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The transformation of the euro: law, contract, solidarity

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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 Bank'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

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- 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 Schimelfennig, '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 Dow 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/11settembre_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 Carnegie, '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 Carnegie 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

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

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 Carnegie, 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 disregardedI 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 Sherlock, '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).