2013) 9 EuConst 37; Paul Craig, '*Pringle* and Use of EU Institutions Outside the EU Legal Framework: Foundations, Procedure and Substance' (2013) 9 EuConst 263.

15 See on this point Vestert Borger, 'Outright Monetary Transactions and the Stability Mandate of the ECB: *Gauweiler*' (2016) 53 CML Rev 139, 167-169; Takis Tridimas and Napoleon Xanthoulis, 'A Legal Analysis of the *Gauweiler* Case: Between Monetary Policy and Constitutional Conflict' (2016) 23 MJ 17, 21-23.

16 See on this point Borger, 'Outright Monetary Transactions' (n 15) 165-167; Paul Craig and Menelaos Markakis, 'Gauweiler and the Legality of Outright Monetary Transactions' (2016) 41 EL Rev 4, 14-17; Matthias Goldmann, 'Constitutional Pluralism as Mutually Assured Discretion' (2016) 23 MJ 119; Daniel R Kelemen, 'On the Unsustainability of Constitutional Pluralism: European Supremacy and the Survival of the Eurozone' (2016) 23 MJ 136; Tridimas and Xanthoulis (n 15) 35-37.

2 ACCOMMODATING THE SHIFT IN SOLIDARITY

2.1 The boundary between economic and monetary policy

The Decision of the European Council to insert a third paragraph into Article 136 TFEU to clear the way for the ESM had been a German desire.[17] Berlin wanted to take away constitutional concerns about a violation of the no-bailout clause following the shift towards positive solidarity with the establishment of the 'Greek' facility and the EFSF in spring 2010.[18] At the same time, it was precisely this Decision that allowed these concerns to find their way into national courtrooms. As both the amending Decision and the ESM Treaty itself required ratification and/or approval at national level, all across the Union legal challenges were brought against these instruments. In as many as five member states – Germany, Estonia, Poland, Ireland and Austria –[19] they even reached the highest courts.[20]

Of these five challenges, the one before the *Bundesverfassungsgericht* held the public spotlight. As the entry into force of the ESM Treaty was dependent

17 European Council Decision 2011/199/EU of 25 March 2011 amending Article 136 of the Treaty on the Functioning of the European Union with regard to a stability mechanism for Member States whose currency is the euro [2011] OJ L 91/1 (European Council Decision 2011/199). See also text to n 308 (ch 5).

18 Both assistance facilities were challenged before the *BVerfG*, which contributed to the constitutional concerns. See BVerfG, 2 BvR 987/10 of 7 September 2011 (BVerfG *Greek Loan Facility and EFSF*). The *BVerfG* only approved of the facilities on 7 September 2011, long after the European Council had decided to amend Article 136 TFEU and establish the ESM. See also text to n 187 (ch 7).

19 Supreme Court of Estonia, Judgment of 12 July 2012, Case No 3-4-1-6-12; Supreme Court of Ireland, *Thomas Pringle v The Government of Ireland, Ireland and the Attorney General* [2012] IESC 47; Austrian Constitutional Court, Judgment of 16 March 2013, Case No SV 2/12-18; Polish Constitutional Tribunal, Judgment of 26 June 2013, Case No K 33/12; BVerfG, 2BvR 1390/12 12 September 2012 (BVerfG *ESM and TSCG summary review*); BVerfG, 2 BvR 1390/12 of 18 March 2014 (BVerfG *ESM and TSCG principal proceedings*). For an overview of (some of) these judgments see Samo Bardutzky and Elaine Fahey, 'Who Got to Adjudicate the EU's Financial crisis and Why? Judicial Review of the Legal Instruments of the Eurozone' in Maurice Adams, Federico Fabbrini and Pierre Larouche (eds), *The Constitutionalization of European Budgetary Constraints* (Hart Publishing 2014) 348-352. See also Federico Fabbrini, 'The Euro-Crisis and the Courts: Judicial Review and the Political Process in Comparative Perspective' (2014) 32 Berkeley Journal of International Law 64. Concerning the *BVerfG*'s judgments see also text to n 187 (ch 7).

20 In some member states lower courts had to review challenges against the ESM Treaty and/or European Council Decision 2011/199. An example forms the Netherlands, where the Dutch member of parliament and leader of the Freedom Party ('PVV') brought an unsuccessful challenge against the ESM Treaty in summary proceedings. See Rechtbank Den Haag 1 June 2012, Case No 419556, KG ZA 12-523, LJN: BW7242). For analysis see Stefaan Van den Bogaert, Tom de Gans and Johan van de Gronden, 'National report: The Netherlands' in Ulla Neergaard, Catherine Jacqueson and Jens Hartig Danielsen (eds), *The Economic and Monetary Union: Constitutional and Institutional Aspects of the Economic Governance within the EU* (XXVI FIDE Congress Publications Vol 1, 2014) 482-483.

on its ratification by Contracting Parties representing no less than 90% of the total subscriptions to its authorised capital stock,[21] a negative ruling from the German constitutional court could prevent the permanent rescue mechanism from becoming operational.[22] But whilst markets and the media were holding their breath in anticipation of the verdict from Karlsruhe, it was the Irish supreme court that made the most interesting move from a legal point of view: it referred preliminary questions to the Court.

Ireland's ratification of the ESM Treaty coincided with that of the Treaty on Stability Coordination and Governance.[23] And it was the latter that gained most attention in the public debate. As the fiscal treaty is not a measure of Union law but exists separately from the Union Treaties, it could not benefit from Article 29 of the Irish constitution according to which measures necessitated by Union membership enjoy 'automatic compatibility' with it.[24] The Government therefore decided to put it to a popular vote in a referendum on 31 May 2012.[25] No such referendum, however, was considered necessary for the ESM; an act of parliament sufficed for the ratification of the amending Decision of the European Council as well as the ESM Treaty.[26]

But not everyone agreed with this course of action, not even within the Irish parliament itself. Thomas Pringle, a left-wing independent member of the Irish lower house (*Dáil*), did consider a referendum necessary and even went to court for it.[27] His argument was based not only on Irish constitutional law, but also explicitly on the law of the Union.[28] In his view, the European Council Decision amending Article 136 TFEU violated the Union Treaties and,

21 Art 48(1) ESM Treaty and Annex II. See also text to n 330 (ch 5).

22 As discussed in ch 5, this scenario eventually did not materialise as the German constitutional court refused to issue a temporary injunction, allowing ratification of the ESM Treaty provided it would be ensured that Germany's payment obligations could not exceed the amount of €190bn that was specifically mentioned in the Treaty. Moreover, none of the provisions on the inviolability of documents, professional secrecy and immunities of persons should bar detailed information of the *Bundestag*. See text to n 332 (ch 5).

23 For analysis of the TSCG see text to n 93 (ch 6).

24 Stephen Coutts, *Constitutional Change Through Euro Crisis Law: Ireland* (EUI 2014) <eurocrisislaw.eui.eu/ireland/> accessed 2 May 2017.

25 The referendum was passed by a majority of 60% of the votes cast. For more detail see Coutts (n 24).

26 European Council Decision 2011/199 was ratified through the European Communities Act 2012. This act amends the European Communities Act 1972, including Decision 2011/199 in the definition of 'Treaties governing the European Union'. The ESM Treaty was ratified through the ESM Act 2012. For more information on these acts of ratification see Coutts (n 24).

27 For an analysis of whether Irish constitutional law indeed necessitated such a referendum see Gavin Barrett, 'The Treaty Amendment on the European Stability Mechanism: Does it Require a Referendum in Ireland?' (2011) 29 Irish Law Times 152.

28 For an overview of the arguments relating to Union law see High Court of Ireland, *Thomas Pringle v Government of Ireland, Ireland and the Attorney General* [2012] IEHC 296, para 18 (High Court of Ireland *Pringle*).

by extension, the Irish constitution, not in the least because it had been improperly adopted on the basis of the simplified revision procedure in Article 48(6) TEU.[29] As the third paragraph it sought to insert into Article 136 TFEU envisaged an alteration of Union competences, the Decision should have been adopted on the basis of the ordinary revision procedure in Articles 48(2)-(5) TEU. Moreover, the ESM Treaty itself was contrary to Union law and, consequently, the Irish constitution.[30] According to Mr Pringle the Treaty violated Union law for various reasons, yet his most fundamental objection was that it ran counter to the very essence of the single currency's legal set-up and the stability conception it embodied. It contradicted the system of market discipline that the prohibitions on monetary financing and bail-out sought to install and circumvented the limited assistance option in Article 122(2) TFEU.

At first instance, Justice Marty Laffoy in the High Court rejected most of Mr Pringle's claims in a judgment rendered on 17 July 2012.[31] But on appeal, on 31 July 2012, the Irish Supreme Court decided to refer the case to Luxembourg to obtain greater clarity on its Union law dimension.[32] Three questions were of particular concern to it, each of them relating to the change in the Contract and the shift in solidarity it had caused.[33] The first asked whether the amending Decision of the European Council was valid in as far as it was adopted on the basis of the simplified revision procedure in Article 48(6) TEU. The second sought guidance on the interpretation of several provisions of primary Union law with a view to ascertaining whether and to what extent they allowed the members of the currency union to conclude and ratify the ESM Treaty. Of particular interest were those provisions that made up the core of the single currency's original stability set-up, especially the ban on bail-out in Article 125 TFEU and the assistance clause in Article 122(2) TFEU.[34] The third question, finally, concerned the legal nature of the third paragraph that the European Council Decision aimed to insert into Article 136 TFEU and asked whether conclusion and ratification of the ESM Treaty was dependent on the Decision's entry into force.

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29 High Court of Ireland *Pringle* (n 28) para 152.

30 High Court of Ireland *Pringle* (n 28) paras 58-90.

31 High Court of Ireland *Pringle* (n 28).

32 In as far as Mr Pringle's claims concerning Irish constitutional law as well as his request for a temporary injunction preventing Irish ratification of the ESM Treaty pending the outcome of the preliminary ruling procedure were concerned, the Supreme Court dismissed them in a judgment on 19 October 2012. See Supreme Court of Ireland, *Thomas Pringle v Government of Ireland, Ireland and the Attorney General* [2012] IESC 47.

33 For an overview of the questions see *Pringle* (n 1) para 28.

34 Besides these two provisions, the Supreme Court sought guidance on Arts 2, 3, 4(3) and 13 TEU, Arts 2(3), 3(1)(c), 3(2), 119, 120, 121, 123, 126 and 127 TFEU, as well as Art 47 of the Charter. This study will only discuss the Court's interpretation of these provisions in as far as they relate to the shift in solidarity and the questions it raises about Arts 122(2) and 125 TFEU.

At first sight, the answer to the first question seemed straightforward. Article 136(3) TFEU clearly belongs to Title III of the TFEU on the Union's internal policies and does not increase the competences of the Union as it speaks about the possibility for *member states* to establish a permanent mechanism.[35] The European Council could therefore resort to the simplified revision procedure in Article 48(6) TEU to adopt the amendment. At a closer look, however, the matter was more complicated. Mr Pringle asserted that even though Article 136(3) TFEU formed part of Title III, it had an impact on provisions located elsewhere in the Treaties. More specifically, it affected the classification of monetary policy in Article 3(1)(c) TFEU as an exclusive Union competence by allowing states to establish a stability mechanism for the currency union. In so doing, its legal significance reached beyond Title III and the European Council should therefore have adopted it on the basis of the ordinary revision procedure.[36]

The claim that the European Council Decision amounted to an '*implied*' amendment to the division of competences between the Union and the member states forced the Court to pronounce on the policy nature of the stability mechanism mentioned by Article 136(3) TFEU. *De facto* this meant it had to identify the policy nature of the ESM.[37] After all, only when the latter belonged to the realm of monetary policy was there force in the argument that the Decision went beyond amending Title III of the TFEU. Identifying this policy nature was far from easy, however, since the Treaties define neither monetary nor economic policy. The absence of a clear definition is by no means a characteristic peculiar to the set-up of the single currency; Union law is renowned for its many undefined, 'open-ended' concepts.[38] In such situations the Court has to venture beyond the text and look to context and purpose to interpret

35 See in this regard also *Pringle* (n 1) paras 46, 71-75.

36 This argument finds support in academic writings. According to Steve Peers, for example, 'Neither can Article 48(6) be used to make *implied* amendments to other parts of the Treaty (or to other primary law texts). So it would not be possible to use Article 48(6) to adopt an amendment which is nominally placed in Part Three TFEU but which de facto amends other primary law provisions'. See Steve Peers, 'The Future of EU Treaty Amendments' (2012) 31 YEL 17, 38. See also De Witte and Beukers (n 14) 827.

37 Later in its judgment, when analysing the conformity of the ESM Treaty with Union law, the Court would also specifically address the policy nature of the ESM (instead of the mechanism envisaged by European Council Decision 2011/199). See *Pringle* (n 1) paras 95-98.

38 See in this regard Albors Llorens, 'The European Court of Justice, More than a Teleological Court' (1999-2000) 2 CYEL 373, 377-378. See also Anthony Arnull, *The European Union and Its Court of Justice* (2nd edn, OUP 2006) 612-613; Koen Lenaerts and Jose A Gutiérrez-Fons, 'To Say What the Law of the EU Is: Methods of Interpretation and the European Court of Justice' (2013-2014) 20 Colum J Eur L 3, 16.

the law. In fact, in this case the Court resorted to both to determine the policy nature of Article 136(3) TFEU.[39]

Although the Treaties contain no definition of monetary policy, they do set out its objectives and instruments. In the view of the Court both are relevant for determining the policy nature of the mechanism envisaged by Article 136(3) TFEU, yet the objective takes centre stage.[40] Whereas the primary objective of the Union's monetary policy is to maintain price stability, that of the mechanism in Article 136(3) TFEU is to safeguard the stability of the euro area as a whole. This latter objective, according to the Court, is 'clearly distinct' from the objective of price stability and shows the envisaged mechanism falls within the realm of economic policy.[41] Although the stability of the euro area 'may have repercussions' on the stability of the single currency, 'an economic policy measure cannot be treated as equivalent to a monetary one for the mere reason it may have indirect effects on the stability of the euro'.[42]

The presumption flowing from the objective that the mechanism in Article 136(3) TFEU constitutes economic policy, the Court reasoned, is further strengthened by its instruments. Article 136(3) TFEU states that the mechanism may grant financial assistance, which clearly does not fall within the realm of monetary policy.[43] The provision's ties to other elements of Union law further underline its economic policy character.[44] Whereas the single currency's original legal set-up, in particular the prohibitions on bail-out and monetary financing, was largely 'preventive' in nature, aiming to avoid public debt crises, the mechanism in Article 136(3) TFEU intends to manage such crises if they 'nonetheless arise'.[45]

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39 This fusion of different methods of interpretation reflects the fact that they cannot be clearly separated in practice. When the Court resorts to the 'technical meaning' of a word instead of its ordinary one, for example, textual interpretation approaches a schematic reading of the law. Schematic and purposive criteria of interpretation may similarly overlap. When the Court identifies the purpose of a certain piece of legislation by having regard to its formulation by the legislator in its preamble, one could qualify it both as a purposive and schematic interpretation. See Giulio Itzcovich, 'The Interpretation of Community Law by the European Court of Justice' (2009) 10 GLJ 537, 550-552, 555-556; Beck, *The Legal Reasoning of the Court of Justice* (n 3) 214-215, 314-315.

40 *Pringle* (n 1) paras 53, 55.

41 *Pringle* (n 1) para 56.

42 *Pringle* (n 1) para 56. For an analysis of how this statement on effects fits the Court's 'centre of gravity approach' to identifying a measure's correct legal basis see Armin Steinbach, 'Effect-Based Analysis in the Court's Jurisprudence on the Euro Crisis' (2017) 42 EL Rev 254, 261-262.

43 *Pringle* (n 1) para 57.

44 *Pringle* (n 1) paras 58-59.

45 *Pringle* (n 1) para 59. For a broader analysis of how this fits the currency union's transition from a 'rule-based' to a 'policy-based' enterprise and how the Court has approved of this in *Pringle* see Alicia Hinarejos, *The Euro Area Crisis in Constitutional Perspective* (OUP 2015) 127-129.

The finding that Article 136(3) TFEU belongs to economic policy would have sufficed for the conclusion that the amendment contained in the Decision of the European Council was restricted to Title III of the TFEU and had therefore been validly adopted on the basis of the simplified revision procedure.[46] Yet, as the Irish Supreme Court also wanted to know whether the Decision encroached on the Union's competences in the area of economic policy the Court continued its analysis. Articles 2(2) and 5(1) TFEU, it argued, limit the Union's role in this area to 'the adoption of coordinating measures' and there is no 'specific' Union power to establish a mechanism such as the one in Article 136(3) TFEU.[47] It admitted that Article 122(2) TFEU allows the Union to grant assistance to a member state which is coping with difficulties caused by 'exceptional occurrences beyond its control', yet it argued that this provision only covers '*ad hoc* financial assistance' and does not provide a legal basis for a mechanism that is permanent and whose objective is to safeguard the financial stability of the euro area as a whole.[48]

This part of the Court's reasoning seems unnecessary. Article 122(2) TFEU is not affected by the Decision of the European Council, and even if it were it is not clear how that would have a bearing on Treaty provisions outside Title III, for example those on the division and nature of competences in Title I.[49] The reasoning is not only unnecessary, it is also strained. For one thing, the Union's role in the area of economic policy is not restricted to that of coordination, if only because the assistance clause in Article 122(2) TFEU itself cannot be qualified as 'coordinative'.[50] More fundamentally, as will be explained below when looking specifically at this provision, the statement that this clause does not provide a legal basis for the stability mechanism envisaged by the European Council Decision due to its permanency and objective is too radical and unnecessarily casts doubt on the legality of the EFSM and its assistance operations.[51]

The Court's analysis of the policy nature of Article 136(3) TFEU shows how an act's perception in practice may differ from its classification under the law. Few who observed the succession of events back in 2010 would hold Article 136(3) TFEU nor the ESM Treaty to be acts of monetary policy. In fact, after

46 *Pringle* (n 1) para 63.

47 *Pringle* (n 1) para 64. Concerning the possibility to establish a mechanism like the one envisaged by European Council Decision 2011/199 on the basis of the flexibility clause in Art 352 TFEU, the Court limited its analyses to saying that the Union had 'not used its powers' under that provision and the latter does not impose 'any obligation to act' in this regard. See *Pringle* (n 1) para 67. For the argument that the ESM could have been established on the basis of that provision see Chris Koedooder, 'The *Pringle* Judgment: Economic and/or Monetary Policy?' (2013-2014) 37 Fordham Int'l LJ 111, 142.

48 *Pringle* (n 1) paras 64-65.

49 See also De Witte and Beukers (n 14) 834 (fn 103).

50 See also De Witte and Beukers (n 14) 833.

51 See text to n 141 (ch 7).

political leaders had initiated the change in the Contract on 11 February 2010 the European Central Bank waited with using its monetary policy tools to stem market unrest so as to put pressure on the member states to act first.[52] *They* had to demonstrate their commitment to safeguard financial stability through acts of positive solidarity before it could step in. The ESM is the permanent successor to the temporary rescue facilities that the states established in response.

But this clarity in practice between economic and monetary policy was of little help to the Court. It could not make the distinction between the two policy areas based on how this is played out in practice but had to ground it in the law. The latter does not give a definition of monetary nor economic policy, and for good reason. Economists already have a hard time understanding the law's endeavour to draw the boundary between the two, let alone attempts to do so by legal definition. But the absence of such a definition left the Court no option other than to base its reasoning on systemic-teleological arguments, causing it to engage directly with the single currency's new stability conception.[53] Paul Craig has criticised the way in which it did so. He argues that the Court's classification of financial stability as being 'clearly distinct' from price stability is no more than 'legal formalism' as the financial stability of the euro area 'is surely a condition precedent to price stability within that area'.[54] Yet, the Court is not denying that the two are related. On the contrary, precisely because of the fact that they are distinct yet highly connected objectives it stated that an economic policy measure should not be equated with a monetary one for the sole reason it may have indirect effects on price stability.

A different question is to what extent the objective of financial stability can be pursued by the Bank. In *Pringle* the Court did not provide an answer, and there was also no need to as it was not asked by the referring court. But in *Gauweiler* the Court would have to settle the issue, with its reasoning in *Pringle* coming to figure as a source of inspiration.

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52 See text to n 12 (ch 6).

53 Note that AG Kokott argued, by referring to Art 2(1) TFEU, that the member states may also act in areas of exclusive Union competence as long as they are empowered by the Union to do so. It was therefore not necessary to pronounce on the policy nature of Art 136(3) TFEU given that even if it were to have a monetary policy nature it would not amount to a substantive alteration of Arts 2(1) and 3(1) TFEU. See *Pringle* (n 1), View of AG Kokott, paras 48-53. However, this reasoning seems doubtful, especially in view of the fact that the Treaties first and foremost regulate the division of competences between the Union and the member states. On the basis of the AG's reasoning member states could flood the Treaties with 'empowering' clauses whilst formally leaving the exclusive nature of a Union competence intact.

54 Paul Craig, '*Pringle*: Legal Reasoning, Text, Purpose and Teleology' (2013) 20 MJ 3, 5.

2.2 The Court's struggle with history

2.2.1 Reading the ban on bail-out

When determining the policy nature of Article 136(3) TFEU, the Court stated that it 'complements' the single currency's economic policy set-up, including the no-bailout clause in Article 125 TFEU.[55] Whereas the latter is preventive in nature, focused on mitigating the risk of public debt crises, Article 136(3) TFEU covers situations in which such crises nonetheless occur. This is undoubtedly correct: Article 136(3) TFEU addresses an important policy need by indicating that the members of the currency union can establish a permanent stability mechanism. That still leaves open the question *how* it addresses this gap. Does it do so by providing an exception to the prohibition on bail-out or does it merely make explicit an assistance possibility that has always stood at the disposal of member states? This issue was at the very heart of the Court's quest to accommodate the shift towards positive solidarity, which it therefore had no choice but to address when assessing the ESM Treaty's conformity with Union law.

The relation between the ESM and the ban on bail-out illustrates how sometimes the meaning of a legal provision is unveiled only under the pressure of events. Prior to the crisis, the interpretation of the ban offered by most lawyers did not significantly exceed its general understanding among policy makers or economists; it sought to promote fiscal discipline by subjecting states to the logic of the market in order to allow the Bank to deliver price stability.[56] But the crisis forced lawyers to sharpen their reading of the ban and discover the true limits to financial assistance operations. The many different interpretations taken may be subdivided into three general categories: those defending a *literal*, a *systemic-teleological* and an *ultima ratio* reading.[57] To understand each of them, Article 125 TFEU deserves to be quoted in full:

> 'The Union shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law or public undertakings of any Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project. A Member State shall not be liable for or assume the commitments of central governments, regional, local, or other public authorities, other bodies governed by public law, or public undertakings of another Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project.'

55 *Pringle* (n 1) para 58. See also text to n 44 (ch 7).

56 René Smits, for example, argued that 'the rationale for this prohibition is ... the application of full market rigour to the activities of Governments'. See René Smits, *The European Central Bank: Institutional Aspects* (Kluwer Law International 1997) 77. See also text to n 274 (ch 3).

57 See Vestert Borger, 'The ESM and the European Court's Predicament in *Pringle*' (2013) 14 GLJ 113, 129-131.

Those defending a *literal* interpretation focused on the ban's text and hence advocated a narrow reading.[58] Article 125 TFEU refers to the impossibility for the Union or member states to 'be liable for' or 'assume' the commitments of another state. This implies that it only rules out that the Union and its member states support a debtor state by guaranteeing or assuming its financial commitments to its creditors. Or to put it in the words of Advocate General Kokott: '[I]n addition to the exclusion of liability….The prohibition on assumption of commitments therefore prevents a Member State….from taking upon itself the commitments of another Member State, either by discharging the commitment by making payment or by itself becoming the obligated party subject to the commitment, which it then has to discharge at a late date'.[59]

For most lawyers, however, such a literal reading was too restrictive in nature and contrary to the *context* and *purpose* of the ban. It had been included to promote fiscal prudence by subjecting states to the logic of the market. Together with the prohibitions on monetary financing and privileged access to financial institutions in Articles 123 and 124 TFEU, it seeks to ensure that states can only (re)finance their debt on the markets under conditions similar to private entities.[60] Any form of assistance – not just the provision of guarantees or the direct assumption of commitments – has the capacity to weaken that discipline as it signals to both markets and states themselves that it is not only a state's individual capacity, but that of the Union and other member states which ultimately determines whether and to what extent financial commitments will be honoured. In its purest form, and except for 'mutual financial guarantees for the joint execution of a specific project' which are explicitly excluded by Article 125 TFEU, a systemic-teleological reading of the ban therefore rules out any form of assistance.[61]

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58 See eg Christoph Herrmann, 'Griechische Tragödie: der währungsverfassungsrechtliche Rahmen für die Rettung, den Austritt oder den Ausschluss von überschuldeten Staaten aus der Eurozone' (2010) 21 EuZW 413, 415. According to Herrmann: 'Art. 125I AEUV beinhaltet gerade kein generelles Verbot einer freiwilligen Hilfeleistung der Mitgliedstaaten füreinander. Primär verbietet Art. 125I AEUV nur den Eintritt in die Schuldbeziehung zwischen einem Mitgliedstaat und seinem Gläubiger'.

59 *Pringle* (n 1), View of AG Kokott, paras 119, 121.

60 See text to n 274 (ch 3).

61 See eg Kurt Fassbender, 'Der europäische "Stabilisierungsmechanismus" im Lichte von Unionsrecht und deutschem Verfassungsrecht' (2010) 29 NVwZ 799, 800; Lothar Knopp, 'Griechenland-Nothilfe auf dem verfassungsrechtlichen Prüfstand' (2010) 29 NVwZ 1777, 1779-1780; Hanno Kube and Ekkehart Reimer, 'Grenzes der Europäischen Stabilisierungsmechanismus' (2010) 63 NJW 1911, 1912-1914; Kai Hentschelmann, 'Finanzhilfen im Lichte der No Bailout-Klausel: Eigenverantwortung und Solidarität in der Währungsunion' (2011) 46 EuR 282, 286, 290-294; Hannes Hofmeister, 'To Bail Out or not to Bail Out?: Legal Aspects of the Greek Crisis' (2010-2011) 13 CYEL 113, 119-123; Matthias Ruffert, 'The European Debt Crisis and European Union Law' (2011) 48 CML Rev 1777, 1785-1787; Rainer Palmstorfer, 'To Bail Out or Not to Bail Out? The Current Framework of Financial Assistance for Euro Area Member States Measured Against the Requirements of EU Primary Law' (2012) 37 EL Rev 771, 775-779. According to the latter author (p 778): '[A]rt. 125(1) TFEU

Even though widely supported, this interpretation also met with objections as it would lead to the perverse result that the Union and its states are barred from granting assistance even if what is at stake is the very survival of their currency union. Some argued that fiscal prudence was not the no-bailout clause's sole, let alone its highest purpose. By subjecting states to the logic of the market and inducing them to budgetary discipline it ultimately seeks to safeguard the single currency.[62] If applying the prohibition with full rigour would not only lead to the default of the distressed state but, as a result of contagion and panic, would threaten to tear down that currency, the prohibition should gave way to this higher purpose.[63] Financial assistance should then, as *ultima ratio*, be possible.

The Court could not freely choose between these different interpretations. Unlike the scholars defending them, it could not afford to be guided solely by concerns of a legal '*fit*'.[64] Its reading of the no-bailout clause *had* to allow for the establishment of the ESM.[65] And it had to do so in a way that respected the change in the Founding Contract. This meant that not just any judgment permissive of the ESM would suffice. It had to be one that reflected the fact that the member states had jointly committed themselves to a move away from the no-bailout clause, yet only in a limited, carefully circumscribed way. It had to be one that reflected Article 136(3) TFEU.

But even an interpretation of the no-bailout clause that reflected this provision would not suffice in itself. After all, its entry into force on 1 May 2013 marked the end of a process in which the members of the currency union had already been shaping, and acting on, their new Contract.[66] The ESM Treaty had already seen the light of day on 27 September 2012, right after Karlsruhe had given the green light for the initiative.[67] And even before that, since May 2010, states had provided hundreds of billions of financial assistance to their distressed partners, first through the 'Greek' facility and shortly thereafter

covers and bans all forms of financial assistance given by the European Union or through a Member State to another'.

62 See Ulrich Häde, 'Die europäische Währungsunion in der internationalen Finanzkrise: An den Grenzen europäischer Solidarität' (2010) 45 EuR 854, 859-862.

63 Häde, 'Die europäische Währungsunion in der internationalen Finanzkrise' (n 62) 859-862.

64 Legal 'fit' refers to Dworkin's use of the term to indicate the requirement that in legal interpretation one should aim for consistency with existing law. See eg Ronald Dworkin, *Justice in Robes* (HUP 2006) 15.

65 See text to n 2 (ch 7) and the conclusion to this study. See also Martin Nettesheim, 'Europarechtskonformität des Europäischen Stabilitätsmechanismus' (2013) 66 NJW 14, 16 who notes about the Court's reasoning in this respect: 'Die diesbezüglichen Passagen lesen sich, als ob sie nicht aus dem AEUV heraus entwickelt, sonder zur Rechtfertigung des ESM passgenau zugeschnitten wurden. Sie nehmen damit einen tendenziell apologetischen Grundzug an'.

66 See also text to n 17ff (ch 5).

67 See text to n 336 (ch 5).

through the EFSF. If the legality of these constructs up to the entry into force of Article 136(3) TFEU was to be beyond doubt, this provision could not form an exception to the ban on bail-out. As the European Council had stressed in December 2010: it had to be declaratory in nature, 'not modifying Article 125 TFEU'.[68]

The Court managed to succeed in this task by adopting a reading of Article 125 TFEU that combined elements of all three suggested interpretations.[69] It began by pointing out that, judging from the prohibition's text which only speaks about liability for, or assumption of, commitments, it does not seek to rule out all forms of assistance.[70] The Court then supported this textual analysis with two systemic arguments. One concerned the prohibition on monetary financing in Article 123 TFEU.[71] Compared to its wording, which rules out 'overdraft facilities or any other type of credit facility', Article 125 TFEU is formulated in a much 'stricter' way and hence does not intend to prohibit all forms of assistance.[72] The other argument drew inspiration from the assistance clause in Article 122(2) TFEU. If Article 125 TFEU had contained an all-encompassing prohibition, this clause would have had to indicate that it 'derogated' from it.[73] Especially this second argument is unconvincing, as will be explained more fully below when reflecting on Article 122(2) TFEU and the EFSM.[74]

Having identified the lower limit to assistance operations through textual reasoning, the Court then resorted to its purpose to find out which kinds of financial support it does allow. It identified this purpose, quite exceptionally, with the help of the legislative history of the Treaty of Maastricht.[75] The Court rarely makes use of the *travaux préparatoires*,[76] if only because during the first

68 European Council, Conclusions, 28-29 October, Brussels, para 2. See also text to n 289 (ch 5).

69 In the run-up to the Court's judgment several academic contributions had already suggested a reading of the no-bailout clause consisting of several interpretative arguments. See eg Alberto De Gregorio Merino, 'Legal Developments in the Economic and Monetary Union During the Debt Crisis: The Mechanisms of Financial Assistance' (2012) 49 CML Rev 1613, 1625-1630; Phoebus Athanassiou, 'Of Past Measures and Future Plans for Europe's Exit From the Sovereign Debt Crisis: What is Legally Possible (and What is Not)' (2011) 36 EL Rev 558, 560-565. For a careful analysis of the Court's interpretation see also Ben Smulders and Jean-Paul Keppenne, 'Artikel 125' in Hans von der Groeben, Jürgen Schwarze and Armin Hatje (eds), *Europäisches Unionsrecht* (Nomos 2015) Rn 13-16.

70 *Pringle* (n 1) para 130.

71 *Pringle* (n 1) paras 131-132.

72 *Pringle* (n 1) para 132.

73 *Pringle* (n 1) para 131.

74 See text to n 141 (ch 7).

75 *Pringle* (n 1) para 135.

76 The situation is different as far as historical interpretation in relation to secondary Union law is concerned. Although here too historical interpretation is still not as common as other methods of interpretation, the Court displays an increasing tendency to resort to this interpretative instrument in relation to secondary legislation. See in this regard Soren

35 years those of the Treaty of Rome were accessible only to a limited extent.[77] This time, however, it did adopt an originalist interpretation by referring to the draft treaty that the Commission had tabled in December 1990.[78] Although this draft represents the views of only one participant in the negotiations,[79] one moreover that would not become a party to the Treaty, the Court posited nothing less than a truism when distilling from it the legislative intention to ensure that states follow a sound budgetary policy by subjecting them to 'the logic of the market'.[80] This led it to conclude that Article 125 TFEU rules out assistance that weakens the 'incentive' of the benefiting state 'to conduct a sound budgetary policy'.[81] But such budgetary prudence is not an end in itself, the Court then reasoned, yet 'contributes at Union level to the attainment of a higher objective, namely maintaining the financial stability of the monetary union'.[82]

Schønberg and Karin Frick, 'Finishing, Refining, Polishing: On the Use of Travaux Préparatoires as an Aid to the Interpretation of Community Legislation' (2003) 28 EL Rev 149.

77 Lenaerts and Gutiérrez-Fons (n 38) 23. AG Mayras stated in this regard in *Reyners*: '[T]he States, signatories to the Treaty of Rome have themselves excluded all recourse to the preparatory work and it is very doubtful whether the declarations and reservations, inconsistent as they are, which have been relied upon can be regarded as constituting true preparatory work'. See Case 2/74 *Reyners* [1974] ECLI:EU:C:1974:68, View of AG Mayras, 657,666. The fact that the *travaux préparatoires* of the Treaty of Rome have not been officially published does not mean they are completely unavailable. See on this point Gerard Conway, *The Limits of Legal Reasoning and the European Court of Justice* (CUP 2012) 256 (fn 43).

78 Commission, 'Communication of 21 August 1990 on economic and monetary union' SEC(90)1659 final (Bulletin of the European Communities 1991, supplement 2/91) 24; Commission, *Commentary to the Draft Treaty amending the Treaty establishing the European Economic Community with a view to achieving economic and monetary union* (Bulletin of the European Communities, supplement 2/91) 54 (Commentary to the Commission EMU-Draft Treaty). The Court's reliance in *Pringle* on the draft of just a single negotiating party can be contrasted with its more inclusive approach in *Inuit*. In that case it had to decide on the meaning of the notion 'regulatory act' in Art 263(4) TFEU. Prior to its inclusion into the TFEU this notion had already been incorporated into the (failed) Constitution for Europe (Article III-365). The Court could therefore have recourse to the publicly accessible workings of the European Convention to interpret the notion. More specifically, it could rely on a cover note of the Praesidium explaining the choice for the wording 'regulatory act' instead of 'act of general application' when discussing proposals for amending Art 263 TFEU. See Case C-583/11 *P Inuit* [2013] ECLI:EU:C:2013:625, paras 58-59. See also Lenaerts and Gutiérrez-Fons (n 38) 25-27.

79 For an analysis of the drafts of key players at the negotiating table, notably France and Germany, see ch 3.

80 *Pringle* (n 1) para 135.

81 *Pringle* (n 1) para 136.

82 *Pringle* (n 1) para 135. One may wonder why the Court specifically defines this higher objective as 'financial stability *of the monetary union*'. Given that Art 125 TFEU applies to all member states it is far from obvious why it should not allow for assistance targeting financial stability concerns outside the currency union or that of the Union as a whole. See also De Witte and Beukers (n 14) 841.

The Court subsequently made two crucial observations that synthesised the interpretive elements it had set out and defined the material scope of the ban on bailout. It first stated:

> '[T]he activation of financial assistance by means of a stability mechanism such as the ESM is not compatible with Article 125 TFEU unless it is indispensable for the safeguarding of the financial stability of the euro area as a whole and subject to strict conditions.'[83]

Immediately thereafter, it stipulated:

> 'Article 125 TFEU does not prohibit the granting of financial assistance by one or more Member States to a Member State which remains responsible for its commitments to its creditors provided that the conditions attached to such assistance are such as to prompt that Member State to implement a sound budgetary policy.'[84]

Defined in this way, the ban not only matches Article 136(3) TFEU, it also avoids classifying the latter as an exception by indicating that assistance granted if indispensable to safeguard financial stability and subject to strict conditions falls outside its scope.

The ESM Treaty itself is in conformity with this reading of the ban. Concerning the lower limit to assistance, the Court reasoned that none of the instruments at the disposal of the ESM have as a result that it will 'act as guarantor of the debts of the recipient member state', which 'remains responsible to its creditors for its financial commitments'.[85] Neither credit lines granted on the basis of Article 14 ESM Treaty nor loans issued in accordance with Articles 15 and 16 free the recipient state from its commitments.[86] On the contrary, they give rise to a 'new debt', owed by that state to the ESM, which has to be repaid to the mechanism in line with Article 13(6) ESM Treaty.[87] Bond market intervention also stays clear of the lower limit to assistance. As regards primary market purchases on the basis of Article 18 ESM Treaty, the Court pointed out that this is 'comparable to the granting of a loan'.[88] And whereas in the case of secondary market purchases the ESM pays a price to the holder of a bond,

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83 *Pringle* (n 1) para 136.

84 *Pringle* (n 1) para 137.

85 *Pringle* (n 1) para 138. See also Athanassiou (n 69) 561: 'To lend is not to assume any obligations, as loans are "assets" (unlike obligations, which are "liabilities")'. For a discussion on to what extent this lower limit to assistance bars creditor member states from consenting to a 'haircut' on loans to a beneficiary state see Steinbach, 'The Haircut of Public Creditors Under EU Law' (2016) 12 EuConst 223, 231-232 (arguing that it rules out such a haircut); Alexander Thiele, '(No) Haircut for Hellas? (2016) 12 EuConst 520, 530 (arguing that it does not rule out such a haircut).

86 *Pringle* (n 1) para 139

87 *Pringle* (n 1) para 139. See also *Pringle* (n 1), View of AG Kokott, para 122.

88 *Pringle* (n 1) para 140.

such payment does not amount to an assumption of responsibility for the debt of the benefiting state.[89]

In relation to the purposes that Article 125 TFEU pursues, the Court drew attention to the fact that Articles 3 and 12(1) ESM Treaty provide that assistance may only be granted 'subject to strict conditionality' suited to the instrument used, thereby *inter alia* ensuring that the recipient state pursues 'a sound budgetary policy'.[90] These provisions also prescribe that the ESM cannot be activated as soon as a state is threatened with market foreclosure. They qualify assistance as *ultima ratio*, possible only 'if indispensable to safeguard the financial stability of the euro area as a whole and of its Member States'.[91]

The Court's interpretation of the ban on bailout not only paved the way for the ESM, it also ensured that the conclusion and ratification of its founding Treaty was not dependent on the prior entry into force of Article 136(3) TFEU. The latter only has a declaratory value, confirming 'the existence of a power possessed by the Member States'.[92] This interpretation also provided an implicit seal of approval to all intergovernmental assistance operations following the change in the Contract initiated on 11 February 2010.[93] What is more, given that the scope of Article 125 TFEU is not restricted to members of the currency union, it also allows member states with their own currency to participate in assistance operations,[94] like the United Kingdom, Denmark and Sweden did in relation to Ireland in the fall of 2010.[95]

2.2.2 *The struggle with history*

What to think of this reading? The fact that the Court based it on a blend of textual, systematic and purposive considerations should come as no surprise. In many legal systems higher courts tend to reason cumulatively by resorting

89 *Pringle* (n 1) para 141. Kaarlo Tuori and Klaus Tuori challenge the Court's reasoning on this point, arguing that secondary market purchases 'certainly amount to discharging the issuing state's commitment to the former creditor and thus imply ... violation of the explicit prohibition on bailouts'. See Kaarlo Tuori and Klaus Tuori, *The Eurozone Crisis: A Constitutional Analysis* (CUP 2014) 126. This view seems incorrect, however. The state that issues a bond has certain payment commitments *under that bond* which remain in place when it is purchased by the ESM from the original creditor.

90 *Pringle* (n 1) paras 142-143.

91 *Pringle* (n 1) para 142.

92 *Pringle* (n 1) paras 184-185.

93 See also Borger, 'The ESM and the European Court's Predicament' (n 57) 132.

94 Note in this regard that Recital 9 and Art 38 ESM Treaty make clear that member states outside the currency union can participate in assistance operations alongside the ESM on an *ad hoc* basis. See also Art 5(4) and 6(3) ESM Treaty.

95 See n 194 (ch 5).

to all three interpretative criteria and the Court is no exception in this regard.[96] This does not mean that the particular cumulative reasoning it employed to elucidate the meaning of the no-bailout clause is above all criticism. Gunnar Beck, for example, has fiercely criticised the Court's literal interpretation of the ban for confining its scope to 'the narrowest of circumstances', that is: situations in which a state's debt is legally 'assigned' to another state as a result of which the latter becomes responsible for that debt.[97] 'As the purpose of such an assignment can easily be achieved by other means, be it the establishment of a stability mechanism or rescue fund, or other multi- or bilateral aid packages', Beck argues, 'the Court's seemingly literal interpretation renders the prohibition in art. 125 TFEU effectively meaningless – a *reductio ad absurdum*, for if as the Court evidently implies, art. 125 was never intended to prevent the transfer of financial risk between euro zone governments, then the so-called "no-bailout" clause does little or nothing to restrict the mutualisation of debt within the euro zone.'[98]

More problematic even, according to Beck, is that the Court did not adhere to its own minimalist textual reading when it declared Article 25 of the ESM Treaty on coverage of losses to be compatible with the ban on bailout.[99] The second paragraph of this Article states that if an ESM member 'fails' to meet payments in the context of capital calls, a 'revised call' will be made to all other members in order to make sure that the ESM receives the envisaged amount of paid-in capital. Only when the non-paying member eventually 'settles its debt to the ESM', will the 'excess capital' be returned to the other members.[100] According to the Court this system is compatible with Article 125 TFEU as other ESM members 'do not act as guarantors of the debt of the defaulting ESM

96 See for an analysis Robert Summers and Michele Taruffo, 'Interpretation and Comparative Analysis' in Neil MacCormick and Robert Summers (eds), *Interpreting Statutes: A Comparative Study* (Dartmouth Publishing Company 1991) 461ff as well as Neil MacCormick and Robert Summers, 'Interpretation and Justification' in Neil MacCormick and Robert Summers (eds), *Interpreting Statutes: A Comparative Study* (Darmouth Publishing Company 1991) 511ff. Gunnar Beck, *The Legal Reasoning of the Court of Justice* (n 3) 312-313 points out, however, that contrary to most higher courts the Court of Justice tends to accord less weight to linguistic arguments. Whereas such arguments enjoy 'presumptive status' in most legal systems, the Court 'may readily consider systemic and purposive arguments even where the wording is tolerably clear'.

97 Gunnar Beck, 'The Court of Justice, Legal Reasoning and the *Pringle* Case' (2014) 39 EL Rev 234, 243. Subscribing to Beck's critique as far as the Court's reasoning is concerned is Michelle Everson, 'An Exercise in Legal Honesty: Rewriting the Court of Justice and the *Bundesverfassungsgericht*' (2015) 21 ELJ 474, 477-480. Voicing similar critique on the Court's literal interpretation is Jonathan Tomkin, 'Contradiction, Circumvention and Conceptual Gymnastics: The Impact of the Adoption of the ESM Treaty on the State of European Democracy' (2013) 14 GLJ 169, 181-182.

98 Beck, 'The Court of Justice, Legal Reasoning and the *Pringle* case' (n 97) 243.

99 Beck, 'The Court of Justice, Legal Reasoning and the *Pringle* case' (n 97) 244.

100 Art 25(3) ESM Treaty.

member', which 'remains bound to pay its part of the capital'.[101] To Beck, however, the increased capital calls constitute precisely the assumption of liability that the ban prohibits.

Beck's critique is unjustified. First let us consider the issue of capital calls. Although it pushes the boundaries of the no-bailout clause, Article 25 ESM Treaty does not violate it. As Advocate General Kokott argued, every ESM member only needs to comply with its own payment obligations under the ESM Treaty.[102] A disregard of these obligations has as a result that others have to pay up an increased amount of their own capital contribution. They do not, however, assume the commitments of the defaulting member, which the latter remains bound to fulfil as Articles 25(2) and (3) ESM Treaty make clear. What *would* amount to a violation of Article 125 TFEU is a mechanism that is based on joint and several liability. Further shifts in the direction of positive solidarity, like a fiscal capacity for the currency union with common debt issuance proposed in the 'five presidents report' of 2015, would therefore be unlawful if and to the extent it makes use of joint and several liability of states.[103]

More fundamentally, the Court's literal reading is not overly limited, as Beck contends. In fact, it is precisely a reasoning such as his that is strained as it implicitly reads into Article 125 TFEU an objective – a ban on transfers of financial risk – that is spelled out nowhere in the text.[104] What would have been problematic is if the Court's interpretation had only consisted of its literal strand.[105] Then, the ban would indeed be devoid of much purpose, only covering a particular legal construct which can easily be circumvented by other means. But the Court did not do that as it also took into account the ban's purpose. Contrary to Beck, however, it made that purposive reasoning explicit instead of trying to present it as a literal one justified on the basis of text alone.

At the same time, it is precisely on the point of objectives that the Court did run into trouble. At first, it correctly identified the purpose of Article 125 TFEU as the maintenance of fiscal discipline by ensuring that member states remain subject to the logic of the market. Immediately thereafter, however, it concluded that financial assistance is therefore allowed provided it is subject to

101 *Pringle* (n 1) paras 144-145.
102 *Pringle* (n 1), View of AG Kokott, paras 161-165.
103 See text to n 356 (ch 5).
104 See Paul Craig, '*Pringle* and the Nature of Legal Reasoning' (2014) 21 MJ 205, 218.
105 Interestingly, in her View on the case AG Kokott argued in favour of an interpretation of Art 125 TFEU consisting only of a literal strand. She was against a purposive interpretation of the no-bailout clause, covering assistance that has the *effect* of discharging the commitments of a state, as it would go against 'basic structural principles' of the Union 'that rank as of at least equal importance to Article 125 TFEU', in particular the protection of the sovereignty of the states and the solidarity that exists between them. See *Pringle* (n 1), View of AG Kokott, paras 136-144. This appeal to sovereignty and solidarity will be examined in more detail in the conclusion to this study. See text to n 89 (conclusion).

strict conditions that force the benefiting state to pursue a sound budgetary policy. This is nothing less than a jump over objectives.[106] When the leaders of the currency union decided on the main parameters of assistance operations in early 2010, they tried to stay as close as possible to the ban on bailout by demanding that any assistance had to be accompanied by strict conditionality.[107] But this cannot conceal the fact that this latter instrument of public discipline differs fundamentally from that of market discipline originally relied on by Article 125 TFEU. Certainly, both aim for budgetary prudence, yet their *modus operandi* vary greatly. Whereas markets operate at a preventive stage, trying to induce states to budgetary prudence through risk premia that match their fiscal record, conditionality usually comes into play *ex post*, once states can no longer (re)finance their debt on the market and are dependent on financial assistance from their partners.[108]

Stability-minded states, especially Germany, realised this when they were negotiating the modalities for assistance and that is why in addition to conditionality they initially insisted on non-concessional interest rates for any loans distressed states would receive.[109] Throughout the crisis, however, these interest rates have been lowered several times,[110] as a result of which assistance mechanisms like the ESM differ in nature from the Bank's bond purchases, as will be explained more fully below.[111] But in theory one could ensure that financial assistance pays tribute to the instrument of market discipline, at least in situations where the markets find themselves in a bad equilibrium and the official interest rate charged by them exceeds what can be explained by a state's fundamental economic condition.[112] In these situations assistance could be offered at interest rates that would prevail on the market under a good equilibrium. In its judgment, however, the Court did not pay attention to market discipline. It did mention that Article 20(1) ESM Treaty demands that assistance includes an appropriate 'margin',[113] yet it failed to operationalise that finding, instead limiting itself to the conclusion that financial assistance

106 Borger, 'The ESM and the European Court's Predicament' (n 57) 135-137; Craig, 'Pringle: Legal Reasoning, Text, Purpose and Teleology' (n 54) 8-9.

107 See text to n 85 (ch 5).

108 Note, however, that some of the ESM's assistance instruments can be used at a preventive stage, especially precautionary credit lines which aim to promote sound economic policies by supporting states before they face major difficulties accessing the capital markets. See Art 14 ESM Treaty and ESM Guideline on Precautionary Financial Assistance.

109 See text to n 69 and n 89 (ch 5).

110 See eg text to n 199 (ch 5).

111 See text to n 229, n 244 and n 325 (ch 7).

112 On the issue of 'multiple equilibria' see text to n 27 (ch 4).

113 *Pringle* (n 1) para 139. This notion is less demanding than non-concessional interest rates, and the ESM's pricing policy may therefore be below market rates. For the ESM's current pricing policy see ESM Guideline on Pricing Policy.

falls outside the scope of Article 125 TFEU when it is subject to strict conditionality.[114]

Some have argued that this jump over objectives is not problematic as the Court's reasoning is ultimately tied to the *ultima ratio* consideration of financial stability. Take Kaarlo Tuori and Klaus Tuori. In their view the Court has confirmed that Article 125 TFEU has a 'double *telos*'.[115] Its primary objective, bringing about budgetary prudence through the markets, 'contributes' to the higher objective of financial stability.[116] It shares this latter objective with the ESM which, contrary to the ban on bailout, does not relate to 'crisis prevention' but 'crisis resolution'.[117] Due to this commonality in objectives, the ban should not stand in the way of financial assistance if indispensable to safeguard financial stability. But too much leeway for financial stability is not called for either, Tuori and Tuori argue. Realising that assistance is allowed to safeguard this stability, states may lapse into fiscal profligacy, which may endanger not only the ban's primary objective of budgetary prudence but also, and 'paradoxically', the higher objective of financial stability itself.[118] To prevent that scenario from unfolding, and to reconcile the ban's primary and secondary objectives, assistance to safeguard financial stability needs to be subject to 'strict conditionality'.[119]

This reasoning has its appeal, yet it does require regarding financial stability as an objective that has always been pursued by the ban on bailout.[120] It is the issue of financial stability, then, that puts most strain on the reasoning

114 For a different view see Steinbach, 'The "Haircut" of Public Creditors under EU Law' (n 85) 228 (arguing that the Court has effectively turned the presence of an 'appropriate margin' into a requirement for the granting of assistance).

115 Tuori and Tuori (n 89) 127-134. The term 'double telos' comes from Paul Craig. Contrary, to Tuori and Tuori, however, Craig argues that the Court should have opted (solely) for this double teology argument, considering that the Court's current reasoning does create problems from the perspective of market discipline. See Craig, '*Pringle*: Legal Reasoning, Text, Purpose and Teleology' (n 54) 9-11; Craig, 'Pringle and the Nature of Legal Reasoning' (n 104) 219-220. Note, however, that such a reading would restrict the scope of Art 125 TFEU beyond what the European Council agreed in Decision 2011/199. Moreover, this reasoning necessitates the problematic conclusion that financial stability has always been an objective of the no-bailout clause. See on this point text to n 120 (ch 7).

116 Tuori and Tuori (n 89) 129.

117 Tuori and Tuori (n 89) 129.

118 Tuori and Tuori (n 89) 130.

119 Tuori and Tuori (n 89) 130.

120 Tuori and Tuori themselves also struggle with that finding. Whilst they argue that the no-bailout clause has a double telos, they also classify the objective of financial stability of the euro area as a whole as a 'legal innovation' and as 'an important modification of the European macroeconomic constitution'. See Tuori and Tuori (n 89) 131-133. See also Christian Joerges, 'Brother Can You Paradigm?' (2014) 12 ICON 769, 783-785 (discussing the problematic nature of this innovation from the perspective of ordoliberalism).

of the Court.[121] If one were to identify an objective besides budgetary discipline that has inspired the no-bailout clause ever since the currency union's inception, it would have to be price stability.[122] To argue, as the Court did, that financial stability too has come within the purview of Article 125 TFEU from the start is to play with history.[123] Neither a '*subjective*' originalist interpretation – concentrating on the intention of the drafters of the Union Treaties – nor an '*objective*' one – focusing on the general perception of a provision in the legal system or political society when it was created – can justify such a conclusion.[124] To put it in the words of Pisany-Ferry:

> 'When thinking about possible threats that EMU should be defended against, policymakers in Maastricht looked back at past experience and identified two: inflation and fiscal laxity. Financial instability was at the time perceived as being of minor importance and, even though currency unification was expected to reinforce financial integration, no provision was envisaged to deal with the effects of private credit booms-and-busts.'[125]

It is only as a result of the crisis that one discovered the true importance of financial stability for the currency union and the inability of its original legal set-up to address it.[126] Or as Philippine Cour-Thimann and Bernhard Winkler argue: 'The concept of "ensuring the financial stability of the *euro area as a whole*" had to be "invented" in the crisis'.[127] Telling is the difference in justification for the Stability and Growth Pact put forward by the legislator in the preambles to its founding Regulations of 1997 and those amending it in 2011.[128] Whereas the former state that the Pact 'is based on the objective of sound government finances as a means of strengthening the conditions for

121 Not everyone, however, considers this element of the Court's reasoning to be problematic. See eg Adam and Parras (n 14) 861. See also Daniel Thym and Matthias Wendel, 'Préserver le respect du droit dans la crise: la Cour de justice, le MES et le mythe du déclin de la Communauté de droit (arrêt *Pringle*)' (2012) CDE 733, 746; Daniel Thym, 'Anmerkung: Europarechtskonformität des Euro-Rettungsschirms' (2013) 60 Juristenzeitung 259, 262.

122 For a discussion of the stability focus of the single currency's original legal-setup and the predominance attributed to price stability as a policy goal see text to n 112ff (ch 3).

123 See also Borger, 'The ESM and the European Court's Predicament' (n 57) 134-135, 138-139; De Witte and Beukers (n 14) 840-843.

124 On the distinction between 'subjective' and 'objective' originalist interpretation see Conway (n 77) 20-21.

125 Jean Pisany-Ferry, 'The Known Unknowns and Unknown Unknowns of EMU' (Bruegel Policy Contribution No 18, October 2012) 7.

126 See text to n 258 (ch 4).

127 Philippine Cour-Thimann and Bernhard Winkler, 'The ECB's non-standard monetary policy measures: the role of institutional factors and financial structure' (2012) 28 Oxf Rev Econ Policy 765, 767.

128 Tuori and Tuori (n 89) 132-133 (n 21).

price stability and for strong sustainable growth',[129] the latter reconstrues the objective of sound finances as a means for attaining 'price stability and sustainable growth *underpinned by financial stability*'.[130]

To be clear: this study has no objection to purposive reasoning as such.[131] Rather, the difficulty is the absence of a proper legal basis for the argument that the objective of financial stability has always been pursued by Article 125 TFEU. Under international law, where the will of the contracting parties is key, the interpreter has to take into account the behaviour of the parties after treaty conclusion.[132] Article 31(2) of the Vienna Convention on the law of treaties stipulates that he or she needs to consider 'any subsequent agreement between the parties regarding the interpretation of the treaty' and 'any subsequent practice in the application of the treaty which establishes the agreement for the parties regarding its interpretation'.[133] On that basis, one could argue that the declaration that political leaders adopted on 11 February 2010 and the actions of positive solidarity to which it has given rise allow for the objective of financial stability to be read into Article 125 TFEU.

The problem is, however, that the Union Treaties are more than an agreement between sovereign states.[134] Ever since *Costa/ENEL* the Court has taken the view that the Union Treaties form an 'independent source of law',[135] that is not simply an '*expression*' of state sovereignty but also a '*limit*' to it.[136] This

129 Recital 1 of Council Regulation (EC) 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies [1997] OJ L 209/1 (unamended); Recital 2 of Council Regulation (EC) 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure [1997] OJ L 209/6 (unamended).

130 Recital 3 of Regulation (EU) 1175/2011 of the European Parliament and the Council of 16 November 2011 amending Council Regulation 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies [2011] OJ L 306/12 (emphasis added); Recital 3 of Council Regulation (EU) 1177/2011 of 8 November 2011 amending Regulation 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure [2011] OJ L 306/33 (emphasis added).

131 For scholars that do consider the Court too 'activist', and as straying away from the text of the Treaties too much and reasoning too teleologically, at least during certain periods of European integration, see eg Hjalte Rasmussen, 'Towards a Normative Theory of Interpretation of Community Law' (1992) University of Chicago Legal Forum 135; Trevor C Hartley, 'The European Court, judicial objectivity and the constitution of the European Union' (1996) 112 LQR 95; Conway (n 77).

132 For an analysis of 'informal change' in international organizations like the United Nations, WTO and Council of Europe through the lens of the 'subsequent practice' of contracting parties see Julian Arato, 'Treaty Interpretation and Constitutional Transformation: Informal Change in International Organizations' (2013) 38 Yale J Int'l L 289.

133 Art 31(2) Vienna Convention on the Law of Treaties, Vienna, 23 May 1969.

134 Itzcovich (n 39) 540-544.

135 Case 6/64 *Costa v ENEL* [1964] ECLI:EU:C:1964:66, 593.

136 Itzcovich (n 39) 542-543 (emphasis added). Or in the words of Tom Eijsbouts and Monica Claes: 'The member states are at once masters and servants of the Union, and they are many things in between'. See WT Eijsbouts and Monica Claes, 'From Confederacy to Convoy: Thoughts About the Finality of the Union and its Member States' (2010) 6 EuConst 1, 2.

does not mean that it should have disapproved of the assistance operations prior to the entry into force of Article 136(3) TFEU nor that the declaration of 11 February 2010 has no relevance in this respect. In fact, this declaration is of central importance. As the concluding chapter to this study will show, however, its importance requires a different, deeper explanation, one that goes beyond treating it simply as an agreement regarding the interpretation of a treaty in line with the Vienna Convention.[137]

Finally, what about a further widening of the currency union's stability conception towards *political* stability?[138] Would that be compatible with the no-bailout clause? It could be, in theory. Whereas the purpose of the ESM is to safeguard financial stability,[139] Article 136(3) TFEU merely speaks of 'stability of the euro area as a whole.' That wording is broad enough to cover assistance targeting political stability. However, in *Pringle* as well as in *Gauweiler* the Court has equated the purpose stated in Article 136(3) TFEU with the narrower one of the ESM.[140] Without a change of position, therefore, assistance granted explicitly for the benefit of political stability requires a fresh treaty amendment. Unless, of course, the Court were to reason that this kind of stability has also always formed an objective of the no-bailout clause.

2.3 Union assistance and the deal of Cameron

Although *Pringle* principally concerned the shift towards positive solidarity among the member states, it also shed light on the Union's follow up on the change in the Founding Contract. While giving the green light for the ESM and Article 136(3) TFEU, the Court also pronounced on the relation between Articles 122(2) and 125 TFEU as well as the former's suitability to serve as a legal basis for a mechanism like the ESM. The two issues are separate, yet interrelated and the way the Court deals with them casts doubt on the legality of the *EFSM*. To fully grasp its reasoning it is again important to cite Article 122(2) TFEU in full:

137 See text to n 83 (conclusion).

138 See also text to n 358 (ch 5).

139 Art 3 ESM Treaty.

140 See eg *Pringle* (n 1) para 65 in which the Court states that the mechanism envisaged by European Council Decision 2011/199 (which only relates to the introduction of Article 136(3) into the TFEU) is to safeguard *financial stability*. See also paras 136 and 184 of the same judgment in which the Court reasons that Art 136(3) TFEU confirms that member states may only grant assistance when this is indispensable for the safeguarding of financial stability. As far as *Gauweiler* is concerned, see *Gauweiler* (n 2) para 64 in which the Court states that ESM interventions (which are focused on financial stability on the basis of Art 3 ESM Treaty) are intended to safeguard *the stability of the euro area*.

> 'Where a Member State is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control, the Council, on a proposal of the Commission, may grant, under certain conditions, Union financial assistance to the Member State concerned. The President of the Council shall inform the European Parliament of the decision taken.'

First, the relation between this assistance clause and the ban on bailout. To recall: as a subsidiary argument to justify the conclusion that this ban does not prohibit any form of assistance, the Court reasoned that if it had done so, Article 122(2) TFEU would have had to state that it derogated from the ban.[141] This reasoning is unconvincing. Article 122(2) TFEU does not tell us anything about the scope of the ban on bailout other than that the Union has the competence to grant assistance when a state is coping, or is threatened, with difficulties caused by 'exceptional occurrences beyond its control'.[142] Its wording, in particular the absence of a reference to any exceptions, gives no indication about the reach of the ban in relation to assistance granted by member states.

What, then, to make of the relationship between Articles 122(2) and 125 TFEU? Since both are provisions of primary law and a systemic understanding of the law requires them to be in conformity with each other,[143] and given that there is no indication of any formal hierarchy, their scope of application can only be discovered through a balancing exercise. The legislative history of the Treaty of Maastricht may serve as a starting point. As chapter 3 explained, during the negotiations the Commission as well as southern states pressed for a 'counterweight' to the ban on bailout.[144] In its draft treaty of December 1990 the Commission proposed establishing a financial support mechanism that could be activated in the event of 'serious economic problems' or when 'economic convergence required a particular effort on the part of the Community' alongside national strategies of adjustment.[145] For stability-minded states, however, this went too far, as a result of which the more limited assistance clause in Article 122(2) TFEU was eventually settled for.[146] Even

141 See text to n 73 (ch 7).

142 Borger, 'The ESM and the European Court's Predicament' (n 57) 133-134.

143 See in this regard also Declaration on Article 100 of the Treaty establishing the European Community [2001] OJ LC 80/78: 'The Conference recalls that decisions regarding financial assistance, *such as are provided for in Article 100 and are compatible with the "no-bailout" rule laid down in Article 103*, must comply with…' (emphasis added). See also De Gregorio Merino (n 69) 1633.

144 See text to n 292 (ch 3).

145 Commentary to the Commission EMU-Draft Treaty (n 78) 54.

146 Jörn Pipkorn, 'Legal Arrangements in the Treaty of Maastricht for the Effectiveness of the Economic and Monetary Union' (1994) 31 CML Rev 263, 273; Ulrich Häde 'Haushaltsdisziplin und Solidarität im Zeichen der Finanzkrise' (2009) 20 EuZW 399, 402-403; Jean-Victor Louis, 'Guest Editorial: The No-Bailout Clause and Rescue Packages' (2010) 47 CML Rev (2010) 971, 982-983; De Gregorio Merino (n 69) 1633.

though this clause is not formulated as an exception to the ban, when balancing it against Article 125 TFEU it should therefore nonetheless be construed as one. Its constitutive requirements should be interpreted with this in mind.[147]

The first of these, flowing from the text itself, is that assistance should be granted under 'conditions'. Similar to the role of conditionality under Article 136(3) TFEU, it ensures *inter alia* that assistance granted by the Union does not lead to a lessening of the budgetary prudence that Article 125 TFEU seeks to achieve.[148] The EFSM complies with that requirement as its assistance needs to be subject to conditions.[149] What about the second requirement, that assistance can only be granted when a state faces (a threat of) difficulties caused by 'exceptional occurrences beyond its control'? Budgetary problems as such, even if they cause a state to face exclusion from the capital markets, will not qualify as exceptional. If they did, the prohibitions in Articles 123-126 TFEU aiming at budgetary prudence would lose most of their meaning.[150] But what if a state's budgetary problems spring from a systemic crisis that threatens the financial stability of the currency union at large? It is at this point that the reasoning of the Court casts doubt on the legality of the EFSM.

According to the Court, a mechanism like the *ESM* cannot be based on Article 122(2) TFEU precisely because it aims to safeguard the financial stability of the euro area as a whole, instead of only targeting a specific member state.[151] It thereby implicitly throws doubt upon the *EFSM* whose focus also extends beyond the single state as it similarly seeks to safeguard financial stability, be it not that of the currency union but that of the Union at large.[152] Yet, this should not preclude recourse to Article 122(2) TFEU. Assistance based on this provision can perfectly address financial stability concerns beyond the state as long as every time it is granted the Council verifies whether the recipient state is (also) facing an exceptional occurrence beyond its control.[153]

147 Louis, 'The No-Bailout Clause and Rescue Packages' (n 146) 983.

148 Louis, 'The No-Bailout Clause and Rescue Packages' (n 146) 985.

149 Arts 3(3)(b) and 3(4)(b) Council Regulation (EU) 407/2010 of 11 May 2010 establishing a European financial stabilisation mechanism [2010] OJ L 118/1 (Reg 407/2010).

150 Louis, 'The No-Bailout Clause and Rescue Packages' (n 146) 984; Häde, 'Die europäische Währungsunion in der internationalen Finanzkrise' (n 62) 857; De Gregorio Merino (n 69) 1634.

151 See text to n 48 (ch 7).

152 Art 1 Reg 407/2010. See also text to n 164 (ch 5).

153 Borger, 'The ESM and the European Court's Predicament' (n 57) 128-129; Bruno De Witte and Thomas Beukers argue that the real issue is whether a stability mechanism only concerning the members of the currency union can be based on Art 122(2) TFEU. They argue, however, that this issue can be solved by combining the use of Art 122(2) TFEU with Art 326 TFEU on enhanced cooperation. See De Witte and Beukers (n 14) 833-834. One can even doubt, however, whether such recourse to enhanced cooperation is necessary. There seems to be no reason why Art 122(2) TFEU cannot be used to support several member states that are simultaneously hit by an economic shock instead of just targeting a single state. Moreover, the fact that Art 122(2) TFEU would be used as a legal basis for

Some have argued in this regard that only member states whose financial distress largely results from contagion and panic should qualify for assistance from the Union.[154] Those whose problems are mainly due to fiscal negligence, on the contrary, should not qualify for assistance as their problems were foreseeable and manageable in advance and thus not 'beyond control'. At least Greece, whose predicament is to a great extent grounded in financial mismanagement, should therefore not receive assistance from the EFSM.[155] What makes this reasoning problematic is that it links the requirement that the exceptional occurrence needs to be beyond control to the past instead of the present. Greece's distress is the product of years of fiscal mismanagement, yet it is also inherently bound up with the global financial crisis that affected Europe in 2008, and it was clearly beyond control when it materialised late 2009.

The exceptionality requirement similarly does not rule out using Article 122(2) TFEU for a stability mechanism of a permanent nature, as the Court reasoned.[156] Strictly speaking, this issue is only of relevance for the *ESM*, not the *EFSM*. After all, Article 9 of the latter's founding Regulation prescribes that within six months of its entry into force, and 'where appropriate every six months thereafter', the Commission has to prepare a report verifying whether the exceptional occurrence that justified its adoption still persists.[157] Then again, the Commission has only issued such a report once, after the first six months in November 2010, and since then it has never repeated the exercise.[158] However, the Court's temporal argument is beside the point. As Jean-Victor Louis has made clear, 'exceptional' means 'temporary'.[159] Permanent capital flows giving rise to a transfer union would therefore go against Article 122(2) TFEU.[160] A mechanism's permanency as such, however, is not problematic as long as the assistance it grants is of a temporary nature. The ESM satisfies that requirement: from the condition that it can only grant assistance if

a mechanism focusing on the currency union does not mean that states not (yet) using the single currency no longer qualify for assistance on the basis of this provision.

154 See eg Häde, 'Die europäische Währungsunion in der internationalen Finanzkrise' (n 62) 857-858; Ruffert (n 61) 1787; Palmstorfer (n 61) 780-781. For a different view see Athanassiou (n 69) 565.

155 See eg Ruffert (n 61) 1787; Palmstorfer (n 61) 781

156 In support of the Court's view see De Gregorio Merino (n 69) 1634-1635.

157 Art 9(1) Reg 407/2010.

158 See Commission, 'Communication of 30 November 2010 to the Council and the Economic and Financial Committee on the European Financial Stabilisation Mechanism' COM (2010) 713 final. In its report the Commission concluded that 'the exceptional events and circumstances that justified the adoption of Regulation no. 407/2010 establishing a European financial stabilization mechanism still exist and that the Mechanism should, therefore, be maintained' (without emphasis).

159 Louis, 'The No-Bailout Clause and Rescue Packages' (n 146) 985.

160 Borger, 'The ESM and the European Court's Predicament' (n 57) 128; De Witte and Beukers (n 14) 833.

indispensable to safeguard financial stability one can conclude that assistance operations need to cease the moment such a threat has disappeared.[161]

The Court has never had to clarify its position on the EFSM. After its adoption the mechanism became the subject of an action for annulment on the basis of Article 263 TFEU, but this was declared inadmissible in June 2011 for lack of direct concern.[162] And after the ESM had entered into force, the legality of the EFSM was considered of theoretical interest only as it was no longer supposed to enter into new assistance operations.[163] But things changed in the summer of 2015 when Greece had to receive a third assistance package.[164] On 16 July the Eurogroup decided in principle to agree to Greece's request for new support from the ESM.[165] The negotiations on this third assistance programme would take time, however, especially as trust in the Greek government had reached historic lows due to the decision of Prime Minister Tsipras earlier that month to put the conditionality linked to the final tranche of the second loan package to a popular vote.[166] Such time was not available to Greece which had to repay the European Central Bank only days later and clear its arrears with the IMF shortly thereafter. It needed a bridge loan of around €7bn to keep its head above water.[167] Yet, the options for granting such a loan at short notice were few and far between. The most realistic one, it seemed, was to use the EFSM.

When the British Prime Minister Cameron heard about the idea in the run-up to 16 July he was furious. Back in 2010, under pressure of Eurosceptic voices within and outside his own party, he had been at pains to ensure that his state would no longer participate – via the Union budget – in euro area rescue operations once the ESM became operational.[168] When the European Council had launched the simplified revision procedure to insert Article 136(3) into the TFEU at its meeting of 16 and 17 December 2010, it had therefore decided that Article 122(2) TFEU would 'no longer be needed' to safeguard the currency union's financial stability.[169] The heads of state – but not Commission President Barrosso who had wanted to keep open the possibility to resort to the rescue clause (!) – had even agreed that it 'should not be used'

161 Borger, 'The ESM and the European Court's Predicament' (n 57) 128; Koedooder (n 47) 141.
162 See Case T-259/10 *Thomas Ax v Council* [2011] ECLI:EU:T:2011:274, paras 17-25.
163 European Council, Conclusions, Brussels, 16-17 December 2010, para 1. See also text to n 314 (ch 5).
164 See also text to n 360 (ch 5).
165 Eurogroup statement on Greece, Brussels, 16 July 2015.
166 See also text to n 360 (ch 5).
167 'EU officials plan short term loans for Greece' *Financial Times (FT.Com)* (14 July 2015).
168 See text to n 310 (ch 5).
169 European Council, Conclusions, Brussels, 16-17 December 2010, para 1.

for such purposes.[170] Both decisions had subsequently been incorporated in the preamble to the amending Decision of the European Council.[171]

Cameron had considered the deal to be legally watertight. He had even used it to convince the British electorate of his ability to defend British interests at European level. Over the course of his first term as prime minister the pressure of Eurosceptics had intensified enormously, up to the extent that he had tied his re-election in 2015 to the promise of holding a referendum on membership of the Union. Prior to that referendum, he would negotiate a new 'settlement' for the position of the United Kingdom in the Union. In the Conservative party's electoral programme Cameron had bragged about the deal in support of his negotiating skills, saying: 'We took Britain out of euro-zone bailouts, including for Greece – the first ever return of power from Brussels'.[172] No wonder, therefore, that he sought to avoid a renewed use of the EFSM, fearing this would play into the hands of the 'Brexit' campaign,[173] which could claim that any 'settlement' short of treaty change would be meaningless.[174]

The truth is, of course, that the deal on Article 122(2) TFEU was not watertight, let alone that it amounted to anything like a 'return of power'. Only belonging to the preamble to the Decision of the European Council, it simply was not legally binding. Interestingly, its legal significance did increase as a result of *Pringle*. In its judgment, the Court referred to the deal in support of its contention that Article 122(2) TFEU does not provide a legal basis for a stability mechanism like the ESM due to its objectives and permanent nature.[175] The *European Council*, it argued, had emphasised in its Decision that 'Article 122(2) TFEU does not constitute an appropriate legal basis' for such a mechanism.[176] It thereby bestowed the deal with an authority it did not deserve. National leaders had reached agreement on this issue, not the European Council as President Barroso had deliberately withheld his consent on this point. The European Council had only referred to the agreement it in its Decision on Article 136(3) TFEU.

170 European Council, Conclusions, Brussels, 16-17 December 2010, para 1.
171 Recital 4 European Council Decision 2011/199.
172 Conservatives, 'Strong leadership, a clear economic plan, a brighter, more secure future' (Conservative Party Manifesto 2015) 72.
173 Alex Barker, Peter Spiegel and George Parker, 'Cameron frustrated by bailout manoeuvre; Greece fallout' *Financial Times* (16 July 2015).
174 This also explains why the heads of state and government were so adamant on stressing the 'legal bindingness' of the decision on the new settlement for the UK that they adopted at the European Council meeting of 18 and 19 February 2016. See European Council, Conclusions, Brussels, 18-19 February 2016, para 3(iii).
175 *Pringle* (n 1) para 65.
176 *Pringle* (n 1) para 65.

Politically, the tension surrounding the bridge loan for Greece was eventually taken away through a compromise. The EFSM would provide the loan,[177] yet on the condition that its founding Regulation would be amended so as to make sure that states outside the currency union would incur no financial liability for euro area assistance operations.[178] As a result, Article 3(2)(a) of this Regulation now determines that where the beneficiary state is a member of the currency union, the granting of Union assistance 'shall be conditional upon the enactment of legally binding provisions….guaranteeing that Member States whose currency is not the euro are immediately and fully compensated for any liability they may incur as a result of any failure by the beneficiary Member State to repay the financial assistance…'. This compromise could not, however, take away the legal uncertainty about the soundness of the EFSM that has arisen as a result of the Court's judgment in *Pringle*.

3 Approving central bank action

3.1 Weidmann's replay

When Jens Weidmann took over from Axel Weber as president of the *Bundesbank* in May 2011, it was widely believed that a less dogmatic central banker had taken charge.[179] Since 2006 Weidmann had been Merkel's chief economic advisor and he had been closely involved with the initiatives and actions the chancellor had taken to rescue the currency union. This man, it was thought, would combine the traditional stability-oriented views of the *Bundesbank* with a more pragmatic approach to the currency union's needs in extraordinary times.[180] Soon, however, it became clear he was just as sceptical of the attempts of the European Central Bank to stabilise government bond markets as his predecessor had been. Like Weber had done in relation to the Securities

177 Council Implementing Decision (EU) 2015/1181 of 17 July 2015 on granting short-term financial assistance to Greece [2015] OJ L 192/15. See also Council Implementing Decision (EU) 2016/542 of 17 July 2015 on granting short-term financial assistance to Greece (2015/1181) [2016] OJ L 91/22. Note that since entry into force of the Two-Pack the conditionality linked to EFSM assistance is not only approved through a Council implementing decision on the EFSM's founding Reg 407/2010, but also through a decision based on Reg 472/2013 containing a cross-reference to the former decision.

178 See Joint declaration by the Commission and the Council on the use of the EFSM, Brussels, 16 July 2015, 10994/15. The amendment has been adopted with Council Regulation (EU) 2015/1360 of 4 August 2015 amending Regulation (EU) 407/2010 establishing a European financial stabilisation mechanism [2015] OJ L 210/1.

179 Weidmann was appointed *Bundesbank* president in February 2011. He started his new job in May 2011. See also James Shotter, 'Merkel appoints central bank chief' *Financial Times* (17 February 2011).

180 See also Neil Irwin *The Alchemists: Three Central Bankers and a World on Fire* (Penguin Books 2014) 381.

Markets Programme in May 2010, Weidmann voted against its successor programme Outright Monetary Transactions in September 2012.[181] There was one crucial respect in which Weidmann did differ from his predecessor: he did not leave when he was outvoted in the Bank's Governing Council.

While Weidmann stayed on, he did not compromise on his views. He publicly criticised the new bond programme for what he saw as monetary financing. In a speech given shortly after the launch of the programme at a colloquium of the Institute for Bank-Historical Research, he even associated it with Goethe's *Faust*. Goethe, Weidmann, argued, pictured the modern economy and the use of paper money as 'a continuation of alchemy by other means'.[182] He called to mind the 'money creation' scene in Act One of the Second Part of *Faust* in which Mephisoteles, dressed up as a jester, approaches the emperor, whose royal coffers are empty, telling him: 'In this world, what isn't lacking, somewhere, though? Sometimes it's this, or that: here's what's missing's gold'.[183] The emperor then says: 'I'm tired of the eternal if and when: We're short of gold, well fine, so fetch some then',[184] to which Memphisoteles responds: 'I'll fetch you what you wish, and I'll fetch more'.[185] He subsequently floods the royal court with paper money. The economy initially flourishes and the state profits, yet all this soon gives way to severe inflation. *Faust*, Weidmann told his public, showed early on the importance of a central bank with a 'well-functioning, stability oriented compass' that can resist the 'temptation' of creating 'an unlimited amount of money out of thin air'.[186] It was an implicit sneer at his colleagues at the European Central Bank.

For a central banker to criticise colleagues so vocally is highly unusual, yet Weidmann certainly took it to another level when the bond programme was challenged before Germany's constitutional court.

The challenge formed part of a stream of cases on the response of the Union and its member states to the debt crisis.[187] To a great extent these cases focused on two issues. The first concerns '*ultra vires*' control. When the *Bundesverfassungsgericht* ruled on the compatibility of the Treaty of Maastricht with the German constitution in 1993 it claimed the right to examine whether and to what extent Union institutions had acted outside their competences in the

181 See in this regard text to n 200 (ch 6).

182 Jens Weidmann, 'Money creation and responsibility' (Speech given at 18th colloquium of the Institute for Bank-Historical Research, Frankfurt, 18 September 2012). See also Irwin (n 180) 383-384.

183 Weidmann, 'Money creation and responsibility' (n 182).

184 Weidmann, 'Money creation and responsibility' (n 182).

185 Weidmann, 'Money creation and responsibility' (n 182).

186 Weidmann, 'Money creation and responsibility' (n 182).

187 See especially BVerfG, 2 BvR 987/10 of 7 September 2011 (BVerfG *Greek loan facility and EFSF*); BVerfG, 2 BvE 8/11 of 28 February 2012 (BVerfG *parliamentary involvement EFSF*); BVerfG, 2 BvE 4/11 of 19 June 2012 (BVerfG *Right to information ESM & Euro Plus Pact*); BVerfG *ESM & TSCG summary review* (n 19); BVerfG *ESM/TSCG principal proceedings* (n 19).

Union Treaties.[188] This *ultra vires* review has matured over time.[189] In particular, in its *Lissabon Urteil*, the *Bundesverfassungsgericht* indicated that it would only exercise this review 'if legal protection cannot be obtained at Union level' and always in accordance with the German constitution's 'openness towards European law' (*Europarechtsfreundlichkeit*).[190]

Subsequently, in *Honeywell*, it stressed the importance of streamlining *ultra vires* review with the task of the Court 'to interpret and apply the Treaties'.[191] Before rendering judgment on an *ultra vires* claim, it would therefore first send a request for a preliminary ruling to its European colleague whose judgment it considers binding 'in principle'.[192] Moreover, Karlsruhe indicated it would only consider *ultra vires* review if the transgression of Union competences is 'sufficiently qualified'.[193] This means that it must be 'manifestly in violation of competences' and 'highly significant in the structure of competences between the Member States and the Union…'.[194]

The second issue concerns 'identity control'. Introduced in its *Lisbon* judgment, it allows the *Bundesverfassungsgericht* to verify whether Union acts respect the 'core content' of Germany's constitutional identity, which is 'inviolable' pursuant to Articles 23(1) and 79(3) of the *Grundgesetz*.[195] Such respect requires the retention at national level of competences of 'substantial political importance', not least in the area of fiscal policy, so as to leave 'sufficient space…. for the political formation of the economic, cultural and social living conditions'.[196]

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188 BVerfG, 2 BvR 2134/92 & 2159/92, 12 October 1993, para 106 (BVerfG *Maastricht*).

189 It should be noted, however, that dissenting judge Gerhardt, has criticised the *BVerfG*'s present decision for broadening the reach of *ultra vires* control too far, essentially turning it into an '*actio popularis*' endowing individual citizens with 'a general right to have the laws enforced'. See BVerfG, 2 BvR 2728/13 of 14 January 2014, Diss Opinion Gerhardt, paras 6-7 (BVerfG *OMT reference decision*). For similar criticism from scholars see Matthias Wendel, 'Exceeding Judicial Competence in the Name of Democracy: The German Federal Constitutional Court's OMT Reference' (2014) 10 EuConst 263, 277-280; Franz C Mayer, 'Rebels Without a Cause? A Critical Analysis of the German Constitutional Court's OMT Reference' (2014) 15 GLJ 111, 136-137; Karsten Schneider, 'Questions and Answers: Karlsruhe's Referral for a Preliminary Ruling to the Court of Justice of the European Union' (2014) 15 GLJ 217, 221-222.

190 BVerfG, 2 BvE 2/08 of 30 June 2009, para 240 (BVerfG *Lisbon*) .

191 BVerfG, 2 BvR 2661/06 of 6 July 2010, para 56 (BVerfG *Honeywell*). For extensive analysis of the implications of *Honeywell* for *ultra vires* review see Mehrdad Payandeh, 'Constitutional Review of EU Law After *Honeywell*: Contextualizing the Relationship Between the German Constitutional Court and the EU Court of Justice' (2011) 48 CML Rev 9, 19-27; Wendel, 'Exceeding Judicial Competence' (n 189) 273-274.

192 BVerfG *Honeywell* (n 191) para 60.

193 BVerfG *Honeywell* (n 191) para 61.

194 BVerfG *Honeywell* (n 191) para 61.

195 BVerfG *Lisbon* (n 190) paras 240, 339.

196 BVerfG *Lisbon* (n 190) paras 246-249, 252, 256.

The first case in which crisis measures were challenged for their *ultra vires* nature and disrespect of Germany's constitutional identity, concerned a challenge against the 'Greek' facility and the EFSF. Brought by the same professors that had instituted proceedings against the transition to the third stage of monetary union in 1998,[197] it was rejected by the *Bundesverfassungsgericht* in 2011.[198] The next year a case followed on the ESM and the Treaty on Stability, Coordination and Governance.[199] This case is of particular interest as it required Karlsruhe to explicitly reflect on the shift towards positive solidarity and its relationship with the single currency's original stability set-up.

When it pronounced on the application for a temporary injunction to keep the German government from ratifying the ESM Treaty on 12 September 2012, it displayed an unexpected 'openness' to this shift.[200] Contrary to its European counterpart, the *Bundesverfassungsgericht* acknowledged that Article 136(3) TFEU had modified the ban on bailout. '[T]he introduction of Article 136(3) TFEU',[201] it reasoned, 'constitutes a fundamental reshaping of the existing economic and monetary union',[202] one that 'relativises the market dependence' associated with the ban.[203] It could accept this modification, however, as other pillars of the *Stabilitätsgemeinschaft* to which it had given its blessing twenty years earlier were still 'in place'.[204] In particular the independence of the Bank, 'its commitment to the paramount goal of price stability' and the prohibition on monetary financing remained 'unaffected'.[205] As to the latter stability safeguard, it argued that 'an acquisition of government bonds on the secondary market by the European Central Bank aiming at financing the Members' budgets independently of the capital markets is prohibited as it would circumvent the prohibition on monetary financing'.[206] For the judges in Karlsruhe, then, the independence and stability mandate of the Bank constituted a red line that should not be crossed.

197 See also text to n 7 (ch 4).
198 BVerfG *Greek loan facility & EFSF* (n 187).
199 BVerfG *ESM & TSCG summary review* (n 19).
200 See for an extensive analysis of the judgment Matthias Wendel, 'Judicial Restraint and the Return to Openness: The Decision of the German Federal Constitutional Court on the ESM and the Fiscal Treaty of 12 September 2012' (2013) 14 GLJ 21. See also J-H Reestman and WT Eijsbouts, 'Watching Karlsruhe/Karlsruhe Watchers' (2012) 8 EuConst 367, 373: 'The judgment of 12 September 2012 can be read in two ways: in the key of continuity or in that of a turn ... Reading it as a turn stresses the opening to politics ("the legislator") in the development of the EMU beyond its original parameters. Even the notion of "Stability Community", central to the EMU in the German view, should be allowed to evolve, to include elements of solidarity'.
201 BVerfG *ESM & TSCG summary review* (n 19) para 128.
202 BVerfG *ESM & TSCG summary review* (n 19) para 128.
203 BVerfG *ESM & TSCG summary review* (n 19) para 128.
204 BVerfG *ESM & TSCG summary review* (n 19) para 129.
205 BVerfG *ESM & TSCG summary review* (n 19) para 129.
206 BVerfG *ESM & TSCG summary review* (n 19) para 174.

A week before the German court drew this line, the Bank had announced its Outright Monetary Transactions. In the case on the ESM some of the applicants had already challenged the Bank's activities on the secondary market for government bonds, although they had not yet specifically targeted this new programme. The judges in Karlsruhe had considered this complaint not to be 'covered by the application for the issue of a temporary injunction' and had decided to reserve it for 'the principal proceedings'.[207] Specific complaints concerning the new bond programme then followed and the judges decided to separate them from the ESM proceedings and to treat them in a separate case.[208]

For Weidmann, this offered the chance of a replay. During the oral proceedings he turned against the bond programme.[209] Ever since the start of the launch of the currency union, he argued, the *Bundesbank* had devoted itself to ensuring that the single currency would be stable. As a member of the Eurosystem, it had faithfully implemented the crisis measures of the European Central Bank, even those it saw as problematic. Now, however, it felt it needed to speak out as it considered the bond programme a threat to the Bank's independence and capacity to safeguard price stability, causing it to act outside its monetary policy mandate and engage in monetary financing.

Later the *Bundesbank*'s stance will be examined in greater detail, for now it suffices to point out that the *Bundesverfassungsgericht* shared its concerns.[210] On 14 January 2014 it published a decision in which it argued that the bond programme amounted to an *ultra vires* act as defined in *Honeywell*, considering it an act of economic policy manifestly and significantly exceeding the monetary policy mandate of the European Central Bank.[211] What is more, it believed the bond purchases to be 'politically motivated' and to form the 'functional equivalent' to ESM assistance measures, 'albeit without their parliamentary legitimation and monitoring'.[212] It based that finding on several

207 BVerfG *ESM & TSCG summary review* (n 19) para 98.

208 BVerfG, 2 BvR 1390/12 of 17 December 2013 (BVerfG *OMT separation order*). The *BVerfG* rendered its final judgment in the ESM/TSCG proceedings on 18 March 2014. See BVerfG *ESM/TSCG principal proceedings* (n 19).

209 Jens Weidmann, 'Eingangserklärung anlässlich der mündlichen Verhandlung im Hauptsacheverfahren ESM/EZB' (Karlsruhe, 11 June 2013).

210 Both the *BVerfG* and the Court refer in their judgments to the ESCB, the Eurosystem and the ECB, depending on the legal issue at hand. In what follows, and unless specifically indicated otherwise, this study will simply speak about the 'European Central Bank' or 'Bank'. For a discussion of the institutional framework of the currency union and the difference between the ESCB, the Eurosystem and the ECB see text to n 184 (ch 3).

211 BVerfG *OMT reference decision* (n 189).

212 BVerfG *OMT reference decision* (n 189) paras 55 and 78. See also Dietrich Murswiek, 'ECB, ECJ, Democracy, and the Federal Constitutional Court: Notes on the Federal Constitutional Court's Referral Order From 14 January 2014' (2014) 15 GLJ 147, 149: 'What the ECB wants to do via the OMT program is exactly the same as what the ESM can do with its secondary

features of the bond programme, in particular its objective, the targeted nature of purchases (*selectivity*), its link to ESM conditionality and the parallelism with this mechanism's instruments (*conditionality/parallelism*) and its capacity to bypass the requirements for bond purchases by the latter (*bypassing*).

The *Bundesverfassungsgericht* also stated that the bond programme amounted to a violation of the prohibition on monetary financing.[213] Over and above the features mentioned above, it based that finding on the absence of limits to the size of the bond purchases (*volume*), the possibility of the Bank participating in a debt cut (*pari passu treatment*), the high risk profile of the envisaged purchases (*excessive risk taking*), the option to hold purchased bonds to maturity (*interference with market logic*), the lack of an embargo period between the issuance of a bond on the primary market and its purchase by the Bank on the secondary market (*market pricing*) and, finally, the Bank's encouragement of private investors to buy bonds on the primary market (*encouragement to purchase newly issued securities*).

The German court indicated, however, that its concerns about the bond programme 'could be met by an interpretation in conformity with Union law'.[214] With a view to the mandate of the Bank, this required that it had to implement the programme 'in such a way that it would not undermine the conditionality' linked to ESM assistance and only support the economic policies in the Union.[215] To ensure compliance with the prohibition on monetary financing, the possibility of a debt cut had to be 'excluded', government bonds of specific states should not be 'purchased up to unlimited amounts', and 'interferences with price formation on the market had to be avoided where possible'.[216] Construing the bond programme in line with these demands, however, would have arguably deprived it of much of its magic and would have increased the likelihood that it would actually have to be used.

Although the *Bundesverfassungsgericht* considered that the *ultra vires* claims would 'probably be successful',[217] and notwithstanding its suggestion of a Union law friendly interpretation, it abided by its promise in *Honeywell* to request a preliminary ruling from the Court before taking a final position. But even if it would ultimately reach the conclusion that the Bank had stayed within its mandate, it could still find that the bond purchases violated the *Grundgesetz*. After all, next to its *ultra vires* review, Karlsruhe also examines whether acts of Union law do not run counter to Germany's constitutional identity.[218] In its reference decision it signalled that the bond programme

market facility, except that the volume of purchases of government bonds by the ESM is limited…while the ECB can buy unlimitedly'.

213 BVerfG *OMT reference decision* (n 189) para 55.
214 BVerfG *OMT reference decision* (n 189) paras 99-100.
215 BVerfG *OMT reference decision* (n 189) para 100.
216 BVerfG *OMT reference decision* (n 189) para 100.
217 BVerfG *OMT reference decision* (n 189) para 55.
218 See in this regard text to n 195 (ch 7).

'could violate' this identity 'if it created a mechanism that would amount to an assumption of liability for decisions of third parties which entail consequences that are difficult to calculate', as a result of which the *Bundestag* 'could no longer exercise its budgetary autonomy under its own responsibility'.[219]

The *Bundesverfassungsgericht* would only rule on this issue, however, after having received the Court's interpretation of the Bank's mandate and the prohibition on monetary financing.[220] Although it would then base its analysis on that of the Court, it would not refer another question to Luxembourg. Despite the fact that Article 4(2) TEU demands respect for 'national identities' inherent in the political and constitutional structures of the member states, and contrary to many legal scholars,[221] it considered that 'identity review is not to be assessed according to Union law but exclusively according to German constitutional law'.[222]

Barely a month before the *Bundesverfassungsgericht* made that statement, the General Court had declared inadmissible an action for annulment against the bond programme for lack of direct concern.[223] As a result of the referral from Karlsruhe, however, the programme would nonetheless now be tested on its substance in Luxembourg. Let us therefore turn to the Court's judgment, to see how it dealt with Karlsruhe's concerns and discover what this tells us about the independence of the Bank. It will turn out that its view on this independence ultimately explains why, in spite of the scepticism from Karlsruhe, the Court managed to reconcile the Union's Founding Contract with the Treaties on the point of central bank action too.

219 BVerfG *OMT reference decision* (n 189) para 102.

220 BVerfG *OMT reference decision* (n 189) paras 102-103. In fact, the *BVerfG* indicated it might rule on it more than once, as it could not only review the OMT decision itself but also 'individual implementation measures'.

221 See eg Daniel Thym, 'In the Name of Sovereign Statehood: A Critical Introduction to the Lisbon Judgment of the German Constitutional Court' (2009) 46 CML Rev 1795, 1811; Mattias Kumm, 'Rebel Without a Good Cause: Karlsruhe's Misguided Attempt to Draw the CJEU Into a Game of "Chicken" and What the CJEU Might Do About It' (2014) 15 GLJ 203, 209-210; Mayer (n 189) 128-133; Wendel, 'Exceeding Judicial Competence' (n 189) 284-288.

222 *BVerfG OMT reference decision* (n 189) paras 27, 29 and 103. For a comparison of the German notion of constitutional identity with Art 4(2) TEU see Monica Claes and Jan-Herman Reestman, 'The Protection of National Constitutional Identity and the Limits of European Integration at the Occasion of the *Gauweiler* Case' (2015) 16 GLJ 917, 919-941.

223 Case T-492/12 *Von Storch v ECB* [2013] ECLI:EU:T:2013:702. Earlier, on 16 December 2011, the General Court had dismissed an annulment action against the predecessor programme SMP on similar grounds. See Case T-532/11 *Städter v ECB* [2011] ECLI:EU:T:2011:768, upheld on appeal in Case C-102/12 P *Städter v ECB* [2012] ECLI:EU:C:2012:723.

3.2 The policy nature of bond purchases

3.2.1 The battle over objectives

The discussion about the nature of Outright Monetary Transactions, in particular the question whether they turn the Bank into a lender of last resort for sovereigns, is originally one between economists, as chapter 4 explained.[224] Yet, the proceedings in Karlsruhe brought it to the courtroom for legal treatment. The Union Treaties, however, are unfamiliar with the concept of 'lender of last resort'.[225] In the eyes of the law, with its own notions, categories and methods of reasoning, the discussion is *broader* in nature. As the *Bundesverfassungsgericht* indicated in its reference decision, it concerns the question whether the bond programme falls within the Bank's monetary policy mandate or whether it forms an economic policy measure that lies outside this mandate and amounts to monetary financing. Given that the Bank's mandate in Article 127(1) TFEU is only functionally delimited by the goals it has to achieve, the objectives of the programme are key to this question.[226] The currency union's enlarged stability conception consequently took centre stage during the proceedings in Karlsruhe and Luxembourg. Parties would battle fiercely over the objectives pursued by the bond purchases and the extent to which these purchases could serve to safeguard financial stability. It is this issue, therefore, that ultimately explains much of the difference in views between the two courts.

At the oral hearing in Karlsruhe, Executive Board Member Jörg Asmussen explained to the judges what the objectives of the bond programme were and why they corresponded to the mandate of the European Central Bank. He took them back in time, to the summer of 2012, and reminded them of the daunting rise in bond yields the currency union witnessed in that period:

> 'Part of this rise in interest rates could be explained by the concern of investors about the sustainability of national fiscal positions. Fiscal grounds alone, however, could not fully account for it since the sudden rise in interest rates in the first half of 2012 was not matched by a corresponding deterioration in economic fundamentals of these states. At the same time, there was an immediate threat of contagion of other states in the currency union, which provided proof of systemic, not merely state specific, risk. A substantial, driving factor in all this was market anxiety about a forced break-up of the common currency, that is: the fear of the "reversibility of the euro" and the implicit exchange rate risk that goes with it.'[227]

224 See text to n 328 (ch 4).
225 See text to n 289 (ch 4).
226 See also text to n 162 (ch 3).
227 Jörg Asmussen, 'Einleitende Stellungnahme der EZB in dem Verfahren vor dem Bundesverfassungsgericht' (Karlsruhe, 11 June 2013) (translation by the author).

He subsequently explained once more why such high yields could threaten the transmission and singleness of the Bank's monetary policy and had consequently necessitated the launch of the programme.[228] In its written submissions the Bank further emphasised that it did not intend to harmonise bond yields across the board, but only aimed to bring them back to levels corresponding to fundamentals.[229]

Bundesbank President Weidmann also reflected on the rise in bond yields and made no secret of what *he* thought about the programme's objectives. He admitted that the crisis had revealed the importance of financial stability, but stressed that the European Central Bank could only secure this kind of stability within the limits of its mandate. Then, he argued:

> 'Secondary market purchases in my understanding should, however, not aim at reducing the solvency risk premiums of specific states. For that would risk among other things to knock out the disciplining role of market rates and undermine individual responsibility for financial policy ... The answer to the question whether investors accurately value the degree of risk associated with the bonds of specific Member States, is to a great extent subjective.'[230]

In its written submissions the *Bundesbank* further substantiated its critical stance on the issue of the correctness of bond yields.[231] It stressed the unfeasibility of determining to what extent risk premia reflect economic fundamentals or self-fulfilling beliefs and argued that they should therefore not be used as decisive indicators for central bank action. Moreover, as such premia could very well be the consequence of rational market behaviour, the resulting heterogeneity in the transmission of monetary policy should not necessarily be seen as an unwarranted disruption, and could actually be economically justified.

The difference in views between the two central banks reflected in the reasoning of the *Bundesverfassungsgericht* which, surprisingly, was based on *Pringle*. To recall: in that case the Court had to determine the policy nature of Article 136(3) TFEU and it had reasoned that it was necessary to look to its instruments and ties to other measures of Union law, yet most of all to its objectives. The German court now resorted to this test in order to determine the bond programme's policy nature. In defining the programme's objectives, however, it made two questionable moves. The first concerned the dispute between the

228 See in this regard also text to n 56 and n 335 (ch 4).

229 'Stellungnahme Europäische Zentralbank' (16 January 2013) <handelsblatt.com/downloads/8135244/3/EZB%20Gutachten> accessed 3 May 2017.

230 Weidmann, 'Eingangserklärung anlässlich der mündlichen Verhandlung im Hauptsacheverfahren ESM/EZB' (Karlsruhe, 11 June 2013) (translation by the author).

231 'Stellungnahme Bundesbank' (21 December 2012) <www.handelsblatt.com/downloads/8124832/1/stellungnahme-bundesbank_handelsblatt-online.pdf> accessed 3 May 2017.

European Central Bank and the *Bundesbank* and their diverging opinions about the correctness of yield spreads. The second related to its application of the *Pringle*-test, in particular the kind of objectives that need to be taken into account when determining a measure's policy nature.

Concerning spreads, the *Bundesverfassungsgericht* completely backed the *Bundesbank's* view that it is impossible to distinguish between justified and excessive components of yield spreads.[232] It even seemed to go a step further by saying that according to the 'convincing expertise' (*Überzeugende Expertise)* of the *Bundesbank* such spreads '*only* reflect the scepticism of market participants' about the solvency of individual states and are 'entirely intended'.[233] At the same time it rejected the reasoning of the European Central Bank – not possessing expertise but only a 'view' (*Auffassung*) – that such spreads may very well exceed levels that can be explained by fundamentals. It did so, moreover, without paying any attention to the considerable amount of economic research that does find evidence of multiple equilibria and considers it possible to identify the justified and excessive parts of spreads.[234] It only referred to a report of the German Council of Economic Experts to support its own argument.[235] But this report is not at all conclusive on the issue of spreads.[236] It goes into the difficulty of distinguishing between justified and excessive levels, but does not state this is impossible.[237] At one point it even allows for the possibility that yield levels were indeed excessive in the summer of 2012 and have been brought back to justified levels with the bond programme's announcement.[238]

As to objectives, and by referring to *Pringle*, the judges in Karlsruhe argued that relevant for the determination of a measure's policy nature is the '*immediate*' or *direct* objective of an act.[239] However, the Court did not say in *Pringle* that regard should be had specifically to immediate objectives. It just stated that one should look at objectives, full stop.[240] Limiting the analysis to immediate objectives allowed the German court to ignore the Bank's indirect objective of safeguarding the transmission and singleness of its monetary policy,

232 BVerfG *OMT reference decision* (n 189) para 71. See also Thomas Beukers, 'The *Bundesverfassungsgericht* Preliminary Reference on the OMT Program: "In the ECB We Do Not Trust. What About You?"' (2014) 15 GLJ 343, 348-349; Jürgen Bast, 'Don't Act Beyond Your Powers: The Perils and Pitfalls of the German Constitutional Court's *Ultra Vires* Review' (2014) 15 GLJ 167, 176-177.

233 BVerfG *OMT reference decision* (n 189) paras 71, 98 (emphasis added).

234 See text to n 52 (ch 4).

235 BVerfG *OMT reference decision* (n 189) para 71.

236 See also Beukers (n 232) 348-349.

237 German Council of Economic Experts, *Annual Economic Report 2013/2014* (November 2013), para 200 .

238 German Council of Economic Experts, *Annual Economic Report 2013/2014* (November 2013), para 254.

239 BVerfG *OMT reference decision* (n 189) para 63 (emphasis added).

240 *Pringle* (n 1) paras 55-56 and 60.

and its ultimate aim of safeguarding price stability.[241] Moreover, in identifying the immediate objective of the bond programme, it disregarded its official objective.[242] By purchasing government bonds, the *Bundesverfassungsgericht* stated, the Bank aims to 'neutralise' spreads on bonds of certain states that 'have emerged in the markets' and which negatively affect their refinancing conditions.[243] Yet, the Bank has never said it aims for such neutralisation.[244] It only wants to bring down spreads to levels corresponding to fundamentals.

In what came closest to the recognition of an indirect objective, the German court argued that in as far as the Bank seeks 'to safeguard the current composition' of the currency union with its bond purchases, 'this is obviously not a task of monetary policy but one of economic policy, which remains a responsibility of the Member States'.[245] It backed up this argument with a discussion of the Union's procedure on accession to the currency union in Article 140 TFEU in which the Bank only plays a limited role.[246] Yet, it is unclear why these rules are relevant for identifying the bond programme's objectives. It appears the *Bundesverfassungsgericht* assumed that these accession rules are indicative of a broader division of responsibilities concerning the composition of the currency union.[247] This argument is hardly convincing when one takes into account how and to what extent concerns about the reversibility of the euro played a role in the Bank's decision to launch the bond programme.[248] Reversibility of the single currency played a role in as far as fears about it caused a rise in bond spreads exceeding what can be explained by fundamentals.[249] Given the problems this posed to the transmission and singleness

241 Matthias Goldmann, 'Adjudicating Economics? Central Bank Independence and the Appropriate Standard of Judicial Review' (2014) 15 GLJ 265, 275.

242 Beukers (n 232) 347; Carsten Gerner-Beuerle, Esin Küçük and Edmund Schuster, 'Law Meets Economics in the German Federal Constitutional Court: Outright Monetary Transactions on Trial' (2014) 15 GLJ 281, 298-301.

243 BVerfG *OMT reference decision* (n 189) para 70.

244 The *BVerfG* backed up this statement with a referral to the ECB's Monthly Bulletins of September and October 2012. However, these bulletins do not speak about the aim of neutralising bond spreads. See also Alexander Thiele, 'Friendly or Unfriendly Act? The "Historic" Referral of the Constitutional Court to the ECJ Regarding the ECB's OMT Program' (2014) 15 GLJ 241, 256-257; Wendel, 'Exceeding Judicial Competence' (n 189) 296.

245 BVerfG *OMT reference decision* (n 189) para 72.

246 BVerfG *OMT reference decision* (n 189) para 72.

247 Gerner-Beuerle, Küçük and Schuster (n 242) 303.

248 If one followed this reasoning, one would actually have to conclude that it does not support the *BVerfG*'s argument on the vertical division of competences that safeguarding the currency union's composition is a task of economic policy, falling within the responsibility of the member states. Art 140 TFEU attributes most powers to Union institutions, in particular the Council, not the states. See Bast (n 232) 177.

249 Note, moreover, that some scholars even defend the more principled argument that it is not at all clear that safeguarding the composition of the currency union lies outside the Bank's mandate. See Christoph Herrmann, 'National report: Germany' in Ulla Neergaard, Catherine Jacqueson and Jens Hartig Danielsen (eds), *The Economic and Monetary Union: Constitutional and Institutional Aspects of the Economic Governance within the EU* (XXVI FIDE

of its monetary policy, the Bank decided to intervene on secondary government bond markets.

Did this objective of safeguarding the transmission mechanism not play any role, then, in the decision of the German court? It did, but only in a very limited way. Whilst taking the view that the bond programme forms an act of economic policy that does not pursue monetary policy objectives,[250] at the end of its decision it stated that even if the bond purchases could, 'under certain conditions, help to support the monetary policy objectives' of the Bank, this would not change its conclusion about their policy nature.[251] What is more, 'the (economic) accuracy or plausibility of the reasons' behind the programme were 'irrelevant' and 'meaningless' in this respect.[252] It thereby again referred to *Pringle*, arguing that what the Court had said there in relation to the objectives of the ESM applied 'vice versa' in this case.[253] But in *Pringle* the Court did not make such a finding. It reasoned that the fact that the stability of the euro area as a whole, the objective for permanent stability mechanisms referred to by Article 136(3) TFEU, could have repercussions for price stability did not suffice to turn such mechanisms into monetary policy measures. An economic policy measure, it argued, cannot be treated as equivalent to a monetary policy measure for the sole reason that it may have indirect *effects* on the stability of the single currency.[254] In the case of the bond purchases the issue is not whether they may have indirect effects on price stability, but whether they are allowed when they pursue as their indirect, or ultimate objective this kind of stability.[255]

The objectives of the bond purchases were also central to the judgment of the Court.[256] What is more, in the slipstream of Karlsruhe it similarly adopted

Congress Publications Vol 1, 2014) 362; Martin Selmayr, 'Artikel 282' in Hans Von der Groeben, Jürgen Schwarze and Armin Hatje (eds), *Europäisches Unionsrecht* (Nomos 2015), Rn 66-67.

250 The *BVerfG* drew this conclusion about the bond programme's objective in para 73. Earlier in its decision it was a bit less radical in its findings, arguing that bond purchases may not qualify as a monetary policy act 'for the sole reason that they also indirectly pursue monetary policy objectives'. See BVerfG *OMT reference decision* (n 189) para 64.

251 BVerfG *OMT reference decision* (n 189) para 96.

252 BVerfG *OMT reference decision* (n 189) para 96, 98.

253 BVerfG *OMT reference decision* (n 189) para 96.

254 See text to n 42 (ch 7).

255 See also Beukers (n 232) 346.

256 Formally speaking, the Court did not review the OMT programme itself. It only reviewed whether a programme *such as* OMT did not violate the mandate of the ECB and Art 123 TFEU. See *Gauweiler* (n 2) para 30. In so doing it avoided answering the question to what extent it can review a decision that has not yet been incorporated into a formal legal act. It could adopt this strategy as the *BVerfG* had indicated in its reference decision that the preparatory nature of the OMT programme did not affect the national proceedings. It had therefore also asked the alternative question whether Union law permits bond purchases

a reasoning based on *Pringle*. Yet, its conclusion could not have been more different as it took the view that the bond programme does fall within the Bank's mandate.[257] Central to this difference is the fact that, unlike the *Bundesverfassungsgericht*, the Court took into account the whole range of objectives, including indirect and ultimate ones. Both the objective of securing the transmission of monetary policy and that of ensuring the singleness of that policy indicate that the programme falls within the Bank's monetary policy mandate as they ultimately support its ability to safeguard the primary objective of price stability.[258]

In its reasoning the Court also paid attention to the conflicting views of the *Bundesbank*, but in a more subtle way than the *Bundesverfassungsgericht*. After it had concluded that the bond programme falls within the Bank's monetary policy mandate, it continued by examining whether it is proportionate.[259] This proportionality review is intriguing for various reasons,[260] yet for now it suffices to point out that in the context of reviewing the programme's appropriateness, the Court also assessed whether the Bank had erred on fact by taking the view that spreads for certain bonds were excessive and hampered the transmission of monetary policy.[261] It acknowledged that its analysis had been 'subject to challenge' before the German constitutional court and in so doing implicitly paid tribute to the *Bundesbank*'s critical stance.[262] This challenge, however, did not suffice to conclude that the reasoning of the European Central Bank was 'vitiated by a manifest error of assessment'.[263] Monetary policy issues, the Court reasoned, 'are usually of controversial nature' and highly technical and given the consequently broad discretion of the Bank 'nothing more' can be asked of it other than that it carries out its 'analysis with all care and accuracy'.[264]

Nonetheless, the Court's *Pringle*-inspired reasoning was not free from error either. Like the judges in Karlsruhe, it too gave in to the temptation of making statements on indirect effects of the bond purchases. It reasoned that the fact that they may also contribute to the stability of the euro area – which it equates with the more specific notion of financial stability (!) –[265] does not call into question the finding that their objective is a monetary one.[266] 'A monetary policy measure cannot be treated as equivalent to an economic policy measure'

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such as those envisaged by the OMT programme. See Borger, 'Outright Monetary Transactions' (n 15) 167-169.

257 *Gauweiler* (n 2) paras 46-65.
258 *Gauweiler* (n 2) paras 46-50.
259 *Gauweiler* (n 2) paras 66-92.
260 See text to n 343 (ch 7).
261 *Gauweiler* (n 2) paras 72-75.
262 *Gauweiler* (n 2) para 75.
263 *Gauweiler* (n 2) para 74.
264 *Gauweiler* (n 2) paras 74-75.
265 See text to n 140 (ch 7).
266 *Gauweiler* (n 2) para 51.

for the sole reason 'it may have indirect effects' on financial stability.[267] Later in its judgement it argued that to the extent financial stability does form an objective it does not fall 'within monetary policy'.[268]

This reasoning not only unduly downplays the importance financial stability has for the Bank, it also unnecessarily bans it from its mandate. The Bank targets financial stability to the extent that certain segments of the financial system, in particular bond markets, are dysfunctional and hamper the transmission of monetary policy. The question, therefore, is not whether its purchases have any indirect *effects* on financial stability, but whether they can pursue such an objective as an intermediate target whilst being ultimately focused on price stability. Whilst the Court answered that question in the negative in its *explicit* reasoning, *de facto* it took an affirmative stance by reasoning that restoring the transmission mechanism falls within the area of monetary policy.

3.2.2 The futility of the battle

The readings both courts adopted of the objectives of the bond programme were as different as night and day. Whereas the *Bundesverfassungsgericht* used them as the key indicator for its conclusion that the programme constituted economic policy, the Court regarded them as primary evidence of its monetary policy character. In analogy to *Pringle* both consolidated their positions with arguments based on the programme's instruments and ties to Union law, in particular the selective nature of bond purchases and their link to ESM assistance.[269] The difference in assessment of the programme's policy nature, however, was already decisively made at the stage of identifying objectives.

This begs the question whether it is wise to determine the legality of the programme with a reasoning based on *Pringle*, which serves to define a measure's policy nature primarily through an analysis of its objectives. After all, even the Court, while it managed to declare the programme compatible with the Bank's mandate, struggled with the currency union's new stability conception. Whereas the Bank itself explicitly admits that it targets financial stability to the extent that dysfunctional bond markets hamper the transmission of monetary policy,[270] the Court did so only implicitly. On the one hand, it talked down the importance of financial stability when it stated that a monetary policy measure cannot be treated as being equivalent to an economic policy measure for the reason it may have indirect effects on this kind of stability.

267 *Gauweiler* (n 2) paras 51-52.
268 *Gauweiler* (n 2) para 64.
269 For an extensive analysis of the reasoning of both courts concerning these features see Borger, 'Outright Monetary Transactions' (n 15) 175-179.
270 See text to n 56 and n 335 (ch 4) and n 227 (ch 7).

On the other hand, it argued that to the extent that financial stability does form an objective it does not fall within the remit of monetary policy.

Much of this struggle, this study claims, could have been avoided if the Court had not moulded its reasoning along the lines of *Pringle*. Instead of focusing on the policy nature of the bond purchases, it should have concentrated its analysis on their direct legal basis: Article 18(1) of the Statute.[271] This would have allowed it to better reconcile the change in the Founding Contract with the law.

To see why requires a closer look at *Pringle*. There, the Court had to determine the policy nature of the ESM in order to decide whether the European Council had been right in using the simplified revision procedure in Article 48(6) TEU to add a third paragraph to Article 136 TFEU. Defining the policy nature of Article 136(3) TFEU was therefore directly linked to the question whether Article 48(6) TEU formed the appropriate *legal basis* for the amending Decision of the European Council.[272] In *Gauweiler*, however, the Court's mission to define the policy nature of the bond programme was not directly linked to a legal basis analysis. It was rather the other way around. To the extent that it paid attention to the legal basis of the programme – Article 18.1 of the Statute – it did so only to make the case that targeted, outright purchases of government bonds are an instrument of monetary policy, thereby supporting its argument that the programme concerns monetary policy.[273] In this way, defining a measure's policy nature becomes an end in itself.

What would happen if one starts to address the question of whether the Bank acted within the scope of its powers by examining the legal basis used, which is a plausible thing to do in such cases?[274] One could point out that Article 18.1 of the Statute stipulates that outright bond purchases can be used 'to achieve the *objectives* of the ESCB and to carry out its *tasks*'. Conducting monetary policy, as Articles 127(2) TFEU and 3.1 of the Statute make clear, forms a basic task.[275] It makes little sense to then try to define monetary policy by juxtaposing it to economic policy, especially not by looking at objectives.[276] Not only can that be very difficult as the two policy areas overlap and can at times be hard to distinguish in practice, as judge Gerhardt

271 For similar criticism in relation to the *BVerfG*'s reasoning, see Bast (n 232) 174-176; Wendel, 'Exceeding Judicial Competence' (n 189) 294-295. See also Beukers (n 232) 366.

272 See text to n 35 (ch 7).

273 *Gauweiler* (n 2) paras 54-55.

274 Bast (n 232) 174; Wendel, 'Exceeding Judicial Competence' (n 189) 294; Beukers (n 232) 366.

275 In addition, one could possibly even point to Art 127(5) TFEU and Art 3.3 Central Bank Statute, which enable the ESCB to contribute to policies relating to the stability of the financial system. See René Smits, 'Correspondence' (2012) 49 CML Rev 827, 829; Vestert Borger, 'How the Debt Crisis Exposes the Development of Solidarity in the Euro Area' (2013) 9 EuConst 7, 33. See also text to n 318 (ch 4).

276 See also Bast (n 232) 175; Thiele, 'Friendly or Unfriendly Act?' (n 244) 258-259; Wendel, 'Exceeding Judicial Competence' (n 189) 295.

rightly pointed out in his dissenting opinion to the decision of the *Bundesverfassungsgericht*;[277] it also fails to pay tribute to the fact that Article 127(1) TFEU brings both the objective of price stability and that of supporting the general economic policies within the purview of the Bank, as a result of which the latter can aim for either one in the context of monetary policy.

It is more appropriate to state that not only price stability but also financial stability forms an objective the Bank can pursue. This second kind of stability can serve as an intermediate objective that in line with Article 12.1 of the Statute it can aim for to attain its supreme goal of price stability.[278] This is the approach taken by the Bank when it states that it targets the transmission mechanism so as to deliver monetary stability throughout the currency union. Theoretically, however, one could even envisage the more radical possibility that the Bank treats financial stability as a self-standing objective that it can pursue through bond purchases with a view to supporting the general economic policies in the Union,[279] provided this does not conflict with the primary goal of price stability.[280]

In its reference decision, the *Bundesverfassungsgericht* suggested that in this second, theoretical scenario the Bank would violate its mandate as its purchases would go beyond supporting economic policy. It presented two arguments why they exceeded what can be seen as supporting economic policy. The first was of a quantitative nature and concerned the volume of assistance measures of the ESM. This 'could *de facto* be considerably broadened, and potentially even multiplied', by parallel bond purchases of the Bank, as a result of which the political decisions underlying ESM assistance measures would be 'thwarted'.[281] In this regard, the German court had little confidence in the 'factual limitation'

277 BVerfG *OMT reference decision* (n 189), Diss Opinion of Judge Gerhardt, para 17: 'Monetary and economic policies relate to each other and cannot be strictly separated. The delimitation of the objectives and duties of the European System of Central banks in Art. 127 TFEU corresponds to this'. See also *Gauweiler* (n 2), Opinion of AG Cruz Villalón, para 129; Craig and Markakis (n 16) 20.

278 Peter Sester, 'The ECB's Controversial Securities Market Programme (SMP)' (2012) 9 ECFR 156, 165-166.

279 Selmayr (n 249) Rn 62-63.

280 The OMT programme complies with that limit as the ECB has made it clear that any liquidity that gets injected into the financial system through its bond purchases will be sterilised so as to make sure that the interventions will not negatively influence its monetary policy stance. Moreover, economists like Paul De Grauwe, also point out that what matters for inflation is not only the 'money base' (M0), which the Eurosystem can increase through bond purchases, but also the 'money stock' (M3). During a financial crisis the two may get 'disconnected', as a result of which 'an increase in the money base' does not automatically translate into 'an increase in the money stock'. See Paul De Grauwe, 'The European Central Bank as Lender of Last Resort in the Government Bond Markets' (2013) 59 CESifo Economic Studies 520, 522-525.

281 BVerfG *OMT reference decision* (n 189) para 81.

that the Bank has built into the programme.[282] It will only buy up bonds in the maturity spectrum of one to three years, but states could easily circumvent that constraint by adjusting their refinancing strategies.[283] Although the Bank has announced it will observe the emission behaviour of states, the *Bundesverfassungsgericht* considered it 'unclear' what would follow from that intention.[284]

The second argument was qualitative and related to central bank independence. Due to its independence the Bank has to make its own assessment on the necessity of bond purchases, without being tied to decisions made under the ESM.[285] Such 'independent economic assessments', however, would have the outcome that the purchases no longer qualify as 'support' of economic policy.[286] On the basis of these arguments the judges in Karlsruhe concluded that the bond purchases would only qualify as support 'if their volumes were so limited' that they could not thwart ESM assistance programmes and if they were 'approved on the merits' by the member states.[287]

Both arguments fail to convince. They only work if one accepts the premise that in order to assess whether the Bank's bond programme supports economic policies, one needs a specific 'comparator' like the ESM.[288] It is more plausible, however, to argue that the programme's efforts to prevent states from entering bad equilibria significantly contributes to stabilising the financial system. It is hard to see how this does not support the economic policies of both the Union and its member states.[289]

But even if one accepts, first, the premise of the need for a specific comparator and, second, that the ESM qualifies for that function,[290] both arguments lack persuasion. As to volume, it is a simple fact that the size of the bond programme is curtailed due to its focus on a particular part of the maturity spectrum. Not accepting the Bank's assurance that it will oversee the emission behaviour of states whose bonds are purchased amounts to 'distrust'.[291] Contrary to the *Bundesverfassungsgericht*, the Court did trust the

282 BVerfG *OMT reference decision* (n 189) para 83.
283 BVerfG *OMT reference decision* (n 189) para 83.
284 BVerfG *OMT reference decision* (n 189) para 83.
285 BVerfG *OMT reference decision* (n 189) para 82.
286 BVerfG *OMT reference decision* (n 189) para 82.
287 BVerfG *OMT reference decision* (n 189) para 83.
288 Gerner-Beuerle, Küçük and Schuster (n 242) 311.
289 See Gerner-Beuerle, Küçük and Schuster (n 242) 311; Selmayr (n 249) Rn 67.
290 Some have pointed out that due to its 'mode of operation' and 'pricing policy' the ESM differs significantly from the OMT programme. It should therefore not function as a comparator whose underlying political decisions could be 'thwarted' by OMT-interventions. See Thiele, 'Friendly or Unfriendly Act?' (n 244) 260; Gerner-Beuerle, Küçük and Schuster (n 242) 306-309, 311.
291 See also Beukers (n 232) 352: 'The *Bundesverfassungsgericht*'s distrust in the ECB's monetary policy motivation leads to distrust in its assessment of the appropriate circumstances of activation and the appropriate conditions'.

Bank on this point. When assessing the programme's proportionality, more specifically its necessity, it singled out several other elements besides the focus on a particular part of the maturity spectrum that factually limit the size of the programme, as a result of which there is no need to put an *ex ante* cap on the total volume of purchases.[292] First, bond purchases only take place to the extent this is necessary to achieve the programme's objectives and will cease as soon as these have been attained.[293] Second, and more important, only bonds of states which are subject to a macroeconomic adjustment programme and have regained access to the bond market can be bought.[294] Over and above these elements an *ex ante* cap could also 'trigger' speculation, thereby undermining the programme's effectiveness and increasing the likelihood it will actually have to be used.[295]

Karlsruhe's argument about central bank independence is simply contradictory.[296] Article 130 TFEU makes clear that the Bank is independent in the performance of all its tasks, including when it supports economic policy. Arguing that actions of the Bank exceed what can be qualified as support as it will have to carry out independent economic assessments, runs counter to this independence. Either the Bank carries out independent assessments, but then no longer supports economic policy, or it does support such policy, but then no longer acts independently. Whichever option is chosen, it conflicts with the Treaty's position on this point. The demand that bond purchases are approved on the merits and legitimised by the member states is not compatible with central bank independence either.

3.3 The Court's struggle with the present

Even if the Bank stays within its monetary policy mandate with its bond purchases, it could still violate the prohibition on monetary financing. After all, its acts may run counter to Article 123 TFEU regardless of their policy nature. In its judgment on the ESM, the *Bundesverfassungsgericht* had drawn a red line in this regard by saying that a financing of 'budgets independently from the capital markets' would impermissibly 'circumvent the prohibition on monetary financing'.[297] It had backed up this statement with a reference

292 *Gauweiler* (n 2) paras 82, 85-88. Note that the Court repeats these arguments in para 116 when it reviews compliance with the prohibition on monetary financing. See also text to n 322 and n 347 (ch 7).
293 *Gauweiler* (n 2) para 82.
294 *Gauweiler* (n 2) para 86.
295 *Gauweiler* (n 2), Opinion of AG Cruz Villalón, para 182. See also the Court's judgment in *Gauweiler* (n 2) para 88.
296 Thiele, 'Friendly or Unfriendly Act?' (n 244) 260; Gerner-Beuerle, Küçük and Schuster (n 242) 311.
297 BVerfG *ESM & TSCG summary review* (n 19) para 174. See also text to n 206 (ch 7).

to the legislation specifying Article 123 TFEU, the preamble of which determines that secondary market purchases should 'not be used to circumvent the objective' of the prohibition.[298]

In its reference decision, however, the German court suddenly seemed to adopt a much wider view of what amounts to such circumvention.[299] It no longer spoke about financing independently from markets, but simply stated that in assessing conformity with Article 123 TFEU one should focus on the objective pursued by the prohibition,[300] without however defining what that objective is.[301] The prohibition of buying bonds on the primary market should therefore not be 'circumvented by functionally equivalent measures'.[302] It then singled out five features of the bond programme – the possibility of a debt cut, the high risk profile of purchased bonds, the option to keep these bonds until maturity, an interference with market logic and an encouragement of private investors to purchase bonds on the primary market – which would indicate, 'at least when taken together', that the Bank aims at such circumvention.[303]

In its judgment the Court shared some of Karlsruhe's concerns, yet considered it possible to take care of them within the confines of the bond programme. Others it did not share at all.[304] What matters for this study, however, is that its analysis was embedded in a broader reading of Article 123 TFEU that closely resembled its interpretation of the no-bailout clause in *Pringle*. But not completely, especially on the issue of financial stability. To fully understand the Court's reasoning, Article 123 TFEU should be cited in full:

> 'Overdraft facilities or any other type of credit facility with the European Central Bank or the central banks of the Member States (hereinafter referred to as 'national central banks') in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the European Central Bank or national central banks of debt instruments.'

298 Recital 8 of Council Regulation (EC) 3603/93 of 13 December 1993 specifying definitions for the application of the prohibitions referred to in Articles 104 and 104b(1) of the Treaty [1993] OJ L 332/1 (Reg 3606/93). See also text to n 278 (ch 3).

299 Thiele, 'Friendly or Unfriendly Act?' (n 244) 261-262.

300 BVerfG *OMT reference decision* (n 189) para 86.

301 See also Beukers (n 232) 355.

302 BVerfG *OMT reference decision* (n 189) para 86.

303 BVerfG *OMT reference decision* (n 189) para 87. Note that these features came on top of those that the *BVerfG* had already discussed in relation to determining the policy nature of the bond programme (*objectives*, *selectivity*, *conditionality/parallelism* and *bypassing*).

304 For an extensive analysis of the position of both courts concerning these features see Borger, 'Outright Monetary Transactions' (n 15) 184-188.

In *Pringle*, the Court had used a textual interpretation to negatively define the scope of the ban on bailout. More specifically, it had argued on the basis of its text that Article 125 TFEU does not prohibit any assistance, but only that which leads a member state to be no longer responsible for its commitments to its creditors.[305] In *Gauweiler*, it similarly resorted to the text of Article 123 TFEU to set a lower limit to bond buying that the Bank has to respect. From its wording, covering credit facilities and direct bond purchases, it becomes apparent that it prohibits all forms of financial assistance to a member state.[306]

The Court then went on to say that the prohibition also covers secondary market purchases that would have an 'effect equivalent' to primary market intervention and thereby 'undermine' its effectiveness.[307] In its reference decision the *Bundesverfassungsgericht* had argued that such equivalence could occur if the Bank buys government bonds on the secondary market 'to a considerable extent and shortly after their emission'.[308] That risk would increase if it were to announce its intention to intervene 'prior to a new emission'.[309] In that case, the Bank would position itself as the currency union's 'lender of last resort'.[310] This is a serious problem. If the Bank indeed were to announce that it intends to strongly intervene shortly after emission this could blur the distinction between secondary and primary markets, turning its bond programme into the functional equivalent of primary market intervention.[311] No wonder, therefore, that the Court acknowledged this concern.[312] It pointed out, however, that the Bank had ensured its purchases would not have such an effect. It will observe a 'minimum' or 'embargo' period between a bond's emission and its purchase on the secondary market, so as to allow for a market price to form, and it will 'refrain from making prior announcements' concerning the timing of purchases or their volume.[313]

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305 See text to n 70 and n 84 (ch 7).

306 *Gauweiler* (n 2) paras 94-95.

307 *Gauweiler* (n 2) paras 96-97.

308 BVerfG *OMT reference decision* (n 189) para 92.

309 BVerfG *OMT reference decision* (n 189) para 93.

310 BVerfG *OMT reference decision* (n 189) paras 92-94.

311 Thiele, 'Friendly or Unfriendly Act?' (n 244) 262.

312 *Gauweiler* (n 2) para 104. Also the AG payed attention to this concern. See *Gauweiler* (n 2), Opinion of AG Cruz Villalón, paras 250 and 258.

313 *Gauweiler* (n 2) paras 105-107. Surprisingly, the *BVerfG* also recognised these precautionary efforts in its reference decision, but argued that Draghi's 'whatever it takes' pledge of 26 July 2012 had nonetheless given market participants 'the impression' that the Bank would act as a lender of last resort (para 94). Yet, it is rather strange to find an act – the decision of 6 September 2012 on the principal features of Outright Monetary Transactions – that in principle conforms to Union law to be nonetheless in violation of this law for the reason that an earlier statement has created the impression among the public that the Bank might act *contra legem*. Moreover, Draghi was careful to avoid any such impression as his pledge that the Bank would do 'whatever it takes' was preceded by the words 'within our mandate'. See also text to n 178 (ch 6).

This *effet utile* reasoning did not feature in the Court's interpretation of the ban on bailout in *Pringle*, but that is consistent with its view on the difference in scope of Articles 123 and 125 TFEU. After all, in *Pringle* it had supported its textual reading of Article 125 TFEU with the systemic argument that the difference in wording of the two provisions shows that, contrary to the prohibition on monetary financing, the ban on bailout does not rule out any financial assistance.[314] Given this restricted scope, applying an *effet utile* reasoning in relation to Article 125 TFEU is uncalled for. In fact, it could even undo the difference in scope based on their wording, as the ban on bailout would then also cover assistance measures that have an effect equivalent to taking over a state's financial commitments. One could argue that ESM assistance has such an effect.[315]

Having set a lower limit to bond buying on the basis of a literal reading, the Court shifted to a purposive one to determine which purchases would be compatible with Article 123 TFEU.[316] Like the *Bundesverfassungsgericht*, it supported this strategy by referring to the preamble of the legislation specifying the prohibition,[317] but unlike the latter it made explicit what the prohibition's purpose is. Copying its approach in *Pringle*, it relied on the legislative history of the Treaty of Maastricht to reach the conclusion that, just like the ban on bailout, the prohibition on monetary financing aims for fiscal prudence.[318] It subsequently identified several features of the bond programme that showed that the envisaged bond purchases comply with that purpose, four of which are particularly important.[319]

First, bonds can only be purchased to the extent this is necessary for safeguarding the transmission of monetary policy and up to the extent that bond yields exceed a state's fundamentals.[320] As a result, a state cannot 'rely on the certainty' that the Bank will purchase its bonds, nor can such intervention lead to a 'harmonisation' of yields disconnected from economic fundamentals.[321] Second, due to the focus on bonds in the maturity spectrum of one to three years that are issued by states undergoing an adjustment programme and having regained access to the bond market, the volume of bonds that can be bought and, by extension, the impact on the 'financing conditions' of states is '*de facto*' limited.[322] Third, as the Bank decides on the start, con-

314 See text to n 71 (ch 7).
315 See eg Beck, 'The Court of Justice, Legal Reasoning, and the *Pringle* Case' (n 97) 243-244.
316 *Gauweiler* (n 2) para 98.
317 *Gauweiler* (n 2) para 101.
318 *Gauweiler* (n 2) paras 99-102. It thereby followed a reasoning that was already suggested in the literature. See eg Athanassiou (n 69) 567.
319 *Gauweiler* (n 2) paras 98-102 and 109-120.
320 *Gauweiler* (n 2) paras 112-113.
321 *Gauweiler* (n 2) paras 113-114.
322 *Gauweiler* (n 2) para 116.

tinuation and suspension of purchases, it can adapt its strategy if it appears that a state tries to finance its budget by changing its issuance behaviour in favour of bonds that fall within the eligible maturity spectrum.[323] Fourth, bond purchases are conditional on 'full compliance' with an ESM adjustment programme, which limits the risk that the state whose bonds are purchased lapses into fiscal profligacy once the programme is activated.[324]

Where the Court's teleological interpretation differed from *Pringle* is on the point of market discipline. Whereas the Court had jumped over this objective when interpreting the ban on bailout,[325] it made it part of its reading of the prohibition on monetary financing.[326] Since bond purchases are only conducted to the extent necessary for safeguarding the transmission of monetary policy, member states cannot know for certain that the Bank will intervene on bond markets. More importantly, the disciplining effect of markets remains in place as the purchases do not aim to harmonise bond yields, but only to combat those parts that exceed fundamentals. *A contrario*, this means that a state's bonds cannot be purchased when yields do correspond to fundamentals, even when they are extremely high and hamper the transmission of monetary policy.[327]

The Court's third and final step in *Pringle* had been to rule that the no-bailout clause's goal of securing budgetary discipline in turn contributed to the higher aim of financial stability. Granting assistance is therefore only allowed when it is indispensable for safeguarding that stability.[328] This was a surprising move since the prohibition on bailout had originally intended to safeguard budgetary discipline and ultimately price stability, but not financial stability. Equally surprising, however, was that in *Gauweiler* the Court did not identify any superior goal in its interpretation of the ban on monetary financing, not even price stability. It simply confined its analysis to the aim of budgetary discipline.

Turning financial stability into the ultimate goal of Article 123 TFEU would also have been very difficult for the Court, and not only because it would then have repeated the strained reasoning in *Pringle* that this objective has always been pursued by the prohibitions focusing on fiscal prudence.[329] This de-

323 *Gauweiler* (n 2) para 117.
324 *Gauweiler* (n 2) para 120.
325 See text to n 106 (ch 7).
326 *Gauweiler* (n 2) paras 72 and 112-114.
327 This should assuage the *BVerfG*'s fear, expressed in its reference decision, that any deterioration of the transmission mechanism could justify improving a State's 'credit rating' through bond purchases. See BVerfG *OMT reference decision* (n 189) paras 97-98.
328 See text to n 82 and n 83 (ch 7).
329 In his Opinion the AG did identify financial stability as the ultimate objective of Art 123 TFEU but hardly operationalised that finding as he merely argued that it therefore constitutes a 'fundamental rule' of the currency union 'exceptions to which should be interpreted restrictively'. See *Gauweiler* (n 2), Opinion of AG Cruz Villalón, para 219.

viation from *Pringle* also occurred, paradoxically, because it had stayed faithful to that judgment at the stage of defining the Bank's monetary policy mandate.[330] Given its strategy to juxtapose monetary and economic policy and its related reasoning that financial stability is not a goal of the former, identifying financial stability as an objective of Article 123 TFEU, be it as an intermediate or ultimate one, is no longer an option if one wants to uphold the bond programme.

To reconcile the Founding Contract with the Treaties in *Pringle*, the Court had to play a little with history by arguing that it had always been possible for the members of the currency union to grant financial assistance when indispensable to safeguard financial stability. In *Gauweiler*, it did the same with the present by not allowing this stability to play any explicit role in its analysis of Outright Monetary Transactions at all.

3.4 Courts and central banks in a stability community

The views of the *Bundesverfassungsgericht* and the Court on the legality of the bond purchases could not have been more different. Whereas the former indicated in no uncertain terms in its reference decision that it considered the bond purchases a violation of the Bank's mandate, the latter found them to be compatible with it and in so doing managed to reconcile the Founding Contract with the Treaties. What can explain this enormous difference in views? It turns out that the judges in Karlsruhe and Luxembourg have a different opinion about the independence of the Bank and the authority of its position in a community based on stability.

The Union Treaties endow the Bank with great independence, institutionally, organisationally, functionally as well as financially.[331] This inevitably has consequences for the intensity of judicial review courts should exercise when called upon to interpret and rule on the validity of its actions. This is not to say the Bank should have *carte blanche* or be exempted from judicial review. Apart from the fact that this would be undesirable, it would also contradict Article 35 of the Statute which states that its 'acts or omissions are open to review or interpretation' by the Court in line with the arrangements in the Union Treaties. It does mean that courts should be careful not to get caught up in economic disputes which they cannot settle anyway and exercise considerable restraint in reviewing assessments of the Bank.[332]

330 See text to n 256 and n 269 (ch 7).

331 See text to n 184 (ch 3).

332 Goldmann, 'Adjudicating Economics?' (n 241) 271-272. See also Christoph Herrmann, 'Die Bewältigung der Euro-Staatsschulden-Krise an den Grenzen des deutschen und Europäischen Währungsverfassungsrechts" (2012) 24 EuZW 805, 810-811; Alicia Hinarejos,

At first sight the *Bundesverfassungsgericht* seemed to be aware of the necessity of such restraint in its reference decision. It argued that the independence guarantee in 130 TFEU covers the 'actual powers' conferred on the Bank, but not the 'determination of the extent and scope of its mandate' which it could therefore delineate.[333] This was particularly important given that this independence constituted a departure from the requirements of the *Grundgesetz* concerning 'the democratic legitimation of political decisions'.[334] It had consented to that independence given its beneficial effects on price stability, yet it had to be ensured that the Bank stuck to its carefully delineated mandate and did not expand it 'at will'.[335]

Although plausible at first sight, upon closer examination this approach is questionable.[336] In theory one can distinguish between a mandate's delineation and the actual exercise of powers, but in practice such a distinction hardly stands up. Especially in the case of the Bank, whose mandate is only functionally delimited by the goals it has to achieve, it is extremely difficult, if not impossible, to delineate its mandate without taking into consideration the actions that are based on it. This showed in the analysis of the *Bundesverfassungsgericht*, which only managed to identify and delimitate the Bank's mandate by discussing and interpreting the bond programme at length.

Moreover, when interpreting the programme any restraint on the side of the German court was hard to discern, in particular when it came to identifying objectives, the determining factor in the proceedings.[337] Not only did it limit its analysis to the programme's immediate objective, it also reconstrued that objective when it stated that the Bank intended to 'neutralise' bond spreads. In addition, it took a clear stance on the possibility to differentiate between excessive and justified yield spreads by arguing that such a division is not only unfeasible, but also 'meaningless'. In doing so, it essentially broke into the policy debate that was held within the Governing Council of the European Central Bank and that *Bundesbank* President Weidmann failed to win.[338] One would think that a court plays it safe when it overrules the expert assessment of an independent central bank, and backs up its reasoning with strong evidence. Yet, the *Bundesverfassungsgericht* only referred to the Annual Economic

'*Gauweiler* and the Outright Monetary Transactions Programme: The Mandate of the European Central Bank and the Changing Nature of Economic and Monetary Union' (2015) 11 EuConst 563, 575; Sven Simon, 'Direct Cooperation Has Begun: Some Remarks on the Judgment of the ECJ on the OMT Decision of the ECB in Response to the German Federal Constitutional Court's First Request for a Preliminary Ruling' (2015) 16 GLJ 1025, 1032.

333 BVerfG *OMT reference decision* (n 189) para 60.

334 BVerfG *OMT reference decision* (n 189) para 59.

335 BVerfG *OMT reference decision* (n 189) paras 59-60.

336 Wendel, 'Exceeding Judicial Competence' (n 189) 301-302.

337 BVerfG *OMT reference decision* (n 189) paras 63, 71, 98. See also text to n 232ff (ch 7).

338 See also Heiko Sauer, 'Doubtful It Stood…: Competence and Power in European Monetary and Constitutional Law in the Aftermath of the CJEU's OMT Judgment' (2015) 16 GLJ 971, 979.

Report of the German Council of Economic Experts, which does not even support its view indisputably.

This very intrusive review also had consequences for the way Karlsruhe abided by its promise in *Honeywell* to only consider *ultra vires* review in case of 'manifest' transgressions of competences. Admittedly, for a court to find an act *ultra vires* it is not required that its reasoning is immune to challenge. Yet, its reasoning does need to possess considerable authority in light of the arguments used.[339] It is highly questionable whether such authority is present when it leads a court to overrule a central bank not just on points of law, but on the definition and feasibility of the objectives pursued to find that it acts *ultra vires*. The German court's position on the *ultra vires* nature of the bond programme becomes only more startling when one realises that it also kept open the possibility that the instrument was interpreted in conformity with Union law.[340] How can a court establish a manifest violation when it considers itself that a Union law-friendly interpretation is possible too?[341]

Contrary to the *Bundesverfassungsgericht*, the Court was much more sensitive to the independence of the Bank.[342] This showed up most clearly in its proportionality analysis of the bond programme.[343] As is well known, in the case of policy measures involving a considerable amount of discretion the Court is cautious in its proportionality review, and for good reason.[344] It is not for a court to strike down a policy measure solely because it thinks it would have dealt with a situation differently, especially not when it concerns

339 According to dissenting Judge Gerhardt, the threshold of manifestness would be meaningful if it implies that the *BVerfG* only acts in the case of 'violations of the distribution of powers which are obvious from the outset and which suggest themselves without further legal analysis'. However, the majority of Judges 'also considered possible that a transgression of powers can be manifest if it is preceded by a lengthy clarification process'. See BVerfG *OMT reference decision* (n 189), Diss Opinion Judge Gerhardt, para 16. See also Wendel, 'Exceeding Judicial Competence' (n 189) 275; Dariusz Adamski, 'Economic Constitution of the Euro Area after the *Gauweiler* Preliminary Ruling' (2015) 52 CML Rev 1451, 1481.

340 Bast (n 232) 179; Wendel, 'Exceeding Judicial Competence' (n 189) 276.

341 As Thiele, 'Friendly or Unfriendly Act?' (n 244) 254-255 explains, the answer is that the *BVerfG* twists the criterion of 'manifestness' by 'delinking' the violation from its 'qualification'. The violation of Union law can be subject to debate, but nonetheless be manifest if ultimately considered a violation. See also Mayer (n 189) 137-138.

342 To put it in the words of Chiara Zilioli, the European Central Bank's general counsel: '[T]he Court of Justice has recognized that the right place for discussion among experts in matters of monetary policy and for monetary-policy-related decision making, is the Governing Council itself, rather than a court'. See Chiaro Zilioli, 'The ECB's Powers and Institutional Role in the Financial Crisis: A Confirmation From the Court of Justice of the European Union' (2016) 23 MJ 171, 172-173.

343 See also Georgios Anagnostaras, 'In the ECB We Trust…the FCC We Dare! The OMT Preliminary Ruling' (2015) 40 EL Rev 744, 754-755.

344 See extensively Paul Craig, *EU Administrative Law* (OUP 2012) 592-593.

matters requiring considerable expertise.[345] In such situations the Court will only examine whether it is 'manifestly' disproportionate. That standard was also applied in this case.[346] The Court considered reducing excessive bond rates through secondary market purchases a suitable instrument to safeguard the transmission of monetary policy and reasoned that the programme did not go manifestly beyond what was necessary to achieve that goal, thereby paying particular attention to the need to put an *ex ante* cap on the amount of purchases.[347]

In the context of its proportionality analysis the Court also examined whether the Bank had manifestly erred on *fact* by taking the view that spreads for certain bonds were excessive and hampered the transmission of monetary policy.[348] Here, central bank independence made itself heard when the Court stated that nothing more can be required of the Bank than that it uses its expertise 'with all care and accuracy'.[349] Perhaps it even made itself heard a bit too much.[350] By requiring the Bank to act to the best of its ability the Court actually did not establish any 'standard of proof' in relation to the facts that need to be met when taking decisions, nor a meaningful 'standard of judicial review' to examine whether the Bank had complied with that standard of proof.[351] The Court also used the manifest error of assessment test to avoid Karlsruhe's error of getting trapped in the debate between the *Bundesbank* and the European Central Bank. It reasoned that the mere fact that the latter's assessment is open to challenge does not suffice to establish a manifest error.[352]

It is significant that the Court dealt with many of Karlsruhe's concerns at the stage of proportionality review. This review is only warranted if the objective or interest pursued by a measure is a legitimate one. If the Court, like the *Bundesverfassungsgericht*, had found that the bond purchases were 'politically motivated', had limited its analysis to their immediate objective and had reconstrued that objective to the 'neutralisation' of bond spreads, it would have come close to accusing the Bank of a misuse of powers. Such misuse differs from a proportionality assessment in that it entails an ex-

345 See also Jean-Victor Louis, 'The EMU After the *Gauweiler* Judgment and the Juncker Report' (2016) 23 MJ 55, 63-64 (noting that in *Gauweiler* the Court did 'not aim at substituting its judgment to the one of the ECB').

346 See in particular *Gauweiler* (n 2) paras 68, 81 and 91.

347 See text to n 292 (ch 7).

348 See text to n 261 (ch 7).

349 See text to n 264 (ch 7).

350 See also Tridimas and Xanthoulis (n 15) 31: 'The key point that emerges from the judgment is the enormous discretion left to the ECB. Although its power is restricted by a number of conditions, none of those conditions are firm and the determination whether they are fulfilled invariably entails complex technical assessment in relation to which the Court of Justice left the ECB with broad discretion'.

351 Craig, *EU Administrative Law* (n 344) 432-434.

352 *Gauweiler* (n 2) paras 72-75.

amination of the 'motives' of the actor to see whether it aims for a goal different from the one which it is allowed to pursue by law.[353] That is a step the Court was clearly not prepared to take. Before it started its proportionality assessment, it first accepted the stated objective of the bond purchases – safeguarding the singleness and transmission of monetary policy and ultimately price stability – and used it as the primary indicator for the conclusion that they fell within the Bank's mandate in Article 127(1) TFEU.[354] It is at the point of objectives, then, that the Court paid most deference to the independence of the Bank.

The intensity with which the *Bundesverfassungsgericht* reviewed the bond programme in its reference decision tended to lead to a perverse result.[355] When it approved of the establishment of the currency union more than twenty years ago in its *Maastricht Urteil*, it did so on the condition that this union would be a *Stabilitätsgemeinschaft*, a community based on stability.[356] The independence of the Bank is the greatest symbol of, and safeguard for, such a currency union. It greatly contributes to its authority, enabling it to safeguard monetary stability, *especially* during a crisis when it needs to take actions that push the boundaries of its mandate.[357] Yet, in its desire to safeguard the currency union's continued existence as a community based on stability, the German constitutional court now reviewed the bond programme with such intensity that it actually risked undermining the Bank's independence as a powerful asset.

In the end, the judges in Karlsruhe too realised they should not go that far. In their final judgment of 21 June 2016 they accepted the Court's ruling that the Bank had stayed within its mandate and had not violated the prohibition on monetary financing.[358] If interpreted in line with that ruling, the bond programme did not constitute an *ultra vires* act nor violate Germany's

353 Takis Tridimas, *The General Principles of EU Law* (OUP 2006) 140.

354 *Gauweiler* (n 2) paras 46-50, 56 and 64.

355 See also Stefania Baroncelli, 'The *Gauweiler* Judgment in View of the Case Law of the European Court of Justice on European Central Bank Independence: Between Substance and Form' (2016) 23 MJ 79, 87: 'It is even paradoxical that the FCC has employed the notion of central bank independence to criticize the ECB's actions, considering that it was specifically at Germany's request that the ECB was made independent under the Treaty of Maastricht'.

356 See text to n 1 (ch 4).

357 See also WT Eijsbouts and B Michel, 'Between Frankfurt and Karlsruhe: The Move, the Law and the Institutions' (2013) 9 EuConst 355, 356-357 noting in relation to Draghi's 'whatever it takes' pledge that 'Draghi took *responsibility* for the survival of the euro and claimed fresh *authority* for his Bank through this action. The law is part of this, of course: the legal claim that he acted within his mandate was a part of his taking responsibility'.

358 BVerfG, 2 BvR 2728/12 of 21 June 2016 (BVerfG *final judgment OMT*). For extensive analysis of this judgment see Asteris Pliakos and Georgios Anagnostaras, 'Saving Face? The German Federal Constitutional Court Decides *Gauweiler*' (2017) 18 GLJ 213.

constitutional identity.[359] The judgment reveals how the assessment of the *ultra vires* nature of actions of the Bank, or of any other institution for that matter, ultimately requires the *Bundesverfassungsgericht* to determine whether the Court itself has acted *ultra vires*. It cannot avoid such a determination due to its commitment in *Honeywell* to always first ask a preliminary question before ruling on an *ultra vires* challenge and to regard the answer of its European counterpart as binding 'in principle'.[360]

In its judgment the *Bundesverfassungsgericht* argued that the Court had remained within its mandate in Article 19(1) TEU to ensure that in the application of the Union Treaties the law is observed, even though it had 'serious objections' against its reasoning.[361] It considered particularly worrisome the fact that the Court had accepted the Bank's assertion that its purchases have a monetary policy objective 'without questioning or at least discussing….the soundness of the underlying factual assumptions' and that it had not adequately addressed the necessity of a 'restrictive interpretation' of the Bank's mandate given its independence.[362] These objections did not suffice, however, for Karlsruhe to substitute its own views for those of the Court.[363]

4 Conclusion

The change in the Founding Contract that political leaders initiated on 11 February 2010 set in motion an unprecedented transformation of the currency union, turning it into something very different from what had been agreed to when they signed and ratified the Treaty of Maastricht. Its original set-up aimed to create an environment in which the Bank could effectively keep inflation in check. The Bank's mandate, which declares price stability to be the primary aim of monetary policy, as well as the bans on bail-out and monetary financing, constituted its most essential building blocks. Due to the change in the Contract, however, the currency union's stability conception changed profoundly, being no longer predominantly geared towards price stability, but acknowledging the importance of financial stability as well. This necessitated actions by the Union and its member states that before the crisis would have been considered impossible.

359 BVerfG *final judgment OMT* (n 358) paras 190-220.

360 See text to n 191 (ch 7).

361 BVerfG *final judgment OMT* (n 358) para 181.

362 BVerfG *final judgment OMT* (n 358) paras 182, 186-189.

363 The *BVerfG* could avoid that conclusion by setting the bar for a 'manifest' violation of competences extremely high. In *Honeywell* it had already stated that the Court should be granted 'a right to tolerance of error'. See BVerfG *Honeywell* (n 191) para 66. In furtherance thereof, it now reasoned that the Court only manifestly violates its mandate when it interprets the Treaties in a way that is 'manifestly utterly incomprehensible and thus objectively arbitrary'. See BVerfG *final judgment OMT* (n 358) para 149.

It is therefore tempting to simply dismiss these actions as violations of Union law. Illustrative are the statements of German central bankers Issing and Stark cited in chapter 5, where they show little hesitance in condemning financial assistance to distressed states in whatever form as being a violation of the ban on bailout.[364] Such firm language, however, indicates a misunderstanding of how law operates, as Thomas Beukers and Jan-Herman Reestman point out:

> 'Both *Pringle* and *Gauweiler* show the tension between conventional wisdom on economic and monetary union and the capacity of EU law to accommodate new developments and events, in particular in times of crisis. This may be a tough lesson to learn for – especially German – economists who support only a specific understanding of economic and monetary union'.[365]

What causes this tension? At the core, one could argue, it arises from a mistaken equation of the object of law with law itself. The Union Treaties seek to control and regulate the single currency, but they cannot 'escape' from the linguistic and normative 'uncertainties' that characterise most legal rules.[366] Terms like 'monetary financing' or 'bailout' are mentioned nowhere in the Treaties and are therefore of little legal significance. But even notions such as 'assumption of commitments' or 'exceptional occurrence', are vague and ambiguous and require interpretation before they can be applied.

In combination with a proper degree of deference to the independence of the Bank, this interpretative discretion enabled the Court in *Pringle* and *Gauweiler* to overcome the challenge of reconciling the change in the Founding Contract with the law. Central to this challenge was the requirement to accommodate the currency union's new stability conception, which formed the base for much of its reading of the ban on bailout, the assistance clause in Article 122(2) TFEU, as well as the mandate of the Bank and the prohibition on monetary financing. Much of it is well argued, although at times the Court could have been more permissive of financial stability as an objective. Despite its indications to the contrary in *Pringle,* Article 122(2) TFEU does seem to allow the Union to enter into assistance operations that pursue this objective. And if it had not applied *Pringle* logic in interpreting the Bank's mandate in the

364 See text to n 35 and n 36 (ch 5).

365 T Beukers and J-H Reestman, 'On Courts of Last Resort and Lenders of Last Resort' (2015) 11 EuConst 227, 237.

366 As Gunnar Beck, explains, such 'uncertainty' is not only present in the rules themselves ('primary level uncertainty') but also at the stage of argumentation ('secondary legal uncertainty'): '*Secondary* legal uncertainty is ultimately as inescapable as *primary* level uncertainty because legal argumentation is subject to the same defining ethical and linguistic constraints as the making of primary legal rules in the first place.' See Beck, *Legal Reasoning of the Court of Justice* (n 3) 139. See also n 9 (ch 7).

slipstream of Karlsruhe, it could have explicitly allowed for the objective to inform monetary policy.

On one crucial point, however, the Court's approval of the change in the Founding Contract pushes, and even crosses, the boundaries of its interpretative discretion: to argue that financial stability has always been an objective of the ban on bailout is to play with history. Does this then imply that it should have disapproved of the assistance operations prior to the entry into force of Article 136(3) TFEU? No. To see why requires us to return once more to solidarity.

8 Conclusion

Preserving the Contract in an emergency

1 The euro's rescue, the Court and legal justification

The ambition of this study has been to read the legal change experienced in the currency union due to the debt crisis through the lens of solidarity. To make this possible it has widened its focus beyond the law to the fundamental joint commitment underlying the Union, which it termed, in a reference to the notion of social contract discussed in chapter 1,[1] the 'Founding Contract'. It has shown that the crisis has led to a profound upgrade of this Contract, characterised by a widening of the currency union's conception of stability. Whereas in its original form, analysed in chapter 3, the set-up of the euro attributed prime importance to the goal of price stability, it has evolved into one that also has great concern for financial stability.

It now remains to bring back these findings to the level of case law and the position of the Court in relation to this change in the Contract. That is the mission of this conclusion, which consequently both synthesizes the findings of this study and adds an important final element to them. It conducts its mission, first, by distinguishing between the political and legal dimension of changes to the Contract during an emergency. Then, with a focus on the legal dimension, it considers the implications of solidarity, and one of its legal offshoots, loyalty, for the constitutional actors faced with such change. Finally, it examines how the Court should deal with these implications in cases like *Pringle* and *Gauweiler*.

Let us return to the words of Chancellor Merkel, cited at the very beginning of this study.[2] Was her appeal before the *Bundestag* in May 2010 to the 'unbreakable solidarity' states had to display to avert 'risks to the currency union at large' merely political rhetoric? A simple trick to assemble support for assistance for Greece? No. Of course, she had to convince parliamentarians of the need for assistance. Yet her words carried a meaning that reached far beyond the practical necessities of that debate. They referred to the solidarity that ties the member states together and that has driven a fundamental transformation of the currency union, characterised by a widening of its stability

1 See text to n 114 (ch 1).
2 See text to n 1 (prologue).

conception. In fact, the debate in the *Bundestag* itself formed part of that solidarity as it was bound up with the meeting of the heads of state and government of 11 February 2010 and their commitment to safeguard financial stability at all cost. With that commitment political leaders initiated a change of the Founding Contract between their states, a change that was necessary to preserve the euro. The positive solidarity they displayed through their assistance operations was therefore not only of a factual nature, inspired by the desire to safeguard their self-interest; it was deeply *normative* as they were under a political obligation to show it. This normativity to their assistance operations also made it possible for the European Central Bank to carry out purchases of government bonds of a nature and on a scale unthought-of.

Because of these actions, and within little more than two years from the moment national leaders concluded their commitment, the currency union's set-up came to differ fundamentally from that put in place by the Treaty of Maastricht. Only part of that difference found its way into the law, which reflected – and to some extent still reflects – a stability conception from the past. When the Court had to pronounce on the currency union's transformation in *Pringle* and *Gauweiler*, it therefore had to take great pains to reconcile the change in the Contract with the law. With its reading of the no-bailout clause in *Pringle* it even overstretched its interpretive power, as chapter 7 explained.[3] Many scholars have nonetheless approved of that judgment by pointing out the Court's predicament. A negative ruling, they argue, was simply not an option, given its devastating consequences for the single currency and the Union at large.[4] *Fiat iustitia, et pereat mundus* – Let justice be done, though the world perish – was not something to go by.[5]

This is undoubtedly true. It may even be sufficient to justify the Court's ruling from an extra-legal perspective. As a legal justification, however, it cannot suffice. This is not to say that there is no place for 'consequentialist'

3 See text to n 96ff (ch 7).

4 Particularly telling is Crhis Koedooder, 'The *Pringle* Judgment: Economic and/or Monetary Policy?' (2013-2014) 37 Fordham Int'l LJ 111, 145, according to whom in *Pringle* 'the Court had to choose between putting the stability of the euro area at risk….and reducing Article 136(3) TFEU to an essentially superfluous provision' and that 'Given the circumstances sacrificing Article 136(3) TFEU was the only reasonable option'. Others, including the author of the present study, have also stressed the practical necessity of a positive ruling and/or the 'unsurprising' outcome in both cases. See eg Vestert Borger, 'The ESM and the European Court's Predicament in *Pringle*' (2013) 14 GLJ 113, 127; Paul Craig, '*Pringle*: Legal Reasoning, Text, Purpose and Teleology' (2013) 20 MJ 3, 3; Bruno De Witte and Thomas Beukers, 'The Court of Justice approves the creation of the European Stability Mechanism outside the Union legal order: *Pringle*' (2013) 50 CML Rev 805, 805.

5 See also Luuk van Middelaar, 'De Europese Unie en de gebeurtenissenpolitiek' (Inaugural Lecture Leiden University, 23 September 2016) 10. There are even those claiming that the Court rather did the opposite. See eg Christian Joerges, '*Pereat Iustitia, Fiat Mundus*: What is Left of the European Economic Constitution after the *Gauweiler* Litigation?' (2016) 23 MJ 99.

considerations in legal reasoning.[6] As Neil MacCormick stresses, judges do, and should, 'consider and evaluate the consequences of various alternative rulings open to them' when applying and interpreting the law.[7] But to make their reasoning legally sound they also have to show that it is 'consistent' with 'the already existing body of rules',[8] and in line with the broader principles that bestow it with (a degree of) 'coherence'.[9]

Can the Court's approval of the euro's rescue also benefit from such a legal justification? This study argues that it can, based on the nature and quality of the Union's constitution.[10] Clearly, the academic debate on how to read this constitution is still in its infancy compared to most of its national counterparts whose understanding often rests on greater consensus. For a long time to come, it will need to benefit from historic events like the debt crisis which help to understand the Union's deeper constitutional structures. This study therefore does not claim a monopoly on wisdom when it comes to the constitution of the Union. Its concluding reflections aim at the role solidarity plays in the powers enjoyed under the constitution by political leaders to preserve their Founding Contract in an emergency.

2 EMERGENCY AND CONSTITUTION

Günter Frankenberg has argued that if one had to compare the Union with the western 'archetypes of constitutions' – the 'political manifesto', the 'contract', the 'programme' and the 'statute' – it would be with the constitutional contract.[11] Two such contracts can be distinguished.[12] One the one hand, there is the 'organisational contract'.[13] It typically regulates how the government functions by demarcating the powers of its 'central public authority' and those of its 'constituent' parts, and in so doing organizes the (legal) bond between them.[14] An example is the Articles of Confederation of 1781 constitut-

6 Neil MacCormick, *Legal Reasoning and Legal Theory* (Clarendon Press 1978) 108-119, 129-151.
7 MacCormick (n 6) 129.
8 MacCormick (n 6) 196-197. For his treatment of the 'requirement of consistency' see 119-128, 195-228.
9 MacCormick (n 6) 119-128, 152-194.
10 For a negative answer to this question see Gunnar Beck, 'The Court of Justice, the *Bundesverfassungsgericht* and Legal Reasoning during the Euro Crisis: The Rule of Law as a Fair-Weather Phenomenon' (2014) 20 European Public Law 539, 561: 'Law is law not least because anything does *not* go. Where constitutions and treaties, despite their often high level of generality and abstraction, lay down clear objectives and precise constraints on political action, as the EU Treaties evidently do in relation to the conduct of monetary and economic policy….they constrain, or should constrain, the range of permissible political options'.
11 Günter Frankenberg, 'The Return of the Contract: Problems and Pitfalls of European Constitutionalism' (2000) 6 ELJ 257, 258, 260.
12 Frankenberg (n 11) 259.
13 Frankenberg (n 11) 259.
14 Frankenberg (n 11) 258-260.

ing the United States of America through which the participating states entered into 'a firm league of friendship with each other for their common defense, the security of their liberties, and their mutual and general welfare'.[15]

On the other hand, there is the 'social contract'.[16] This contract not only organizes its participating entities but also turns them into a unified whole, giving rise to a joint intention or, in the words of Rousseau, 'a general will'.[17] This focus on the 'legitimacy of political authority', as Frankenberg calls it, is less discernible in organisational contracts, which rather 'presuppose' and build on the legitimacy generated by 'membership' *within* the contracting entities.[18]

Between these two 'contractual models', the Union is most easily equated to the organizational one, even though its two basic Treaties distinguish it from the standard, singular version.[19] The Treaties govern the division of responsibilities between the Union and the member states, thereby restraining the political authority that can be exercised by the former, whilst leaving the states 'intact' as legally separate entities.[20] One could argue that many legal scholars who accept that the Union has a constitutional nature but also maintain that it is still largely an international legal construct originating from its participating states,[21] implicitly subscribe to that view.[22] Yet, whereas the Union undoubtedly has these organisational features, its constitutional nature

15 Art 3 of the Articles of Confederation. For a comparison between the Union and the US Confederation see Armin Cuyvers, 'The Confederal Comeback: Rediscovering the Confederal Form for a Transnational World' (2013) 19 ELJ 711.

16 Frankenberg (n 11) 259.

17 Frankenberg (n 11) 259. On Rousseau and the notion of 'general will' see text to n 150 (ch 1).

18 Frankenberg (n 11) 259-260.

19 Frankenberg (n 11) 260, 266. For a different view, arguing that the Treaties should not be seen as amounting to a fully-fledged constitution because it cannot be traced 'back to a European people' see Dieter Grimm, 'Does Europe Need a Constitution' (1995) 1 ELJ 282, 290-291. For the counterargument that 'true constitutions' do not necessarily have to be grounded in an 'act of the people' see Paul Craig, 'Constitutions, Constitutionalism, and the European Union' (2001) 7 ELJ 125, 136-139.

20 Frankenberg (n 11) 259-260.

21 See eg Alan Dashwood, 'States in the European Union' (1998) 23 EL Rev 201; Alan Dashwood, 'The Relationship Between the Member States and the European Union/European Community' 41 CML Rev 355; Robert Schütze, 'On "Federal Ground": The European Union as an International Phenomenon' (2009) 46 CML Rev 1069; Bruno De Witte, 'The European Union as an international legal experiment' in Gráinne de Búrca and JHH Weiler (eds), *The Worlds of European Constitutionalism* (CUP 2012) 19ff. Note that such scholars would not necessarily agree on the precise definition or characteristics of the Union's constitutional nature or how to label it (eg a 'constitutional order of states' (Dashwood/De Witte), a 'federation of sovereign states' (Dashwood), a 'federation of states' (Schütze)).

22 For a different view see eg Hauke Brunkhorst, 'Constituent Power and Constitutionalization in Europe' (2016) 14 ICON 680, 691: '[F]rom the very outset the European Union was not founded as an international association of states. On the contrary, it was founded as a community of peoples who legitimated the project of European unification directly and democratically through their combined, albeit still national, constitutional powers'.

reaches beyond that of the organisational contract. It also possesses the unifying quality associated with the social contract.[23] As argued in chapter 2,[24] by signing and ratifying the Union Treaties the member states jointly committed themselves to uphold them. That commitment cannot be reduced to their individual intentions but belongs to them *as a body*. This shows *that* and *how* constituent power (still) lies with the states.[25] To put it in popular terms: the Union's constitutional architecture does not stem from a 'We, the People' but a 'We, the States.'[26] One may disagree with the presence of such a '*pouvoir constituant sans peuple*' from a normative point of view,[27] even argue that the Union's constitutional set-up is in need of change,[28] yet it is what characterises the Union at present and this has, and should have, consequences for its constitutional actors, including the Court, when faced with a crisis of unprecedented proportions. The question of course then becomes what these consequences are.

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23 For a different view see Frankenberg (n 11) 259 who argues that the social contract (always) needs to be 'taken as a metaphorical description of ... the transformation of the "society of individuals" into a body politic', whereas organizational contracts are 'a matter of fact'. See also Christoph Möllers, 'Pouvoir Constituant, Constitution, Constitutionalisation' in Armin von Bogdandy and Jürgen Bast (eds), *Principles of European Constitutional Law* (Hart Publishing 2009) 176 (arguing that constitutional treaties cannot (also) be social contracts, as they 'do not represent a theoretical construction for justifying public power'). For the contrary view, supporting the argument of a social contract between the member states see Ton van den Brink and Jan Willem Casper van Rossem, 'Sovereignty, Stability and Solidarity: Conflicting and Converging Principles and the Shaping of Economic Governance in the European Union' (UCD Working Papers in Law Criminology and Socio-Legal Studies No 4, 2014) 12.

24 See text to n 80 and n 98 (ch 2).

25 See also Gerard Conway, *The Limits of Legal Reasoning and the European Court of Justice* (CUP 2012) 102.

26 Luuk van Middelaar, *The Passage to Europe: How a Continent Became a Union* (YUP 2013) 214-215. This is not to say that the Union's constituent basis cannot change. The Constitution for Europe, for example, stated in Article I-1: 'Reflecting the will of *the citizens* and *the States* of Europe…' (emphasis added). The Lisbon Treaty, however, left out this change, as a result of which the Union's constituent basis still rests solely with the member states. See also WT Eijsbouts: 'Wir Sind Das Volk: Notes about the Notion of "The People" as Occasioned by the *Lissabon-Urteil*' (2010) 6 EuConst 199, 200 (fn 1).

27 Möllers (n 23) 186. For the view that goes beyond such normative objections, arguing that the Union does not 'possess a *pounvoir constituant*' as constituent power is not located in a European people, see Miguel Poiares Maduro, 'The importance of being called a constitution: Constitutional authority and the authority of constitutionalism' (2005) 3 Int J Const Law 332, 352.

28 For more general calls for change of the Union's architecture in light of its years of crises see eg Sacha Garben, 'Confronting the Competence Conundrum: Democratising the European Union through an Expansion of its Legislative Powers' (2015) Oxf J Leg Stud 55; Fritz W Scharpf, 'After the Crash: A Perspective on Multilevel European Democracy' (2015) 21 ELJ 384; Mark Dawson and Floris De Witte, 'From Balance to Conflict: A New Constitution for the EU' (2016) 22 ELJ 204.

In trying to understand a historic event that challenges a system's ordinary functioning, grounded in day-to-day practice, it is tempting to take refuge in extremes. Telling is the revival of the ideas about the state of exception of Carl Schmitt, the legal philosopher notorious for his engagement with national socialism in Nazi-Germany, among lawyers analysing the debt crisis.[29] This study does not follow their course. Still, it is worthwhile to reflect on Schmitt's work in some detail as it helps to convey this study's own position and argument.

According to Schmitt, it is during existential crises that the true significance of the *pouvoir constituant* is revealed. Central to his thought, Martin Loughlin explains, is the relation between 'state' and 'constitution'.[30] The state, Schmitt argues, 'is the political unity of the people'.[31] The people can possess constituent power,[32] which Schmitt defines as 'the political will, whose power or authority is capable of making the concrete, comprehensive decision over the type and form of its own political existence'.[33] In so doing, it puts in place the constitution and institutionally shapes its own existence.[34] For Schmitt,

29 Of course, this is not to say that such scholars normatively subscribe to Schmitt's views about the state of exception or follow his analysis across the board. Jonathan White, for example, argues that there is not a single Schmittian 'sovereign' that takes a decision on the state of exception. Rather, Europe's 'emergency regime is a collaborative phenomenon, promoted by those with an interest in its production, and consolidated by those who lack the authority to revoke it or who actively give credence to the authority claims of others'. See Jonathan White, 'Emergency Europe' (2015) 63 Political Studies 300, 301. Christian Joerges also argues that Schmitt's legacy hangs as a 'shadow over Europe' while, similar to White, taking the view that Schmitt's single 'dictator has been replaced by technicity'. See Christian Joerges, 'Europe's Economic Constitution in Crisis and the Emergence of a New Constitutional Constellation' (2015) 15 GLJ 985, 1019. See also Michael A Wilkinson, 'Authoritarian Liberalism in the European Constitutional Imagination: Second Time as Farce?' (2015) 21 ELJ 313, 330; Michelle Everson, 'An Exercise in Legal Honesty: Rewriting the Court of Justice and the *Bundesverfassungsgericht*' (2015) 21 ELJ 474, 482-483.

30 Martin Loughlin, 'The concept of constituent power' (2014) 13 European Journal of Political Theory 218, 224.

31 Carl Schmitt, *Constitutional Theory* (Jeffrey Seitzer tr and ed, Duke University Press 2008) 59. Schmitt ultimately grounds that unity in his infamous 'friend-enemy' distinction. See Carl Schmitt, *The Concept of the Political* (George Schwab tr, University of Chicago Press 1996). For discussion see Ernst-Wolfgang Böckenförde, 'The Concept of the Political: A Key to Understanding Carl Schmitt's Constitutional Theory' in David Dyzenhaus (ed), *Law as Politics: Carl Schmitt's Critique of Liberalism* (Duke University Press 1998) 37ff.

32 Schmitt, *Constitutional Theory* (n 31) 112, 125-128. See also Renato Cristi, 'Carl Schmitt on Sovereignty and Constituent Power' in David Dyzenhaus (ed), *Law as Politics: Carl Schmitt's Critique of Liberalism* (Duke University Press 1998) 188-189; Loughlin (n 30) 225.

33 Schmitt, *Constitutional Theory* (n 31) 125. Schmitt was therefore adamant on stressing the difference between a Roussseaudian 'social contract' and the act of constitution-making. The people as 'political unity' precedes this act. The social contract, turning the people into a unity, is therefore 'presupposed', and prior to, the exercise of 'constitution-making power'. See Schmitt, *Constitutional Theory* (n 31) 112. This study, on the contrary, maintains that the act of signing and ratifying the Treaties simultaneously turned the member states into a whole, a 'We'.

34 Loughlin (n 30) 224.

therefore, the authority of the constitution does not reside in a 'presupposed', ultimate '*Grundnorm*', as positivists like Kelsen argue.[35] It only possesses authority 'because it derives from a constitution-making capacity….and is established by the will of this constitution-making power'.[36] As Loughlin points out, Schmitt therefore considers it misplaced to say that the state 'has' a constitution.[37] To him, 'the state *is* constitution…'.[38]

Given that the constitution is ultimately in its nature political, one cannot, and should not, equate it with the positive rules set out in a document labelled 'Constitution'.[39] Usually, the difference between the two remains below the surface, yet in times of existential crises it shows up. 'Sovereign is he who decides on the exception', Schmitt argues.[40] What such an exception is and when it is present cannot be defined in advance through rules or legislation.[41] 'The precise details of an emergency cannot be anticipated', he reasons, 'nor can one spell out what may take place in such a case, especially when it is truly a matter of an extreme emergency and of how it is to be eliminated'.[42] It is in such a state of emergency that the significance of constituent power becomes visible.[43] It 'stands alongside and above every constitution derived from it' and can protect its political unity even if it takes a violation of constitutional rules.[44] Such transgressions do not lead to the demise of the constitution. More than that, they underscore its continuing authority.[45] An exception

35 Loughlin (n 30) 221-222, 224-225. See also Cristi (n 32) 188. For Kelsen's theory see Hans Kelsen, *Pure Theory of Law* (University of California Press 1967).

36 Schmitt, *Constitutional Theory* (n 31) 64.

37 Loughlin (n 30) 225.

38 Schmitt, *Constitutional Theory* (n 31) 60.

39 Loughlin (n 30) 224. According to Schmitt, *Constitutional Theory* (n 31) 75: 'A concept of the constitution is only possible when one distinguishes constitution and constitutional law'.

40 Carl Schmitt, *Political Theology: Four Chapters on the Concept of Sovereignty* (George Schwab tr and ed, The University of Chicago Press 2005) 5 (footnote omitted).

41 Tracy B Strong, 'The Sovereign and the Exception: Carl Schmitt, Politics, Theology, and Leadership' in Carl Schmitt, *Political Theology: Four Chapters on the Concept of Sovereignty* (George Schwab tr and ed, The University of Chicago Press 2005) xiv.

42 Schmitt, *Political Theology* (n 40) 6-7.

43 Cristi (n 32) 189-191; Loughlin (n 30) 225-226.

44 Schmitt, *Constitutional Theory* (n 31) 80, 140.

45 Cristi (n 32) 191. According to Schmitt, *Political Theology* (n 40) 5, sovereignty is therefore a 'borderline concept' (*Grenzbegriff*). As Strong (n 41) xx-xxi explains, the concept 'thus looks in two directions, marking the line between that which is subject to law – where sovereignty reigns – and that which is not – potentially the space of the exception'. Schmitt is certainly not the only one to have characterised the state of exception as a borderline concept. According to Giorgio Agamben, for example, 'the state of exception is neither external nor internal to the juridical order, and the problem of defining it concerns precisely a threshold, or a zone of indifference, where inside and outside do not exclude each other but rather blur with each other. The suspension of the norm does not mean its abolition, and the zone of anomie that it establishes is not (or at least claims not to be) unrelated to the juridical order'. See Georgio Agamben, *State of Exception* (The University of Chicago Press 2005) 23.

only exists by virtue of a rule, Schmitt argues.[46] 'It confirms not only the rule but also its existence, which derives only from the exception'.[47] The exception reveals 'the superiority of the existential element over the merely normative one'.[48]

Now, is there a need to follow Schmitt in his analysis of the relation between law and constituent power?[49] In other words: can the assistance operations of member states, at least until the insertion of Article 136(3) into the TFEU, only be justified by accepting that states, as *pouvoir constituant*, changed their Founding Contract to preserve their unity and in so doing justifiably acted outside the constraints of Union law? Such a move is unwarranted. To understand why requires putting the finger on the exact point on which Schmitt tries to counter legal positivist thinking. This is not that a sovereign has the capacity to put the law (temporarily) out of operation in an emergency. Positivists can accept that assertion by simply arguing that there may indeed be times in which a '*de facto* power' suspends the law.[50] What they will not subscribe to, however, is the proposition that such power has legal relevance.

The real point Schmitt is making, therefore, one of which he thinks bestows his ideas about the exception with legal significance, is that an ultimate sovereign decider is a *conditio sine qua non* for the '*legitimate* applicability' of the law.[51] But does it really? As Lars Vinx explains, in theory one can accept the assertion that a sovereign possessing the power to 'switch the law off' is a condition for the legitimate application of law.[52] It may be that such a power proves necessary to protect a group's unity in times when blind application of the law would lead to its demise.[53] Still, however, this does not show why the law should give up on its 'own claim to normative finality'.[54]

46 Strong (n 41) xxi.

47 Schmitt, *Political Theology* (n 40) 15.

48 Schmitt, *Constitutional Theory* (n 31) 154. See also Cristi (n 32) 191; Loughlin (n 30) 226.

49 See also Kenneth Dyson, 'Sworn to Grim Necessity? Imperfections of European Economic Governance, Normative Political Theory, and Supreme Emergency' (2013) 35 Journal of European Integration 207, 221 who reflects on the debt crisis and argues that 'It is time….to put flesh on the normative basis for acting in supreme emergency'.

50 Lars Vinx, 'Carl Schmitt's defence of sovereignty' in David Dyzenhaus and Thomas Poole (eds), *Law, Liberty and State* (CUP 2015) 105-106.

51 Vinx (n 50) 106. According to Schmitt, *Constitutional Theory* (n 31) 136: 'A constitution is legitimate not only as a factual condition. It is also recognized as a just order, when the power and authority of the constitution-making power, on whose decision it rests, is acknowledged'.

52 Vinx (n 50) 115-117.

53 Vinx (n 50) 116. This study therefore does not follow the view of those who argue that the law will always be capable of regulating and containing an emergency. For this view see eg David Dyzenhaus, 'The compulsion of legality' in Victor V Ramraj (ed), *Emergencies and the Limits of Legality* (CUP 2008) 33ff. For discussion of this 'legality model' see Karin Loevy, *Emergencies in Public Law* (CUP 2016) 28-32.

54 Vinx (n 50) 116.

Does this then mean that up until the entry into force of Article 136(3) TFEU political leaders were *only* exercising *de facto* power, lacking legal significance, and that the Court could not justifiably approve of the assistance operations implemented during that period due to their violation of the ban on bailout? This conclusion is not called for either. In this regard it serves to distinguish between the 'constitutional document' and the 'constitutional settlement'.[55] As Tom Eijsbouts, Thomas Beukers and Jan-Herman Reestman explain:

> 'Constitutional law is not the field of law concerning the formal Constitution only. It is the law springing from and concerning the wider constitutional settlement, the political constitution or the constitution with a "small c"…. Constitutional law thus depends, for its acknowledgement and for its development, on a wider-than-legal reality.'[56]

The initiation of the change in the Founding Contract by the leaders on 11 February 2010 was indeed a political act, an exercise of constitutional power outside the law. However, this exercise of political power to some extent *does* receive recognition in the law. To see why the focus needs to shift from rules to principles. Let us therefore turn to the manifestation of solidarity in the realm of principles, and discover how under the Union's constitutional constellation it enables as well as constrains the ability of political leaders to uphold their Contract in an emergency.

3 Solidarity, loyalty and the Contract

The debate about legal principles – i.e. what they are and how they function – is complex and this study has no intention to settle it. It only focuses on particular principles, those relating to obligation, and refrains from providing an exact definition.[57] One can say that compared to *rules* of obligation, *principles* usually prescribe fairly general actions and serve a wider variety of purposes.[58] To name but a few: they can be used as a tool for interpreting

55 WT Eijsbouts, T Beukers and J-H Reestman, 'Between the Constitutional Document and the Constitutional Settlement' (2014) 10 EuConst 375, 375.

56 Eijsbouts, Beukers and Reestman (n 55) 375-376. See also Julian Arato, 'Treaty Interpretation and Constitutional Transformation: Informal Change in International Organizations' (2013) 38 Yale J Int'l L 289, 302-303.

57 Explaining that not all principles are norm setting in nature is Joseph Raz, 'Legal Principles and the Limits of Law' (1972) 81 Yale LJ 823, 834-836.

58 One can debate to what extent this 'criterion of generality' is correct. For the view that it is only 'relatively correct' see Robert Alexy, *A Theory of Constitutional Rights* (OUP 2010) 60-61. According to Alexy (n 58) 47-48, one can indeed say that compared to rules principles are usually characterised by a greater generality, yet this is not what ultimately distinguishes the two. Instead, he qualifies principles as 'optimization requirements', contrary to rules which are 'always either fulfilled or not'. For a similar reasoning, though without character-

laws, amending laws, creating exceptions to them, introducing new rules, or even prescribing action in specific circumstances.[59]

Exceptions notwithstanding,[60] scholars take the view that Union law recognises a principle of solidarity. In line with Article 2 TEU, which lists solidarity as one of the Union's founding values, they posit solidarity as a value *in itself*, as a conception of 'the Good',[61] and argue that there is a legal principle that prescribes its protection. At a very general level, the principle demands the organisation of 'cohesion' and 'mutual assistance' in different policy areas.[62] Depending on the actors as well as the subject matter concerned, it translates into more specific requirements.[63] When it comes to Union citizens, it requires member states to extend the solidarity that sustains their welfare systems to citizens from other states exercising their (market) freedoms.[64] As the Court famously found in *Grzelczyk* and has repeated many times since, states need to show 'a certain degree of financial solidarity' with nationals of other states.[65]

As far as member states themselves are concerned, they too are required to mutually assist each other. In the area of migration and asylum law, for example, Articles 67(2) and 80 TFEU prescribe that policies in this area shall be governed by 'the principle of solidarity' between the states. In light of the

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ising principles as optimization requirements, see Ronald Dworkin, *Taking Rights Seriously* (Duckworth 1977) 24. For the view that it is absolutely correct, even though the precise distinction between rules and principles will always be 'one of degree' as there is no clear dividing line between 'specific' and 'unspecific' acts, see Raz (n 57) 838. See also Graham Hughes, 'Rules, Policy and Decision Making' (1967-1968) 77 Yale LJ 411, 419.

59 Raz (n 57) 839-841. For an analysis of the role of principles in the specific context of Union law see Takis Tridimas, *The General Principles of EU Law* (OUP 2006) 1-58.

60 See Marcus Klamert, *The Principle of Loyalty in EU Law* (OUP 2014) 35-41.

61 Alexy (n 58) 87.

62 Armin von Bogdandy, 'Founding Principles' in Armin von Bogdandy and Jürgen Bast (eds), *Principles of European Constitutional Law* (Hart Publishing 2009) 53-54.

63 For overviews of its application in different areas of Union law see Malcolm Ross and Yuri Borgmann-Prebil (eds), *Promoting Solidarity in the European Union* (OUP 2010); Stefan Kadelbach (ed), *Solidarität als Europäisches Rechtsprinzip?* (Nomos 2014); Michèle Knodt and Anne Tews (eds), *Solidarität in der EU* (Nomos 2014); Peter Hilpold, 'Understanding Solidarity within EU Law: An Analysis of the "Islands of Solidarity" with Particular Regard to Monetary Union' (2015) 34 YEL 257.

64 See Catherine Barnard, 'EU Citizenship and the Principle of Solidarity' in Eleanor Spaventa and Michael Dougan (eds), *Social Welfare and EU Law* (Hart Publishing 2005) 157ff; Stefano Giubboni, 'A Certain Degree of Solidarity? Free Movement of Persons and Access to Social Protection in the Case Law of the European Court of Justice' in Malcolm Ross and Yuri Borgmann-Prebil (eds), *Promoting Solidarity in the European Union* (OUP 2010) 166ff. For an overview of different 'norms' of transnational solidarity and how Union law relates them to national conceptions of justice underlying national welfare systems see Floris De Witte, *Justice in the EU: The Emergence of Transnational Solidarity* (OUP 2015).

65 Case C-184/99 *Grzelzcyk* [2000] ECLI:EU:C:2001:458, para 44; Case C-209/03 *Bidar* [2005] ECLI:EU:C:2005:169, para 56; Case C-158/07 *Förster* [2008] ECLI:EU:C:2008:630, para 48; Case C-75/11 *Commission v Austria* [2012] ECLI:EU:C:2012:605, para 60; Case C-140/12 *Brey* [2013] ECLI:EU:C:2013:565, para 72.

current refugee crisis, many have argued that the Union's present asylum system falls short of the demands of this principle and have stressed the need for reform.[66]

And also in relation to the single currency, the principle of solidarity has made its entry. The amendment of the EFSM in August 2015, paving the way for its continued use as an assistance facility for the currency union alongside the ESM,[67] is motivated by the necessity to transpose the 'principle of solidarity between member states whose currency is the euro….to the financial assistance mechanism operated under Union law'.[68]

Even if one follows this line of reasoning and accepts that there is indeed a principle of solidarity that demands the organisation of cohesion and mutual assistance,[69] it cannot answer the question of concern to this study. The principle does not address the relation between the Founding Contract that binds the member states together and the law. It does not prescribe how to deal with the solidarity that exists independently from the law and that has driven a fundamental transformation of the currency union. This is not governed by the principle of solidarity, but by that of loyalty. Some have equated the two, arguing that the duty of loyalty constitutes the 'formal' or 'institutional' dimension of the principle of solidarity,[70] yet the Court has given a more refined analysis. Early on in its jurisprudence, in a case concerning balance of payments assistance (!), it stated that solidarity lies 'at the basis of the whole Community system in accordance with the undertaking in Article 5 of the Treaty'.[71]

How to understand that statement? The principle of loyal cooperation, now codified in Article 4(3) TEU, has had a great influence on the shaping of the Union's legal construction, and it still does. Called 'foundational' or 'system-

66 See eg Roland Bieber and Francesco Maiani, 'Sans solidarité point d'Union européenne' (2012) 48 RTD eur 295, 312-326; Jürgen Bast, 'Deepening Supranational Integration: Interstate Solidarity in EU Migration Law' (2016) 22 European Public Law 289; Esin Kücük, 'The Principle of Solidarity and Fairness in Sharing Responsibility: More than Window Dressing?' (2016) 22 ELJ 448.

67 See text to n 164 (ch 7).

68 Recital 4 Council Regulation (EU) 2015/1360 of 4 August 2015 amending Regulation (EU) 407/2010 establishing a European financial stabilization mechanism [2015] L 210/1.

69 Note that in her View in *Pringle* AG Kokott did recognise a principle of solidarity, yet without reading into it a duty to grant assistance. See Case C-370/12 *Pringle* [2012] ECLI:EU:C:2012:756, View of AG Kokott, para 143 (*Pringle*). See also text to n 89 (conclusion).

70 Christian Calliess, 'Das Europäische Solidaritätsprinzip und die Krise des Euro: Von der Rechtsgemeinschaft zur Solidaritätsgemeinschaft?' (Vortrag an der Humboldt-Universität zu Berlin, 18 January 2011) 15-16; Bieber and Maiani (n 66) 296-297.

71 Joined Cases 6/69 and 11/69, *Commission v France* [1969] ECLI:EU:C:1969:68, para 16. See also Epaminondas A Marias, 'Solidarity as an Objective of the European Union and the European Community' (1994) 21 LIEI 85, 94.

ic',[72] it has inspired other key principles and doctrines like supremacy,[73] effectiveness,[74] and pre-emption.[75] It can also impose obligations on states as well as Union institutions to act, or abstain from acting, in order to promote the 'Union interest',[76] at times even if such obligations have no basis in other provisions of Union law.[77] Armin Von Bogdandy has explained the principle's far-reaching potential by representing it as an instrument compensating for the lack of 'sanctioning power' at Union level.[78] 'Much of European law – namely all legal norms that represent, at their core, a communication between different public authorities – is not even symbolically sanctioned by possible coercion', he argues.[79] Hence the need for a principle like loyal cooperation, which establishes 'supplementary duties that secure the law's effectiveness and may solve conflicts'.[80] Unfortunately, this reasoning suffers from circularity as it tries to improve respect for the law through yet another legal principle, i.e. loyalty.

Allow this study now to put forward a different explanation, one that links the principle of loyalty to the Founding Contract that exists between the member states. Such an explanation also informs the Court's statement that the principle of loyalty is an expression of the solidarity at the basis of the Union. The Contract that underlies the Union makes the states *pouvoir constituant*, turns them into a unity and normatively obliges them to display solidarity by respecting their joint commitment to uphold the Treaties. As argued in chapter 2,[81] that commitment not only relates to the laws laid down in these Treaties but also to their object that these Treaties govern, the Union

72 Von Bogdandy (n 62) 21, 41-42 (listing it as a 'founding principle'); Tridimas (n 59) 4 (calling it a 'systemic principle').

73 Case 6/64 *Costa v ENEL* [1964] ECLI:EU:C:1964:66: 'The executive force of Community law cannot vary from one state to another in deference to subsequent domestic laws, without jeopardizing the attainment of the objectives of the Treaty set out in Article 5(2)'. See also Eleftheria Neframi, 'The Duty of Loyalty: Rethinking its Scope Through its Application in the Field of EU External Relations' (2010) 47 CML Rev 323, 325-326; Klamert (n 60) 71-73.

74 See Case C-106/89 *Marleasing* [1990] ECLI:EU:C:1990:395, para 8 read in combination with Case C-397/01 *Pfeiffer* [2004] ECLI:EU:C:2004:584, para 114. See also John Temple Lang, 'Community Constitutional Law: Article 5 EEC Treaty' (1990) 27 CML Rev 645, 647-654; See also Neframi (n 73) 330-331.

75 Case 22/70 *Commission v Council* [1971] ECLI:EU:C:1971:32, paras 20-21. See also Neframi (n 73) 339-342.

76 For an exploration of the duty of loyalty and how it promotes the 'Union interest' see Klamert (n 60) 9-30.

77 See eg Case C-374/89 *Commission v Belgium* [1991] ECLI:EU:C:1991:60, paras 14-15; Case C-82/03 *Commission v Italy* [2004] ECLI:EU:C:2004:433, paras 15-18; Case C-217/88 *Commission v Germany* [1990] ECLI:EU:C:1990:290, para 33. On loyalty as an independent source of obligations see extensively Klamert (n 60) 234-241.

78 Von Bogdandy (n 62) 41.

79 Von Bogdandy (n 62) 41.

80 Von Bogdandy (n 62) 41.

81 See text to n 126 (ch 2).

itself. This is just as they have not only committed themselves to the law governing the single currency, but also to that currency as such. The many rules governing the cooperation between the member states and the institutions in pursuit of these objectives will never exhaust their full relationship.[82] The duty of loyalty, as an expression of basic solidarity, fills that regulatory gap by inspiring principles and establishing supplementary duties that ensure the law's effectiveness; it thus connects the law to the Contract that grounds it.

4 The Contract and the Court

When the Court has to rule on a measure that has proven essential to preserve the Founding Contract in an emergency, this study argues, it is under a duty of loyalty to abstain from disapproving it.[83] It owes that duty to the member states in their collective capacity, as the Union's constituent power. But how is that possible if the principle of loyal cooperation mainly governs the relationship between the institutions and states *singular*, that is: the interaction between these entities taking place once the Union is constituted? It is possible because the states as a *collective* not only play a role as *pouvoir constituant*, but also as *pouvoirs constitués*.[84] They are not only the Union's constituent power but, in their *executive* capacity, also exercise constituted power, especially in the European Council.[85] And when the crisis set in and exposed the flaws of the euro discussed in chapter 4, when the 'body politic' was threatened, responsibility to act fell on the political leaders assembled in this highest executive institution. They had to decide whether and how to preserve the political unity between the states they represented. Under the Union's constitutional constellation, characterised by its contractual nature, that power resides with them.[86] And as chapters 5 and 6 showed, they exercised that power on 11 February

82 See also Von Bogdandy (n 62) 41.

83 In *Gauweiler* AG Cruz Villalón states explicitly that the duty of loyal cooperation is also binding on the Court. See Case C-62/14 *Gauweiler* [2015] ECLI:EU:C:2015:400, Opinion of AG Cruz Villalón, para 64.

84 Van Middelaar, *The Passage* (n 26) 124-125. See also text to n 131 (ch 2). That the states as a collective also play a role at the level of constituted power is often missed. Christian Joerges, for example, argues that 'The European Council ... is anything but a unitary actor'. See Christian Joerges, 'Law and Politics in Europe's Crisis: On the History of the Impact of an Unfortunate Configuration' (2014) 21 Constellations 249, 254.

85 See text to n 131 (ch 2).

86 In discussions of executive action during the crisis this is often overlooked. Indeed, executive measures are often, with little distinction, negatively portrayed as being exemplary of 'executive dominance'. See eg Deidre Curtin, 'Challenging Executive Dominance in European Democracy' (2014) 77 MLR 1; Mark Dawson and Floris De Witte, 'Constitutional Balance in the EU after the Euro-Crisis' (2013) 76 MLR 817, 834.

2010 by initiating a change in their Contract, and with it a transformation of the currency union.[87]

This study does not argue that the Court should agree to every aspect of this transformation, be it the extent to which the institutions can be involved in intergovernmental treaties or the respect for individuals' legitimate expectations and fundamental rights in the context of conditionality attached to assistance. Certainly not.[88] But when it comes to the most essential manifestations of this transformation – the display of positive solidarity by states and the bond buying action of the Bank – the main parameters of which leaders decided on, or approved of, at the height of the crisis, the Court is under a duty of loyalty to refrain from rendering a negative judgment. They concern the *basic capacity* of member states to preserve the Contract that ties them together and founds the Union. Denying them that capacity lies outside its authority. But if it lacks the power to decide negatively, does it have the power to judge?

Advocate General Kokott's view in *Pringle* sheds light on the way the Court has tried to discharge this duty. Kokott discussed the different possible interpretations of the no-bailout clause and recognised that a broad, purposive interpretation of the ban focusing on the objective of market discipline would rule out any assistance that allows the recipient state to discharge its commitments to its creditors; only a complete exclusion of such assistance would ensure that a state is disciplined by the markets and that they base their assessment of its 'creditworthiness' solely on its own 'financial capacity'.[89] To her, however, such an interpretation was unacceptable as 'basic structural principles of the Treaties' – 'sovereignty' and 'solidarity' – argued against it.[90] A broad interpretation, with little support in the ban's text, would excessively curb the sovereignty of member states by depriving them of 'the power to avert the bankruptcy' of a fellow state and the collapse of the currency union

87 See also Loevy (n 53) 281: 'What is typical to the operation of law in emergencies, as a regular legal and political field of governance, is that they raise opportunities for mobilization and norm making that may be normalized into the legal and political order'.

88 For a critical analysis of the Union's reaction to the crisis from the perspective of legal certainty and legitimate expectations see Martín Rodríguez, 'A Missing Piece of European Emergency Law: Legal Certainty and Individuals' Expectations in the EU Response to the Crisis' (2016) 12 EuConst 265. For an analysis focusing specifically on the protection of fundamental rights in the context of the conditionality related to assistance operations see Claire Kilpatrick, 'Are the Bailouts Immune to EU Social challenge Because They Are not EU Law?' (2014) 10 EuConst 393. Recently, the Court has confirmed the potential to hold the Commission liable for fundamental rights violation in the context of intergovernmental assistance operations in Case C-8/15 P *Ledra* [2016] ECLI:EU:C:2016:701.

89 *Pringle* (n 69), View of AG Kokott, paras 126-135. On the possible different interpretations see text to n 55 (ch 7).

90 *Pringle* (n 69), View of AG Kokott, para 144.

at large.[91] It would likewise conflict with the concept of solidarity. Although member states are not under an obligation to grant assistance, Kokott reasoned, the fact that they would be free to support a third state but not a fellow member, even '*in a case of emergency*', would call into question 'the very purpose and objective of the Union'.[92] She therefore settled for a purely literal interpretation of Article 125 TFEU, only ruling out liability for, or the direct assumption of, a state's financial commitments.[93]

What Kokott essentially seemed to argue is that the interpretation of the no-bailout clause should be subject to principles so as to allow member states to grant assistance in an emergency and she identified these principles as 'sovereignty' and 'solidarity'.[94] Due to the fact, however, that she did not apply them to the Court itself, but rather to the no-bailout clause *in abstracto*, her literal reading of Article 125 TFEU would have allowed financial assistance in a great variety of situations, going far beyond the carefully circumscribed assistance possibility states had allowed for with their change in the Contract.[95] Yet, one could imagine going a step further and arguing that it is rather the Court itself that is under a duty of loyalty to use the interpretive space at its disposal in 'hard' cases,[96] allowing it to favour a certain reading of the law over others, in such a way that it can approve of the change in the Contract *as defined* by political leaders in an emergency.

Both in *Pringle* and in *Gauweiler* the Court *de facto* acted on that requirement. In *Pringle*, as chapter 7 showed, it employed a cumulative reading of the no-bailout clause that carefully replicated the terms of Article 136(3) TFEU and thereby approved of the ESM as well as all other intergovernmental assistance operations that had taken place since 11 February 2010. In *Gauweiler*, it similarly managed to declare the Bank's bond buying programme 'Outright Monetary Transactions' compatible with its mandate and the prohibition on monetary financing. While the Court approved of the change in the Contract, its reasoning in *Pringle* also exposed the inherent limitations of this approach.

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91 *Pringle* (n 69), View of AG Kokott, paras 137-141.

92 *Pringle* (n 69), View of AG Kokott, paras 142-143.

93 *Pringle* (n 69), View of AG Kokott, paras 113-125, 151.

94 For a different analysis of Kokott's View in light of the principles of sovereignty, solidarity and stability see Van den Brink and Van Rossem (n 23).

95 AG Kokott argued that even a mere literal interpretation of the no-bailout clause would keep in place its *effet utile*, meaning its disciplining functioning, as creditors of the recipient state could neither know for sure whether other states will indeed grant assistance, nor could they take for granted that this assistance will be used to pay off the debts owed to them. See *Pringle* (n 69), View of AG Kokott, paras 145-150. Even if that were true, however, this does not take away the fact that it would have allowed for assistance in a much greater variety of situations than Art 136(3) TFEU allows for. In fact, the latter would have limited the assistance possibilities for states in the currency union, whereas states with their own currency would have only been bound by the requirements flowing from Kokott's literal reading of the no-bailout clause.

96 On the distinction between 'clear' and 'hard' cases see text to n 3 (ch 7).

The argument that financial stability is an objective that has been pursued by the no-bailout clause since the very launch of the single currency overstretches the discretionary boundaries of its interpretative power. Some may disagree with this analysis and argue that it is possible to identify financial stability as an objective that has always inspired the ban on bailout.[97] However, unless one takes the view that Union law is fundamentally 'open' and receptive to any possible economic views or strategies,[98] one will agree on the principle that there are limits to the Court's interpretative discretion and consequently its ability to approve of changes in the Contract.

Ultimately, however, the real problem of the Court's approach does not reside in the practical constraints on its interpretive power. It goes deeper and touches on the constitutional division of powers.

The reference decision of the *Bundesverfassungsgericht* in *Gauweiler* helps to show why this is so. As chapter 7 demonstrated, in their request for a preliminary ruling the majority of judges in Karlsruhe made no secret of their strong objections to the Bank's bond programme. Yet, if it had been down to two judges – Gerhardt and Lübbe-Wolff – the case should never have been referred to Luxembourg. They opposed the view of the majority under which the German constitutional court is prepared to engage in *ultra vires* review. It can only carry out such a review of Union acts to the extent they 'provide the basis of actions taken by German authorities'.[99] Earlier in the crisis, this had been a reason to declare inadmissible a constitutional complaint against the Bank's first bond buying initiative, the 'Securities Markets Programme'.[100] But the majority now broadened the reach of the instrument, arguing that *ultra vires* applications could also be targeted at 'inactivity' of authorities, especially the *Bundestag* and the federal government.[101] Their responsibility for European integration requires that they do 'not remain passive' and 'not simply let a manifest or structurally significant usurpation of sovereign powers by

97 See in this regard Pieter-Augustijn Van Malleghem, '*Pringle*: A Paradigm Shift in the European Union's Monetary Constitution' (2013) 14 GLJ 141, 161-162 who argues that the Union faced a 'Schmittian *Ausnahmezustand*', but that the Court managed to deal with it as it 'elegantly interpreted the no-bailout clause'. See also Christian Kreuder-Sonnen, 'Global Exceptionalism and the Euro Crisis: Schmittian Challenges to Conflicts-Law Constitutionalism' in Christian Joerges and Carola Glinski (eds), *The European Crisis and the Transformation of Transnational Governance* (Hart Publishing 2014) 75.

98 See in this respect Clemens Kaupa, *The Pluralist Character of the European Economic Constitution* (Hart Publishing 2016), especially ch 5.

99 BVerfG, 2 BvR 2728/13 of 14 January 2014, para 23 (BVerfG *OMT reference decision*).

100 BVerfG, 2 BvR 987/10 of 7 September 2011, para 116 (BVerfG *Greek Loan Facility and EFSF*).

101 See extensively Dietrick Murswiek, 'ECB, ECJ, Democracy, and the Federal Constitutional Court: Notes on the Federal Constitutional Court's Referral Order From 14 January 2014' (2014) 15 GLJ 147, 156-157; Matthias Wendel, 'Exceeding Judicial Competence in the Name of Democracy: The German Federal Constitutional Court's OMT Reference' (2014) 10 EuConst 263, 280-284.

European Union organs take place'.[102] They are therefore under the duty to 'actively deal with the question of how the distribution of powers entailed in the treaties can be restored….and which options they want to use to pursue this goal'.[103]

For judges Gerhardt and Lübbe-Wolff this was an unacceptable intrusion into the realm of politics. As the German court cannot specify what kind of actions parliament and government should have taken if it had finally decided that the bond purchases were in violation of Union law – an exit from the monetary union, a change of the Treaties, the reversal of the respective act or perhaps only a parliamentary debate? – it should have refrained from 'dealing with the substance' altogether.[104] In fact, as judge Gerhardt pointed out, government and parliament had dealt with the bond purchases precisely by not opposing them. That should not be seen as inactivity, but as political approval of a measure crucial for the single currency's survival.[105]

Judge Lübbe-Wolff went on to express her desire for a political question doctrine, so far unknown in German law.[106] Under that doctrine, certain cases require exemption from judicial review because of their inherently political character and 'constitutional affiliation to other branches of the government'.[107] 'In an effort to secure the rule of law', Lübbe-Wolff argued, 'a court may happen to exceed judicial competence'.[108]

Lübbe-Wolff's wise words are not only relevant for Karlsruhe. They are equally pertinent to the European Court. Its judges are well aware of the need to draw a 'line between law and politics', not least for securing their own legitimacy,[109] yet until now it does not have a political question doctrine. In the United States courts do. More than 200 years ago, in the famous case of *Marbury v. Madison*, the Supreme Court already stated that 'It is emphatically the province and duty of the Judicial Department to say what the law is',[110] but that 'Questions, in their nature political or which are by the Constitution and laws, submitted to the Executive, can never be made in this court'.[111]

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102 BVerfG *OMT reference decision* (n 99) paras 46-54.
103 BVerfG *OMT reference decision* (n 99) para 53.
104 BVerfG *OMT reference decision* (n 99), Diss Opinion of Judge Lübbe-Wolff, paras 9, 11-27.
105 BVerfG *OMT reference decision* (n 99), Diss Opinion of Judge Gerhardt, paras 22-23.
106 BVerfG *OMT reference decision* (n 99), Diss Opinion of Judge Lübbe-Wolff, paras 4-10.
107 Elad Gil, 'Judicial Answer to Political Question: The Political Question Doctrine in the United States and Israel' (2014) 23 Boston University Public Interest LJ 245, 248.
108 BVerfG *OMT reference decision* (n 99), Diss Opinion of Judge Lübbe-Wolff, para 2.
109 Koen Lenaerts, 'The Court's Outer and Inner Selves: Exploring the External and the Internal Legitimacy of the European Court of Justice' in Maurice Adams and others (eds), *Judging Europe's Judges: The Legitimacy of the Case Law of the European Court of Justice* (Hart Publishing 2013) 13 (and more generally 17-40).
110 *Marbury v Madison*, 5 US 1 Cranch 137 (1803) 177 (*Marbury v Madison*).
111 *Marbury v Madison* (n 110) 170.

The modern, detailed doctrine was introduced much later, in *Baker v. Carr*.[112] There, the Supreme Court identified several features that may turn a question inherently political, each of which separately suffices to render a case 'non-justiciable'.[113] They may do so not just on 'prudential grounds', which may lead a court to shy away from review to protect its own legitimacy,[114] but out of respect for the 'prerogatives' of other branches of government.[115]

Under the political question doctrine that respect is due because of the inherent link between the separation of powers and what the common law tradition calls 'the principle of sovereign immunity'.[116] That principle is characterised as 'a vestige of English feudalism according to which each Lord could be summoned only in the court of a higher noble', as a result of which the King was 'beyond suit' given his position at the apex of the feudal structure.[117] The operation of the principle and its significance for this study can probably be best illustrated by means of a very old case from 1460 concerning King Henry VI.[118] In that case Richard, Duke of York, presented to parliament a petition that he was entitled to 'the Crown'.[119] The Lords then informed King Henry, who ordered them to put together a defence.[120] This the Lords did, and they subsequently sought legal guidance from the judges of the King.[121] But the judges withheld their support, not simply because they could not issue advice in a case that they might have to rule on at some future point in time,[122] but also because if things went that far they would have to decline jurisdiction as the case was 'so high, and touched the Kings high estate and regalie, which is above the lawe and passed ther lernyng'.[123] As a commentator notes, the judges 'faced a double bind: they could not rule for Richard

112 *Baker v Carr* 369 US 186 (1962) (*Baker v Carr*). For a discussion of the development of the doctrine in US law over time see Tara Leigh Grove, 'The Lost History of the Political Question Doctrine' (2015) 90 NYU L Rev 1908.

113 Gil (n 107) 259.

114 Gil (n 107) 250-251.

115 Notes, 'Political Questions, Sovereign Rights, and Sovereign Immunity' (2016) 130 Harv L Rev 723, 736. The (anonymous) author explains (at p 724-726, 733) that it has been questioned whether 'prudential reasons' are still valid grounds for declaring a case to involve a political question in light of recent case law of the Supreme Court (see *Zivotofsky v Clinton* 132 S Ct 1421 (2012)). However, the possibility to hold that a case involves a political question due to 'the prerogatives' of other branches of government and the court's consequent lack of jurisdiction in any case still stands.

116 Harvard Law Review Notes (n 115) 736.

117 Harvard Law Review Notes (n 115) 736 (reference omitted).

118 For discussions of the case see Melville Fuller Weston, 'Political Questions' (1924-1925) 38 Harv L Rev 296, 302-304; Harvard Law Review Notes (n 115) 736-737.

119 Harvard Law Review Notes (n 115) 736-737. See also Fuller Weston (n 118) 302.

120 Harvard Law Review Notes (n 115) 737. See also Fuller Weston (n 118) 302-303.

121 Harvard Law Review Notes (n 115) 737. See also Fuller Weston (n 118) 303.

122 Harvard Law Review Notes (n 115) 737. See also Fuller Weston (n 118) 303.

123 Quoted in Eugene Wambaugh, *A Selection of Cases on Constitutional Law* (HUP 1915) 2-3 (as cited in Fuller Weston (n 118) 303).

without ousting the source of their own authority, but if they could rule only one way, *they were not a real tribunal at all*'.[124]

Under modern liberal constitutions there is no longer a single 'nucleus of sovereignty' as was the case with the ancient kings.[125] Indeed, the sovereign has delegated and divided its power over the different branches of government. This is no different for the Union, where the member states, as *pouvoir constituant*, have bestowed different institutions with legislative, executive and judicial powers. Yet, the political question doctrine requires that certain decisions be exempted from judicial review as the Union's constituent power has entrusted them to one of the political branches and the Court is not in a position to question them without exceeding its authority.

In this regard, two of the grounds mentioned by the Supreme Court in *Baker v. Carr* that may render a matter inherently political deserve a special mention. Although under the American doctrine each of them may apply separately, it is in their combination that their true relevance for this study resides. The first concerns a 'textually demonstrable constitutional commitment of the issue to a coordinate political department'.[126] The second an 'unusual need for unquestioning adherence to a political decision already made'.[127] Together, they show why the change in the Union's Founding Contract that national leaders initiated on 11 February 2010 concerns a political question. The decision to safeguard a basic capacity to preserve the Union during an emergency lies with its highest political leaders, assembled in the European Council. It may not do so because of a textually demonstrable constitutional commitment, even though Article 15(1) TEU mandates the European Council to 'provide the necessary impetus' for the Union's development, yet it surely results from the Union's overall constitutional architecture, based as it is on contract. It was for political leaders to decide whether and how to preserve the unity between their states, and thereby the Union itself, during a crisis of unprecedented proportions.

When the leaders exercised this power on 11 February 2010 they mobilized their political authority in support of the rescue of the euro.[128] Questioning the use of this power lies beyond the reach of the Court, or any other institution for that matter, and the authority they possess themselves. Indeed, the

124 Harvard Law Review Notes (n 115) 737 (emphasis added, footnotes omitted).
125 Harvard Law Review Notes (n 115) 738.
126 *Baker v Carr* (n 112) 217.
127 *Baker v Carr* (n 112) 217.
128 On the difference between *legal* and *political* authority and the fact that the authority exercised by political leaders at the beginning of the debt crisis was political in nature see WT Eijsbouts, 'De Governance Driehoek: Accountability, Legitimiteit en Transparantie' (Working Paper March 2017).

only actors capable of doing so are the member states in their *full* capacity.[129] At the level of constituted power, it is for political leaders to safeguard a basic capacity to preserve the Union by initiating a change of its Founding Contract. Such a change is only complete, however, once it has been approved by the member states acting in full. In the debt crisis, the interval between initiation and completion was often short due to the resort to instruments outside the Union legal order. Between the initiation of the change in the Contract in February 2010 and its first approval by the member states in full through the establishment of the 'European Financial Stability Facility', for example, lie only a few months. Nonetheless, one can imagine that under different circumstances the period between initiation and completion would take considerably longer. In such cases any changes in the Founding Contract initiated by the leaders are provisionally effective at the level of constituted power, where loyalty requires other institutions to respect it and give it expression in legal instruments.[130] Yet, they are only complete once they have been approved by the Union's constituent power, the member states acting in their full capacity, for example at the time of amendment of the Union Treaties.[131]

Now, suppose the Court had indeed decided to abstain from adjudicating on the essential manifestations of the change in the Founding Contract, the assistance granted to distressed states and the bond buying action of the Bank. What if it had declared inadmissible *Pringle* except for those aspects relating to the use of institutions and *Gauweiler* in its entirety? Would that have heralded the demise of its authority, its subjection to the executive branch of government? No. The Court may not be able to review how leaders have safeguarded their basic capacity to preserve the Union during an emergency,[132] but it does control the question of when a case, and which aspects of it, qualifies as a political question.[133] On any future occasion, it would be for the Court to determine whether a political decision is necessary to

129 On the difference between states acting in their *executive* and *full* capacity see text to n 131 (ch 2).

130 Examples of such instruments during the debt crisis are the establishment of the European Financial Stability Mechanism on the basis of Art 122(2) TFEU and the bond buying programmes of the ECB.

131 Such approval can be given tacitly, for example when a change in the Contract initiated by political leaders is not denied or contested by the member states at the time of Treaty amendment.

132 For a discussion of (extra-legal) normative controls on the exercise of emergency powers even when courts stay silent see Mark Tushnet, 'The political constitution of emergency powers: some conceptual issues' in Victor V Ramraj (ed), *Emergencies and the Limits of Legality* (CUP 2008) 145ff.

133 See also Harvard Law Review Notes (n 115) 738 where it is explained that the political question doctrine is 'the *limiting principle* of judicial review. Whereas the courts might decide whether the political branches have exceeded their constitutional roles, they cannot mistake a lack of *wisdom* for a lack of *power*'.

preserve the Contract that underlies the Union and demands its adherence. In that respect, it would still be the Court that decides.[134]

The Court has played a great role in the integration of Europe. It has been instrumental in the construction of the Union, and it still is. But some decisions lie outside its reach. The substantive constitutional change by the currency union is one of them. Never before did the Union experience a crisis so existential as the one by which it was struck in early 2010. It confronted political leaders with the Founding Contract between their states. That Contract not only commits them to the law of the Union, it commits them to uphold the Union *itself*. On 11 February 2010 the leaders decided to respect this latter, most basic commitment. They initiated a change in their Contract, a display of solidarity as fundamental as it can be, and thereby set in motion a profound transformation of the currency union. That change in the Contract is an act the Court cannot disapprove.

What does this tell us about the Union? Does it guarantee that Greece will stay a member of the currency union? That the euro itself will survive? No. It tells us that at the most difficult moments in time, when the Union's Founding Contract is at stake, political leaders possess the power to preserve it, a political power which receives recognition in the law. The debt crisis revealed that power for the first time, yet its significance far exceeds the realm of money and finance. Recently, on 25 March 2017, the leaders of 27 member states convened in Rome to celebrate the 60th anniversary of the Treaty on the European Economic Community and to reflect on the future of the Union post Brexit. The occasion served to renew their 'wedding vows' and reaffirm the Contract that ties their states together and commits them to the Union. They pledged 'to make the European Union stronger and more resilient, through ever greater unity and solidarity…'.[135] With an unpredictable American president in the West, Russian hostility in the East, and severe instability at the southern border, the second time they will have to decide whether to use their power to uphold that Contract may come sooner rather than later.

134 Leigh Grove (n 112) 1970-1973. For a critical view on the capacity and consequences of courts controlling (*ex post*) emergency powers see Bruce Ackerman, 'The Emergency Constitution' (2003-2004) 113 Yale LJ 1029, 1041-1045. For a more general discussion of the influence of *ex ante* uncertainty about *ex post* control on the exercise of power during an emergency see Oren Gross, 'Extra-legality and the ethic of political responsibility' in Victor V Ramraj (ed), *Emergencies and the Limits of Legality* (CUP 2008) 71-81.

135 The Rome Declaration, 25 March 2017.

Samenvatting

Dutch summary

De Transformatie van de Euro: *Recht*, *Contract*, *Solidariteit*

In de strijd om het behoud van de euro hebben de Europese Unie en haar lidstaten maatregelen genomen die het juridische en constitutionele fundament onder de euro ingrijpend hebben veranderd. Als gevolg hiervan verschilt de euro nu wezenlijk ten opzichte van de munt die werd geïntroduceerd door het Verdrag van Maastricht. Toch zijn hieraan nauwelijks wijzingen van de Unieverdragen te pas gekomen; de constitutie van de Unie is niet *geamendeerd*, maar *getransformeerd*.

Constitutionele transformatie speelt zich af op het grensvlak van *recht* en *politiek*, van *legaliteit* en *macht*; zij vindt plaats wanneer constituties veranderen zonder formele amendering. In de context van de Unie kan een onderscheid worden gemaakt tussen *institutionele* en *materiële* transformatie. De eerste houdt verband met veranderingen in besluitvorming en instellingen van de Unie, de tweede met de inhoud van haar beleid.

Tijdens de crisis heeft de Unie een materiële transformatie ondergaan, die wordt gekenmerkt door een verandering in haar conceptie van stabiliteit. Waar de euro aanvankelijk de doelstelling van prijsstabiliteit centraal stelde, is hij getransformeerd tot een munt die ook groot belang hecht aan financiële stabiliteit. Financiële steunoperaties voor noodlijdende lidstaten en het opkopen van staatsobligaties door de Europese Central Bank (Bank) zijn hiervan de belangrijkste uitingen.

Deze transformatie is door het Hof van Justitie (Hof) geaccordeerd in de zaken *Pringle* en *Gauweiler*, waarin het haar verenigbaar verklaarde met het juridisch fundament onder de euro, in het bijzonder het verbod op bail-out in artikel 125 VWEU, dat op monetaire financiering in artikel 123 VWEU en het mandaat van de Bank. Sterker, het Hof kon haar niet afwijzen; het primaat lag niet bij de rechter, maar bij de politiek.

Dit proefschrift bestudeert de transformatie van de euro door de lens van solidariteit. Meer specifiek verdedigt het de these dat i) de Unie een constitutionele transformatie heeft ondergaan, die kan worden begrepen door de lens van solidariteit, aangezien zij het mogelijk maakt ii) de eenheid van de lidstaten te conceptualiseren; en iii) te analyseren hoe deze eenheid werd behouden tijdens de crisis; iv) op welke wijze dit het juridisch fundament onder de euro veranderde; en v) waarom het Hof zich hier niet tegen kon keren.

Het proefschrift bestaat uit drie delen. Deel I, bestaande uit hoofdstukken 1 en 2, bestudeert de solidariteit tussen de lidstaten. Hoofdstuk 1 bevat een algemene verkenning van het concept 'solidariteit'. Het besteedt bijzondere aandacht aan een specifiek soort solidariteit, 'sociale solidariteit', en bespreekt de ontwikkeling ervan door de tijd. Op basis van deze verkenning conceptualiseert hoofdstuk 2 solidariteit tussen de lidstaten. Deze conceptualisering helpt te begrijpen *waarom* lidstaten in het belang van hun eenheid handelen en wat voor een *soort* handelingen zij dientengevolge verrichten. Ze maakt ook de relatie inzichtelijk tussen deze handelingen en de verplichtingen die het Unierecht oplegt aan de lidstaten.

Deel II, dat de hoofdstukken 3 en 4 omvat, verlegt de aandacht naar de oorspronkelijke stabiliteitsconceptie van de muntunie. Hoofdstuk 3 laat zien waarom de opstellers van het Verdrag van Maastricht doorslaggevend belang toedichtten aan prijsstabiliteit, hoe dit het juridische fundament onder de muntunie heeft beïnvloed, en wat voor een soort solidaire handelingen lidstaten op basis daarvan dienden te verrichten in het belang van de euro. Hoofdstuk 4 bespreekt vervolgens enkele kardinale tekortkomingen van dit fundament die door de crisis zijn blootgelegd.

Deel III, bestaande uit de hoofdstukken 5 tot en met 7, kijkt naar de transformatie van de euro. Hoofdstuk 5 bespreekt hoe een commitment om financiële stabiliteit te waarborgen, gemaakt door de lidstaten aan het begin van de crisis, aan de basis ligt van deze transformatie. Het stelt dat dit commitment een fundamenteel solidaire handeling is, die heeft geleid tot een verbreding van de stabiliteitsconceptie van de muntunie. Als gevolg hiervan dienen de lidstaten steun te verlenen aan staten in financiële nood, wat een verandering weergeeft in het soort solidariteit dat zij tonen. Hoofdstuk 6 laat hierna zien hoe de obligatieprogramma's van de Bank zijn verbonden aan dit commitment en daarom een intrinsiek onderdeel vormen van de transformatie. Hoofdstuk 7 analyseert vervolgens hoe het Hof in *Pringle* en *Gauweiler* erin slaagde de steunverlening en obligatieprogramma's goed te keuren, ondanks het feit dat zij enorme druk zetten op het recht, dat nog sterk gericht was op de oorspronkelijke stabiliteitsconceptie.

De conclusie resumeert de bevindingen, om op basis daarvan inzichtelijk te maken waarom het Hof de transformatie niet kon afkeuren; en waarom, in plaats van haar inhoudelijk te beoordelen, het aan deze plicht gevolg had moeten geven door te zwijgen.

Deel I – Solidariteit tussen de lidstaten

Het eerste deel van het proefschrift richt zich op het concept solidariteit. Hoofdstuk 1 vangt aan met een algemene verkenning. Het beperkt zich daarbij niet tot het recht, maar besteedt juist aandacht aan solidariteit buiten het recht, als mechanisme van cohesie. In dit opzicht karakteriseert solidariteit zich op

drieërlei wijze. Ten eerste verbindt zij het individu en de groep, zonder daarbij een van beiden uit het oog te verliezen. Ten tweede is eenheid hiervan het resultaat. Ten derde gaat solidariteit gepaard met positieve verplichtingen; zij vergt van het individu dat het handelt met het oog op, en in lijn met, de groep.

Afgezien van deze algemene kenmerken, kan solidariteit het best worden begrepen door een onderscheid te maken tussen drie verschijningsvormen: sociale solidariteit, solidariteit in de context van de verzorgingsstaat en oppositionele solidariteit. Na een korte bespreking van alle drie, besteedt het hoofdstuk bijzondere aandacht aan sociale solidariteit. Aan de hand van een bespreking van Aristoteliaanse 'vriendschap', Rousseaus 'sociaal contract', Durkheims 'mechanische' en 'organische' solidariteit en Parsons' solidariteit als normatieve verplichting analyseert het de ontwikkeling van het concept door de tijd.

Op basis van deze algemene verkenning conceptualiseert hoofdstuk 2 solidariteit tussen de lidstaten. Hiertoe gebruikt het twee spectrums. Het eerste heeft betrekking op de redenen voor het tonen van solidariteit. Zijn polen vormen *normatieve* en *feitelijke* solidariteit. Normatieve solidariteit doet zich voor wanneer lidstaten handelen in het belang van het geheel op basis van een politieke verplichting. Het hoofdstuk legt uit op welke wijze gezamenlijke commitments aan de basis liggen van zulke verplichtingen, hoe deze commitments hun deelnemers tot een eenheid vormen, en dat ze niet enkel tussen individuen, maar ook tussen staten kunnen voorkomen. Feitelijke solidariteit wordt getoond wanneer lidstaten handelen in het belang van het geheel omdat hun eigenbelang hiermee gediend is. Twee drijfveren voor feitelijke solidariteit krijgen bijzondere aandacht: interdependentie en gezamenlijke lotsbestemming.

Het tweede spectrum is subsidiair van aard en heeft betrekking op het soort handeling dat in het belang van het geheel wordt verricht. De polen hiervan zijn *negatieve* en *positieve* solidariteit. Negatieve solidariteit doet zich voor wanneer de handeling in het belang van het geheel betrekking heeft op de handelende lidstaat zelf. Positieve solidariteit vindt plaats wanneer een lidstaat het geheel behartigt door handelingen die direct ten goede komen aan een andere staat.

Hoofdstuk 2 sluit af met een bespreking van de relatie tussen gezamenlijke commitments en Unierecht. Verdragssluiting leidt tot gezamenlijke commitments en heeft daarmee een intrigerende, tweezijdige functie. Enerzijds roept zij voor de verdragsluitende partijen een juridisch regime in het leven op een bepaald terrein, anderzijds creëert zij een gezamenlijk commitment waardoor op de deelnemende staten een politieke verplichting rust het verdrag te respecteren. De Unieverdragen zijn dan ook veel meer dan een set rechtsregels. Zij vormen het object van een fundamenteel gezamenlijk commitment tussen de lidstaten, het 'Stichtingscontract'.

Alhoewel verdragssluiting leidt tot een gezamenlijk commitment, laat het leerstuk van de politieke verplichting zich in de context van de Unie niet

reduceren tot een verplichting het recht te eerbiedigen, om twee redenen in het bijzonder. Ten eerste omvat het *object* van het Stichtingscontract meer dan het recht. Door ondertekening en ratificatie van de Unieverdragen hebben de lidstaten zich niet enkel gezamenlijk gecommitteerd aan het recht van de Unie, maar aan de Unie als zodanig, inclusief haar munt. Zij hebben dan ook de politieke verplichting de Unie te waarborgen, niet enkel haar rechtsregels. De tweede reden houdt verband met de *hoedanigheid* waarin lidstaten handelen en de *gelegenheden* voor het aangaan van gezamenlijke commitments. Wanneer ministers of politieke leiders samenkomen in de Raad of de Europese Raad, handelen staten in hun *executieve* hoedanigheid. Hetzelfde geldt voor fora zoals de Eurogroep en de Eurotop. Lidstaten kunnen echter ook handelen in hun *volledige* hoedanigheid, zoals in het geval van verdragssluiting. Aangezien de gelegenheden voor het aangaan van gezamenlijke commitments talrijker zijn dan die voor verdragssluiting, kunnen lidstaten politieke verplichtingen op zich nemen – in hun executieve of volledige hoedanigheid – die niet gepaard gaan met een wijziging van de Unieverdragen. Sterker, het zijn juist gezamenlijke commitments aangegaan tijdens gelegenheden anders dan verdragssluiting die cruciaal zijn geweest voor de solidariteit die lidstaten hebben getoond tijdens de crisis, en daarmee zorgden voor grote spanning tussen hun *juridische* en *politieke* verplichtingen.

Deel II – De oorspronkelijke stabiliteitsconceptie

Door het Verdrag van Maastricht te tekenen en ratificeren wijzigden de lidstaten hun Stichtingscontract en committeerden zij zich aan een muntunie die sterk was gericht op prijsstabiliteit. De solidariteit die zij dienden te tonen was hierdoor grotendeels negatief van aard; de handelingen die elke lidstaat diende te verrichten in het belang van het geheel waren voornamelijk gericht op de eigen conditie. Dit gold in het bijzonder voor begrotingsbeleid, in het kader waarvan eenieder zich diende te houden aan begrotingsdiscipline.

Het tweede deel van het proefschrift bespreekt deze muntunie en haar oorspronkelijk juridisch fundament. In hoofdstuk 3 staat de totstandkoming en inhoud van dit fundament centraal. Het hoofdstuk vangt aan met een bespreking van Europese monetaire integratie. In dit opzicht maakt het een onderscheid tussen twee soorten motieven: economische en politieke. Sinds de oprichting van de Europese Economische Gemeenschap vormden beide belangrijke drijfveren voor monetaire integratie. Eind jaren tachtig brachten zij de Gemeenschap er zelfs toe om, na een eerdere poging in 1969, over te gaan tot de instelling van een muntunie. Economisch gezien vormde dit besluit een reactie op toegenomen grensoverschrijdend kapitaalverkeer dat, gegeven het belang van stabiele wisselkoersen voor de interne markt, lidstaten steeds minder in staat stelde om hun monetair beleid op autonome wijze vorm te geven. Sterker, de meeste van hen hadden veel van hun autonomie al verloren

in het kader van het Europees Monetair Systeem, dat hen dwong nauwgezet het beleid van de *Bundesbank* te volgen. Politieke overwegingen waren echter ook cruciaal. De val van de Berlijnse Muur in november 1989 vormde een belangrijke stimulans, in het bijzonder voor Frankrijk en Duitsland, om de totstandkoming van de muntunie te bespoedigen.

Het hoofdstuk verlegt vervolgens de aandacht naar het oorspronkelijke juridisch fundament onder de euro, in het bijzonder zijn *interne* beleidsdimensie. De economische en politieke motieven voor de invoering van de euro hebben ook grote invloed uitgeoefend op dit fundament. Grensoverschrijdend kapitaalverkeer en samenwerking in het Europees Monetair Systeem droegen bij aan een convergentie van 'ideeën' op economisch terrein, die gekarakteriseerd werd door een transitie van 'keynesianisme' naar 'monetarisme' en een bijbehorende toename in het belang van prijsstabiliteit als beleidsdoelstelling. Bovendien werd prijsstabiliteit bijzonder gewaardeerd door Duitsland, dat erop was gebrand dat de Europese munt minstens zo sterk en stabiel zou zijn als de *D-Mark*. Gegeven zijn centrale rol in het Europees Monetair Systeem, kon het hier sterk de nadruk op leggen tijdens de onderhandeling van het Verdrag van Maastricht.

De convergentie in ideeën en Duitslands leidende rol tijdens de verdragsonderhandelingen hadden als gevolg dat het oorspronkelijk juridisch fundament onder de euro sterk was geënt op prijsstabiliteit. Dit was allereerst zichtbaar op het niveau van doelstellingen en beginselen en in het mandaat en de constitutionele positie van de Europese Centrale Bank. Maar de stabiliteitsconceptie liet zich ook gelden op het terrein van economisch beleid, in het bijzonder in relatie tot de beperkte bevoegdheden van de Unie op dit terrein alsmede de grote aandacht voor het handhaven van begrotingsdiscipline. Zelfs de regels inzake toetreding tot de muntunie werden door haar beïnvloed.

Hoofdstuk 4 behandelt vier kardinale tekortkomingen van het oorspronkelijke juridisch fundament die door de crisis zijn blootgelegd. De eerste twee houden verband met begrotingsdiscipline. Hiertoe riep het Unierecht twee instrumenten in het leven: marktdiscipline en publieke discipline. Marktdiscipline was verankerd in de artikelen 123-125 VWEU, die verboden op monetaire financiering, bevoorrechte toegang tot financiële instellingen en bail-out bevatten. Tezamen hadden zij tot doel lidstaten te onderwerpen aan de tucht van de markt bij het (her)financieren van hun schuld. De crisis heeft de disciplinerende werking van de markt echter in twijfel getrokken. Voordat zij uitbrak leek het alsof de markten blind waren voor verschillen in begrotingsbeleid en concurrentiepositie, aangezien de rentes op staatsobligaties van lidstaten in de muntunie steeds meer naar elkaar toegroeiden. Tijdens de crisis liepen deze tarieven voor sommige lidstaten echter sterk op, waardoor zij niet langer toegang hadden tot de kapitaalmarkten en financieel moesten worden gesteund. Het hoofdstuk bespreekt deze wispelturigheid van markten en de

verklaring ervoor van de Europese Centrale Bank, aangezien dit inzichtelijk maakt hoe en waarom de Bank tijdens de crisis ertoe over ging staatsobligaties op te kopen.

Ook het instrument van publieke discipline, verankerd in artikel 126 VWEU alsmede het Protocol betreffende de procedure bij buitensporige tekorten en het Stabiliteits- en Groeipact, heeft niet naar behoren gewerkt. Lang voordat de Griekse crisis zou opspelen, in 2003, waren zijn tekortkomingen al zichtbaar toen Frankrijk en Duitsland de begrotingsregels schonden en de Raad, tegen de wens van de Commissie, zich ervan weerhield de buitensporigtekortprocedure voort te zetten. Het hoofdstuk analyseert dit institutionele conflict, de rechtszaak waarin het resulteerde en de hervorming van het Stabiliteits- en Groeipact die erop volgde in 2005.

De derde tekortkoming heeft betrekking op de excessieve aandacht voor begrotingsdiscipline. In zijn streven naar prijsstabiliteit en begrotingsdiscipline was het juridisch fundament blind voor andere risicofactoren. Een van de belangrijkste redenen waarom de begrotingspositie van lidstaten tijdens de crisis abrupt kon verslechteren lag in het feit dat zij verantwoordelijk waren voor het redden van banken binnen hun jurisdicties. Het was de combinatie van zorgwekkende overheidsfinanciën en noodlijdende banken waardoor investeerders het vertrouwen verloren in verschillende lidstaten en de euro naar de rand van de afgrond werd gebracht.

Bovenstaande gebreken komen samen in de vierde, kardinale tekortkoming. Het oorspronkelijk fundament was gericht op stabiliteit, maar enkel in beperkte vorm: prijsstabiliteit. *Financiële stabiliteit* bleef onderbelicht. Het hoofdstuk bespreekt het belang van deze stabiliteit en de noodzaak haar te laten waarborgen door een *lender of last resort*, voor banken én staten.

Deel III – De nieuwe stabiliteitsconceptie

In het derde deel van het proefschrift staat de transformatie van de euro centraal. Kenmerkend voor deze transformatie is een verbreding van de stabiliteitsconceptie van de muntunie. Waar zij oorspronkelijk sterk was gericht op prijsstabiliteit, kent zij nu ook groot belang toe aan financiële stabiliteit. Hoofdstuk 5 bespreekt de initiëring van deze transformatie en de verschuiving van negatieve naar positieve solidariteit, in de vorm van financiële steun, die ermee gepaard ging. Het analyseert allereerst de positieve solidariteit die lidstaten toonden ten opzichte van Griekenland aan het begin van de crisis. De oorsprong hiervan ligt in een historische bijeenkomst van de staatshoofden en regeringsleiders op 11 februari 2010. Zij initieerden toen een wijziging van het Stichtingscontract door zich gezamenlijk te committeren aan het waarborgen van financiële stabiliteit in de muntunie. In de maanden die volgden zou deze wijziging worden geconsolideerd en uitgewerkt en lidstaten uiteindelijk niet enkel in hun executieve, maar volledige hoedanigheid binden; begin mei

2010 creëerden zij een steunfaciliteit voor Griekenland ter waarde van € 110 mld.

Vervolgens verlegt het hoofdstuk de aandacht naar steunverlening aan andere lidstaten. De instelling van de Griekse faciliteit wist markten niet tot bedaren te brengen. Slechts enkele dagen later, in het weekend van 7-9 mei 2010, besloten politieke leiders daarom een steunfonds voor de gehele muntunie in het leven te roepen ter waarde van € 750 mld. Van dit bedrag was € 250 mld afkomstig van het IMF. De overige € 500 mld werd door de Unie en de lidstaten in de muntunie beschikbaar gesteld middels twee instrumenten: het Europees Financieel Stabilisatiemechanisme (EFSM) en de Europese Faciliteit voor Financiële Stabiliteit (EFSF). Het EFSM was een Unierechtelijk instrument met een omvang van € 60 mld. Verreweg het grootste deel van de fondsen – € 440 mld – bevond zich echter in het EFSF, een intergouvernementeel instrument zonder rechtsbasis in de Unieverdragen.

Deze positieve solidariteit, betuigd aan Griekenland en andere lidstaten, zette grote spanning op het juridisch fundament onder de euro en zijn stabiliteitsconceptie uit het verleden. Eind 2010, toen de muntunie zich door de eerste fase van de crisis had heengeslagen, trachtte de Europese Raad deze spanning weg te nemen door de verschuiving in solidariteit op te nemen in de Unieverdragen. Hij initieerde een amendering van het VWEU om een derde lid toe te voegen aan artikel 136 dat de lidstaten in de muntunie in staat stelt een permanent steunmechanisme op te richten. Ter afsluiting bestudeert het hoofdstuk deze amendering en de oprichting van het Europees Stabilisatiemechanisme (ESM) en legt daarmee de basis voor de bespreking van het oordeel van het Hof over de transformatie van de euro in hoofdstuk 7.

Niet enkel de lidstaten hebben zich ingespannen om de crisis af te weren. Ook de Europese Centrale Bank heeft een belangrijke bijdrage geleverd, in het bijzonder door het opkopen van staatsobligaties op de secundaire markt. Hoofdstuk 6 behandelt deze opkoopprogramma's en stelt dat ze een intrinsiek onderdeel vormen van de transformatie van de euro. In drie stappen laat het zien hoe hun initiëring afhankelijk was van de bereidheid van de lidstaten het Stichtingscontract te wijzigen en hiernaar te handelen. Het vangt aan met een bespreking van het *Securities Markets Programme* (SMP). Dit programma, waarmee de Bank zich voor het eerst begaf op de markt voor staatsobligaties, stond op gespannen voet met het verbod op monetaire financiering in artikel 123 VWEU. De Bank maakte zijn lancering dan ook pas publiekelijk in de nacht van 10 mei, nadat de lidstaten met hun besluit tot oprichting van het EFSF hadden gehandeld naar het gewijzigde Stichtingscontract.

Het opkoopprogramma bracht de markten enkel tijdelijk tot bedaren. De druk op de Bank om heviger geschut in te zetten nam daardoor toe, in het bijzonder nadat in de zomer van 2011 de markten Spanje en Italië in het vizier kregen. Verdergaande interventie op de obligatiemarkt vereiste echter dat de lidstaten zélf zich bereid toonden drastischer maatregelen te nemen ter waar-

borging van financiële stabiliteit. Het hoofdstuk bespreekt hoe de politieke leiders hiertoe een poging ondernamen in december 2011 door de introductie van het Verdrag inzake Stabiliteit, Coördinatie en Bestuur in de Economische en Monetaire Unie. Aangezien dit verdrag zich echter grotendeels bezighield met begrotingsdiscipline, en daarmee eerder gericht was op de oorspronkelijke stabiliteitsconceptie van de muntunie dan op haar nieuwe, vormde het niet de politieke bevestiging die de Bank nodig had; alhoewel ze de bancaire sector voorzag van meer liquiditeit, intensiveerde ze niet haar interventies op de obligatiemarkt.

Het hoofdstuk laat zien dat dit pas gebeurde toen de politieke leiders hun aandacht verlegden naar de structurele implicaties van de wijziging van het Stichtingscontract. Hun besluit in juni 2012 om een gemeenschappelijk toezichtsmechanisme voor banken in te stellen en het tevens mogelijk te maken deze direct te laten herkapitaliseren door het ESM effende de weg voor de Bank om een nieuw opkoopprogramma te lanceren: *Outright Monetary Transactions*. In tegenstelling tot het eerste programma heeft de Bank dit nooit hoeven activeren; enkel de aankondiging ervan volstond om markten te kalmeren.

De wijziging van het Stichtingscontract zette grote druk op het juridisch fundament onder de euro, dat grotendeels onveranderd bleef. Hoofdstuk 7 bespreekt hoe het Hof van Justitie er niettemin in slaagde haar in overeenstemming te verklaren met het Unierecht. Twee zaken staan centraal. In 2012 boog het Hof zich over de rechtmatigheid van het ESM in *Pringle*, om zich vervolgens in 2015 uit te spreken over de toelaatbaarheid van obligatieaankopen door de Bank in *Gauweiler*. Beide zaken draaien in essentie om de vraag of, en in hoeverre, het Unierecht ruimte biedt aan de nieuwe stabiliteitsconceptie van de euro, gekenmerkt door de noodzaak financiële stabiliteit te waarborgen.

Door maximaal gebruik te maken van zijn interpretatievrijheid wist het Hof in zowel *Pringle* als *Gauweiler* tot een positief oordeel te komen. Het hoofdstuk analyseert de redenering van het Hof in beide zaken en laat hun onderlinge verbondenheid zien; de lezing van het verbod op bail-out en artikel 136(3) VWEU in *Pringle* had grote invloed op de interpretatie van het mandaat van de Bank en het verbod op monetaire financiering in *Gauweiler*. De redenering van het Hof in beide zaken is overtuigend of had dat kunnen zijn met gebruik van andere argumenten. Op een belangrijk punt overschrijdt het Hof echter de grenzen van zijn interpretatievrijheid; het speelt met de geschiedenis door te stellen dat financiële stabiliteit altijd een doelstelling is geweest van het verbod op bail-out.

De conclusie van het proefschrift resumeert de bevindingen en maakt op basis daarvan inzichtelijk waarom het Hof niet in de positie was de transformatie van de euro af te keuren. Ze bespreekt hiertoe allereerst de constitutie van de Unie en geeft aan dat deze past binnen de traditie van het constitutionele contract. Binnen deze traditie kunnen twee soorten contracten worden onder-

scheiden: 'organisatorische' en 'sociale'. De constitutie van de Unie verenigt beide in zich. Voor zover de Verdragen de verdeling van verantwoordelijkheden tussen de Unie en de lidstaten reguleren, en daarbij de lidstaten 'intact' laten als juridisch separate entiteiten, is de Unie gestoeld op een organisatorisch contract. Door sluiting van de Verdragen hebben de lidstaten zich echter ook gezamenlijk gecommitteerd aan de Unie. Dit fundamentele commitment – het Stichtingscontract – is geen individuele aangelegenheid. Integendeel, het behoort – gelijk het sociaal contract van Rousseau – toe aan de lidstaten gezamenlijk, als eenheid. Het zijn dan ook de lidstaten gezamenlijk die de constituerende macht van de Unie vormen.

Vervolgens bespreekt de conclusie welke gevolgen dit heeft voor constitutionele actoren, inclusief het Hof, tijdens crises zoals die in de muntunie. Hierbij maakt ze een onderscheid tussen de formele en de politieke constitutie en stelt dat constitutioneel recht, voor zijn erkenning en ontwikkeling, afhankelijk is van beide. De initiëring van de wijziging van het Stichtingscontract door de staatshoofden en regeringsleiders op 11 februari 2010 was een politieke handeling, die zich voltrok buiten de formele constitutie. Zij vindt echter wel erkenning in het recht, in het bijzonder middels het beginsel van loyale samenwerking. De conclusie bespreekt de relatie van dit beginsel tot solidariteit en brengt hierbij in herinnering dat het Stichtingscontract de lidstaten committeert aan de Unieverdragen. Dat commitment heeft niet enkel betrekking op de regels in deze verdragen, maar ook op hun object, de Unie als zodanig. De rechtsregels over de samenwerking tussen de lidstaten en de instellingen ter realisering van dit object beheersen hun relatie niet in al haar volledigheid. Het beginsel van loyale samenwerking vult deze leemte door nadere verplichtingen in het leven te roepen; het verbindt het Unierecht met het Stichtingscontract.

Het proefschrift stelt dat wanneer het Hof wordt geconfronteerd met maatregelen die cruciaal zijn geweest voor het behoud van het Stichtingscontract in geval van nood, die voorzien in het basale vermogen de gezamenlijkheid van de lidstaten te beschermen, het zich krachtens het beginsel van loyale samenwerking dient te onthouden van een negatief oordeel. Deze verplichting is verschuldigd aan de lidstaten gezamenlijk, als constituerende macht. Alhoewel het beginsel van loyale samenwerking enkel een rol speelt nadat de Unie is geconstitueerd, benadrukt het proefschrift dat de lidstaten als collectief ook een rol spelen op het niveau van de geconstitueerde macht, in het bijzonder in de Europese Raad. Tijdens de crisis rustte de verantwoordelijkheid om te handelen op zijn leden, de politieke leiders. Het was aan hen te beslissen of en hoe de gezamenlijkheid van hun lidstaten, en daarmee de Unie, te verdedigen. En zij deden dat op 11 februari 2010 door een wijziging van het Stichtingscontract te initiëren, en daarmee een transformatie van de euro.

In plaats van cruciale maatregelen ter behoud van het Stichtingscontract inhoudelijk te beoordelen en goed te keuren, zoals in *Pringle* en *Gauweiler*, dient het Hof aan zijn verplichting gevolg te geven door te zwijgen. Daarmee voor-

komt het niet alleen dat het stuit op de grenzen van zijn vermogen om deze maatregelen middels interpretatie te accorderen, het erkent vooral dat ze zijn gezag ontstijgen. Of en hoe in nood het Stichtingscontract te behouden is een politieke vraag, voorbehouden aan de politieke leiders van de Unie. Zij kan niet worden beantwoord door het Hof, met als gevolg dat het rechtszaken daarover niet-ontvankelijk dient te verklaren. Levert het zich daarmee uit aan de uitvoerende macht? Geenszins. Alhoewel het Hof niet in de positie is te oordelen over de wijze waarop de leiders het basale vermogen de Unie te behouden hebben veiliggesteld, gaat het wel over de kwestie of een zaak, en welke aspecten daarvan, ziet op een politieke vraag. Het is aan het Hof om vast te stellen of een politiek besluit daadwerkelijk cruciaal is voor het behoud van het Stichtingscontract. In dat opzicht beslist het Hof.

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Curriculum vitae

Vestert Borger was born in 1987 in Nijmegen, the Netherlands. After completing his secondary school education at 'Het Esdalcollege' in Emmen in 2005, he went to study Dutch and European law at Maastricht University, where he graduated with the highest distinction (*cum laude*) in 2010. During his studies he worked as a student assistant for Professor Hildegard Schneider and did an internship at the European law department of the Dutch Ministry of Foreign Affairs where he assisted legal agents in representing the government before European courts. He subsequently started working for the Europa Institute at Leiden University, first as a lecturer and as of January 2011 as a PhD fellow. In 2013 Vestert worked as a trainee on the institutional team of the legal service of the European Commission, where he focused mainly on issues concerning the euro crisis and the law on economic and monetary policy. As of January 2017 he is employed as a post-doc researcher at the Europa Institute in Leiden.

Vestert specialises in the law on economic and monetary policy, yet he also has a keen interest in the institutional and constitutional law of the Union more generally. Over the past years he has participated in various advisory projects on the euro crisis for public authorities, among which the Dutch Ministry of Finance. Vestert has published widely on Union law, in particular the law concerning the single currency. In 2017 he received the Meijers Prize for the best article written by a doctoral student at Leiden Law School.

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Over the past years, during the debt crisis, the euro has changed profoundly. As a result, it now differs fundamentally from what it was when it was introduced in the early 1990s by the Treaty of Maastricht. Characteristic of this change is a broadening of the currency union's conception of stability. Whereas it used to grant overriding importance to price stability, it now also explicitly takes into account financial stability. Financial assistance operations for distressed member states and government bond purchases by the European Central Bank are the essential manifestations of this change. Surprisingly, this has come about with hardly any formal amendment to the Union's 'basic constitutional charter', the Treaties. How, then, to understand this change?

This dissertation argues that the Union has gone through a constitutional transformation, which occurs when constitutions change shape without formal amendment. Using solidarity as its lens, it conceptualises the unity between the member states and analyses how it was preserved during the crisis. It then goes on to show how this substantively changed the euro's set-up and why, ultimately, the Court of Justice could not turn against this change in *Pringle* and *Gauweiler*.

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