
The European Economic and Monetary Union – between vulnerability and reform

Hermann-Josef Blanke

University of Erfurt,
Nordhäuser Str. 63, D-99089 Erfurt, Germany
E-mail: LS_Staatsrecht@uni-erfurt.de

Abstract: For more than two years, the global financial and economic crisis has put the European Union to one of its hardest tests. Until now, no end is foreseeable. Following the need to rescue banks and industrial companies, the rescue of indebted EU Member States is on the Union's agenda. However, the European Treaties neither provide a constitutional framework nor suitable instruments to counteract sovereign default of Member States. In 2011 the Union has to decide on a fundamental reform of its economic constitution. At its core, this is about answering the question of how the European budgetary stability mechanisms and instruments need to be set up in order to ensure a rational design of the Economic and Monetary Union and enable effective budgetary coordination. This contribution will deal with the scope of the budgetary regulatory capacity of the 'new' instruments and will analyse their interaction.

Keywords: Economic and Monetary Union; EMU; debt crisis; sovereign default; reform of the EMU.

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Biographical notes: Hermann-Josef Blanke is the holder of the Chair of Public Law and International Public Law at the University of Erfurt (Germany), coordinator of the Programme DAAD 'Estado de Derecho: Derecho administrativo y justicia administrativa en América Latina', member of the Executive Board 'Staatswissenschaftliches Forum e.V.', Founder and co-editor of the series 'Neue Staatswissenschaften' (Mohr Siebeck, Tübingen), member of the Editorial Board of the Journals *International Journal of Public Law and Policy* and *Teoria del Diritto e dello Stato*, member of various scientific associations, adviser to several commissions of Deutscher Akademischer Austausch Dienst (German Academic Exchange Service – DAAD).

“Every economy depends on the credit system – that is, on the erroneous assumption that others will pay back borrowed money. When they do not, what follows is a so-called ‘rescue operation’ in which all parties, except for the State, make good profits. From such failures, it can be seen that the populace is requested to have *faith*. It generally has nothing else. [...] To recapitulate, it can be said: the political economy is the metaphysics of the poker player.”
(Kurt Tucholsky, 1931)

1 Introduction

On 1 January 1999, the Member States of the then European Community entered the third stage of the Economic and Monetary Union (EMU), as provided for by the Union Treaty of Maastricht. Thus, the responsibility for monetary, credit, and interest rate policy that formerly rested with the national central banks was transferred to the European System of Central Banks. This magical date of the beginning of the “real-life” EMU was accompanied by a number of questions formerly raised in the academic field: Will the introduction of the euro be a significant break in the history of the international monetary system?¹ What role will the Euro Group play?² What are the effects of the EMU on regional convergence³ and on the risks of a “transfer union”?⁴ Will the Stability and Growth Pact collapse?⁵ Does the functioning of the EMU not presuppose, at least in the long run, “the conferral of sovereignty over monetary policy and the restructuring of the Community to an association of states?”⁶ The imminent sovereign default of a number of members of the euro area since 2010 – including, but not only as a result of the financial and economic crisis – has shown the current relevance of all these questions.

2 Stress testing the Eurozone

Another question arises. Can the current construction of the EMU guarantee the stability of the euro area when faced with an international financial crisis? In other words, how can the participants of the euro area prevent a crisis of the private sector from turning into a crisis of the national economy? The financial market crisis that originated in the US real estate market in 2007 and led to a recession of the global economy weighs heavy on the national budgets in almost every state. In addition to losses in tax revenue and higher costs for social expenditures, national finances are burdened with the actions taken to stabilise the financial sector and the economy. This revealed macroeconomic imbalances and structural deficits in the euro area that have accumulated since the introduction of a single Union currency. Their threatening dimension in the form of an imminent sovereign default of several Member States, however, only manifested in the wake of the crisis. These developments show that the over-indebtedness of states is not merely a problem of developing or newly industrialised countries, but a worldwide phenomenon that one could already observe in Europe during the liquidity crises of Russia, Hungary, Romania, Latvia, Lithuania, and Iceland. Against this background, the introduction of a transparent and foreseeable procedure has been proposed for situations with an “unsustainability of debts” (IMF). It aims at restructuring the debtor nation, i.e., at the return of the State to solvency (“resolvency”) within the framework of a quasi-judicial procedure (the Sovereign Debt Tribunal), monitored by experts.⁷

2.1 The imminent sovereign default of the PIIGS-countries

In early 2010 Greece was the first State on the brink of sovereign default. Due to the high budget deficit and weak economic performance, capital markets refused access to new credits and refinancing of matured liabilities. Greece received a total of EUR 110 billion at an interest rate of 5% from the first rescue package. In November 2010, as a direct consequence of its effort to stabilise national banks,⁸ Ireland, the former Celtic Tiger, requested financial support from the European rescue fund set up in May 2010. The European Union and the International Monetary Fund (IMF) agreed to lend financial assistance for 36 months with a volume of EUR 67.5 billion. This support comes in the form guarantees and then in the form of loans accompanied by an Irish contribution of EUR 17.5 billion and bilateral loans from the UK, Denmark, and Sweden (EUR 4.8 billion)⁹ In the first quarter of 2011 alone, Ireland drew EUR 11.7 billion from the “European Financial Stability Mechanism” (EFSM)¹⁰ and the “European Financial Stability Facility” (EFSF).¹¹ Meanwhile, the country has made good progress with the stabilisation of its financial system and budgetary policy. The IMF attested that Ireland is on a good path to a “moderate” and export-based economic recovery – nonetheless, at the cost of rising unemployment rates.¹²

Portugal, another member of the euro area, succumbed to the pressure of capital markets due to rising costs for debt servicing and requested financial support on 7 April 2011. On 16 May 2011 – following the drafting of an adjustment programme by the Commission, the European Central Bank (ECB), the IMF, and Portugal – the Economic and Financial Affairs Council (ECOFIN) agreed to grant financial assistance of a total of EUR 78 billion¹³ provided over three years with equal shares by EFSM, EFSF, and IMF (EUR 26 billion each). At the same time the ECB has backed financial markets by repeatedly lowering the base rate (in 2008/2009) and, in the framework of open market operations, buying bonds of debtor nations at low interest rates (“Securities Market Programme”)¹⁴ although rating agencies had downgraded these bonds to “junk status”. It is estimated that, through these measures of “quantitative easing” of the monetary policy, the volume of bonds of this origin held by the ECB amounts to an estimated EUR 204 billion (in December 2011). It is thus accused of blurring the dividing line of competences for monetary and financial policy, increasing the risk of inflation and endangering the independence of the ECB.¹⁵

On 21 July 2011 the Heads of States or Government of the European Union set up a second rescue package for Greece, amounting to EUR 109 billion – including a debt buyback programme of up to EUR 20 billion. Through lower interest rates (currently approx. 3.5%) and extended maturities, this programme is designed to improve Greece’s debt sustainability and refinancing profile. The EFSF is intended to be used as the financing instrument. In that regard it was decided “to lengthen the maturity of future EFSF loans to Greece to the maximum extent possible from the current 7.5 years to a minimum of 15 years and up to 30 years with a grace period of 10 years.”¹⁶ In order to restore trust by the financial markets, the Heads of State or Government of the European Union at their meeting on 26 October 2011 agreed on additional measures. At its core is the participation of the private sector for paying off Greece’s debt. Through a ‘haircut’ of 50% in January 2012 by an exchange of Greek bonds into bonds of extended maturity and lower interest rates the private sector involvement should secure the decline of the Greek debt to GDP ratio to a level of 120% by 2020. However, this decision was declared unique and exceptional by the euro area Heads of State or Government, thus, drawing the

consequences of the negative effects of this ‘roadmap’ for the southern members of the euro area.

This objective, however, can only be achieved if Greece’s economy undergoes an ambitious reform. At the same time, recapitalisation of Greek banks shall prevent an imminent banking crisis due to the haircut. To this end, a higher capital ratio of 9% will have to be attained by the banks by 30 June 2012.¹⁷ According to the European Banking Authority (EBA), the building of this capital buffer by the financial institutions amounts to EUR 106 billion.¹⁸

2.2 Institutional form and function of the EFSF

Due to the tight interweaving of the economies, especially of the financial sectors, as well as the risk of contagion following the Portuguese request for financial aid, Spain and Italy are potential candidates for the European rescue fund. A system of *bilateral* loans and credit lines has been set up and is now composed of EFSM (EUR 60 billion), EFSF (EUR 440 billion), and IMF (EUR 250 billion) resources.¹⁹

On 7 June 2010, following the experience with Greece, the EFSF was designed as a temporary special purpose vehicle (SPV) in order to avert an imminent sovereign default of euro area States.²⁰ To ensure refinancing at the capital market, the SPV is backed by guarantees given by the euro area Member States. One instrument is the granting of loans. Government bonds of a Member State of the Eurozone are only purchased on the secondary market if the ECB recognises after an analysis that there are “exceptional financial market circumstances and risks to financial stability”.²¹

The decisions of the European Council in 11 March 2011 allow intervention in the debt primary market with strict conditionality “to maximise the cost efficiency of their support”.²² This was confirmed by the European Council Meeting of 24/25 March 2011 with regard to the ESM (sub 5.1).²³ This will allow Member States – unlike the ECB – to purchase bonds not only from private investors but directly from another Member State (debtor country). With the statement by the Heads of State or Government of the euro area and EU institutions of 21 July 2011, the EFSF was then entrusted with additional, more flexible instruments to avoid the “contagion” represented by the public debt of a euro area State. Accordingly, the EFSF will be in a position to take precautionary measures for a Member State of the euro area, such as the granting of loans to governments, including non-programme countries, to finance both the recapitalisation of financial institutions and the intervention in the secondary market in case of exceptional financial market circumstances.²⁴ By a solely legal point of view, the other Member States are not liable as joint and several debtors for any EFSF loans. The borrowing State is obliged to restore a sound national budget. Non-compliance with the terms and conditions of the assistance would rule out further financial aid, leading to the situation that was meant to be avoided: insolvency. In October 2011, the Member States of the euro area agreed to raise the amount of the total guarantees for the EFSF (EFSF and EFSM) to EUR 780 billion, thereby increasing the maximum effective lending capacity to EUR 500 billion (previously EUR 250 billion) For the Federal Republic of Germany this required a raise of the guarantees from EUR 123 billion to EUR 211.0459 billion by a decision of the German *Bundestag* of 29. September 2011.²⁵

In order to maximise the available resources of the extended EFSF, the Heads of State or Government in fall of 2011 agreed to deploy a ‘lever’ to the EFSF’s capital base to increase it to over EUR 1 billion. Two basic options to leverage the resources of the

EFSF were discussed: the so called ‘insurance’ solution and an SPV. For the insurance solution credit enhancement to new debt issued by Member States will be provided by the EFSF, leading to a reduction of the funding cost. In Germany this requires an amendment to sentence 2 of § 1 paragraph 1 StabMechG (German Euro Stabilisation Mechanism Act).²⁶ As for the model of the SPV, this solution combines resources of private and public financial institutions on the one hand and of creditors on the other. State funds could contribute to this SPV as well. The modalities of both solutions have been put in concrete terms by the Euro Group in November 2011. Euro area finance ministers agreed on the terms and conditions to extend EFSF’s capacity by introducing sovereign bond partial risk participation and co-investment approach. In any case, the leverage effect was initially subestimated by a factor of 4 or 5.²⁷ The effective asset portfolio is evaluated by EUR 750 billion.

2.3 *Causes and consequences of the crisis*

What is called for is above all austerity, meaning a reduction of government spending.²⁸ Returning to this path is a necessary precondition for the euro’s future stability. Let us recall that the former devaluating States (Lira, Peseta) of the EU, when entering the Monetary Union, benefited from the low interest rates introduced by Germany due to its reliable and sustainable monetary policy – the hoped-for “Euro-dividend”. The resulting interest rates for those States were extremely low. Taking domestic inflation into account they had been negative for a long time, leading to excessive private and public spending. The good economic situation tempted the social partners to demand and grant generous wage agreements.²⁹ During the financial crisis, a Keynesian macroeconomic approach was the characteristic element of national policy.³⁰ Although already highly indebted, these States set up multi-billion euro programmes to stimulate demand without having previously followed an anti-cyclical economic policy. With their eyes wide open, the euro area members have caused an even more dramatic level of public debt, while acquiescing with a degree of approval in breach of the reference values of the Treaty of Maastricht.

The other reason for the crisis in the euro area, in addition to the national debt, is the banking crisis as a result of the global financial crisis that began in 2007. This crisis was caused by low real interest rates stimulating an asset price bubble fuelled by new financial products that were not stress tested and that failed in downturn. So far, the Group of Eight and the Outreach Five have largely failed to comply with their imperative duty that lies in the regulation of the international financial markets. Thirdly, Member States will overcome the crisis only if the Union drives a political and economic strategy that pushes the markets and strives for sustainable competitiveness of economic structures. Therefore, pure fiscal compact and stabilisation tools are not enough to set the way towards a stronger Economic Union.

The European Commission, too, is responsible for these undesirable developments, as it has not taken any measures to counteract the alarming budgetary scenarios of some Member States. On 3 March 2009 then Commissioner for Economic and Monetary Affairs, *Joaquín Almunia*, explained before the European Policy Centre: “Issuing joint EU bonds, or EU-backed government debt, to raise money for troubled member states is ‘possible and reasonable’ but unrealistic in the short run [...]” The deciding failure, however, has been the gradual dissolution of the Stability and Growth Pact (SGP) of 1997 by the larger Member States of Germany and France since November 2003.³¹ In

this context the German Parliament, the *Bundestag*, also has to deal with the question of whether or not it had the possibility to oppose this weakening. As is well known, the German Federal Constitutional Court in its *Maastricht* judgment stated that it was sufficiently guaranteed by the Treaties “that without German agreement – and therefore without the substantial co-operation of the German Bundestag – the convergence criteria cannot be relaxed.”³² In terms of democratic legitimation, the political accountability for occurrences in the European EMU – beyond the primary responsibility of debtor nations for their domestic budgetary situation – will thus still be an issue even once the acute crisis is over.

3 The binary structure of the EMU

The questions which were raised since the launch of the project of an EMU originated in the fact that only monetary, credit, and interest rate policy have been transferred to the Union as central competences. These competences of “inner monetary policy” have been conferred at the Union level on a purpose-built European System of Central Banks that is independent from the exertion of political influence by the Member States. The independence of the ECB, and its obligation to have price stability as its paramount objective, should be considered the “first and foremost [...] pillar” of the euro’s stability.³³ On the other hand, economic policy (along with regional, budgetary, and revenue policy) remains with the Member States, as they were not willing to erect a true Economic Union. Thus, the construction of the so-called “Economic and Monetary Union” of the EU is significantly different from the Monetary Union of a nation state. It is a Monetary Union without Economic Union.³⁴

Similarly to the domestic level, the political system in which the Monetary Union is embedded is characterised by a lack of a structured network between the decision-makers. There are no European political parties, transnational groupings of civil society or cross-border mass media that would spark discussions on the necessity of monetary stability and lead to broad acceptance. The Delors Report of 12 April 1989 laid down the necessary preconditions for the establishment of an EMU in a three-step process, yet could not prevail with its claim for centralisation of economic policy by way of transferring the corresponding national sovereign rights. Based on a French idea, according to which the integration process demands “more intensive and effective policy coordination [...] not only in the monetary field but also in areas of national economic management affecting aggregate demand, prices and costs of production,”³⁵ the proposal has not been followed by the Intergovernmental Conference of the early 1990s.

The central formulation of economic policy would require a “dominant budget” in the sense of comprehensive Union competences for revenue and expenditure. This would entail an enormous transfer of sovereign rights to the Union, since such a budget as a regulating instrument of a central economic policy would necessitate that the Member States confer upon the Union large-scale authority in such expenditure-related policy areas such as defence, social, educational or infrastructural policy, combined with the respective competence to create revenue. Accordingly, the Union would need to have the competence to raise taxes, while the European Parliament (EP) would need to have budgetary sovereignty as was conferred upon national assemblies in the wake of emerging parliamentarism at the domestic level. As a result, this would imply the

transformation of the Union from an “association of sovereign States” to a true federal State.³⁶

This, however, does not correspond to the political will of the Member States that want to remain masters of the Treaties also for tax and fiscal policy. The call for stronger centralisation of national economic and financial policies within the EU is thus yet to be realised – at least in a first step – apart from the constitutional restructuring of the EMU. The Euro Group’s “Euro Plus Pact” of 24 March 2011 is a first step on this way. The Pact names central policy areas and fields of action to strengthen competitiveness. Progress is to be evaluated by objective indicators, such as unit labour cost. To that end the Heads of State or Government are to make annual, concrete commitments that would increase competitiveness, foster employment, contribute further to the sustainability of public finances, and reinforce the long-term stability of these public finances. Nonetheless it is doubtful whether the Pact will achieve these goals, as it includes neither binding commitments nor sanctions.³⁷

The decentralised design of the Economic Union holds another, economic problem. Even with a high level of independence, central banks in the domestic sphere are not the sole bearers of the responsibility for monetary policy. Rather, monetary stability is also ensured by budgetary and financial policy of national governments as well as by wage and income policy of the social partners. Budgetary and revenue policy must be oriented so as not to undermine the central bank’s conception of monetary policy. If budgetary, income, and wage policy do not take into account the safeguard of monetary policy, then the central bank runs the risk of resolving the dilemma between price stability on the one hand and economic growth and employment on the other by respective monetary policy measures at the expense of price stability.³⁸ As this is all the more true for a supranational monetary system, all members of the European Monetary Union would experience a higher level of either inflation or interest rates, and such interest rates would be set by the ECB as a countermeasure.

4 The Member States’ involvement in the responsibility for stability

In order to overcome the gap between the decentralised Economic Union and the supranational Monetary Union, the Contracting Parties of Maastricht have considered it indispensable to include the Member States as bearers of the competence for economic policy – and thus budgetary and financial policy – in the responsibility for stability. To that end they are committed by the Treaties to convergent economic policies of individual responsibility. In order to support the magical triangle of price stability, economic growth, and full employment (Art. 3.3 TEU) the Member States shall regard their economic policies as a matter of common European interest (Art. 121.1 TFEU). Common rules of budgetary discipline are defined, and procedures for economic policy coordination are introduced, so as to achieve macroeconomic equilibrium within domestic economic and financial policy. For participation in the final stage of the Monetary Union, it is decisive for the Member States concerned to avoid excessive deficits. For this reason, reference values are laid down in the Treaties (Art. 126.2 TFEU) and are specified in the Protocol No. 12 on the excessive deficit procedure.³⁹ These so called “Maastricht criteria” include:

- sustainable public financing, manifested in government deficit of no more than 3% of the GDP
- government debt of no more than 60% of the GDP.

For Member States outside the euro area (the so called “Member States with derogation”), the Commission and the ECB regularly examine “the achievement of a high degree of sustainable convergence” with regard to a potential accession to the EMU. The convergence criteria as laid down by the Treaties (Art. 140.1 TFEU in conjunction with the Protocol No. 13 on the convergence criteria) are:

- the achievement of a high degree of price stability, expressed by a rate of inflation of no more than 1.5% above the average of the three best performing Member States in terms of price stability
- the sustainability of the government financial position, according to which the public deficit may not exceed 3% of the GDP and the public debt may not rise above the level of 60% of the GDP
- the observance of the normal fluctuation margins provided for by the exchange-rate mechanism of the European Monetary System (EMS), for at least two years, without devaluing against the euro
- the durability of convergence achieved by the Member States concerned, and the durability of its participation in the exchange-rate mechanism, reflected in the long-term interest rate levels. They may not exceed by more than 2% of the three best performing Member States’ interest rate levels in terms of price stability.

4.1 The reform of the Stability and Growth Pact

In 1997 the Stability and Growth Pact was put into force in order to specify and make permanent the obligation to “avoid excessive government deficits”. This Pact was decided on by the Dublin European Council in 1996 under German pressure in liaison with the Netherlands and directed by German Finance Minister Theo Waigel and his State Secretary Jürgen Stark. The SGP aims at “sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation”⁴⁰ and commits the Member States to the “guiding principles” of the Treaty (Art. 119.3 TFEU), namely: stable prices, sound public finances, and monetary conditions and a sustainable balance of payments.⁴¹ The Pact thus follows an economic approach according to which (close to) debt-free budgets are the key to achieve the stated goals. This is an attempt to bridge the gap between centralised monetary policy and continued decentralised financial policy. Essentially, it is composed of a preventive arm, Council Regulation (EC) No. 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, and a corrective arm, Council Regulation (EC) No. 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure.⁴² In their totality these constitute the second pillar, which is to guarantee the stability of the euro.

With the adoption of the Commission’s 2010 proposals on the improvement and intensification of the SGP,⁴³ the Heads of State or Government of the EU Member States have initiated a reform of the European economic constitution that forms part of a

comprehensive package of six legal acts to strengthen economic governance.⁴⁴ They will be completed by two regulations to further strengthen budgetary surveillance in the euro area: the first regulation refers to the monitoring and assessment of draft budgetary plans and the correction of excessive deficit in euro area Member States; the second to the strengthening of economic and budgetary surveillance of Member States experiencing or threatened with serious difficulties with respect to their financial stability in the euro area. A revision of the current coordination and surveillance procedures is inevitable as the members of the euro area suffer from high budget deficits, excessive public debts, and macroeconomic imbalances.

4.1.1 Reform of the preventive part

The new rules provide for amendments to both the preventive and the corrective part of the SGP. Under the preventive arm of the Pact the Member States are obliged to sound budgetary policy in order to achieve robust public financing as a means to improve the preconditions for price stability and healthy and sustainable growth. Therefore, Member States have to meet and permanently hold a medium-term budgetary objective. To that end, according to Regulation 1466/97, each Member State, taking into account public debt and liabilities in relation to the ageing of the population, sets a differentiated medium-term objective for its budgetary position. They shall provide a safety margin with respect to the government deficit ratio (3% of the GDP) and “ensure rapid progress towards sustainability”.⁴⁵ Member States that have not yet met their medium-term objective are required to approach that objective with an annual structural adjustment of 0.5% of their GDP.⁴⁶

In order to enhance credibility of national budgetary efforts and ensure transparency in the euro area, members have to submit a stability programme to the Council and Commission in April of each year, providing information on how to achieve the medium-term objective.⁴⁷ Analogously, non-Eurozone members submit a convergence programme.⁴⁸ Both programmes provide the basis for evaluation by the ECOFIN whether these States have met the budgetary objectives. The submission of the stability and convergence programmes is the second stage of the “European Semester”, followed in June/July by an opinion of the Council, advising the Member States on how to set up their budgets for the coming fiscal year.⁴⁹

The procedure is to be made operational by a reform of the SGP by implementing the principle of prudent fiscal policy-making. With this “spending brake” government expenditure may not grow faster than the prudently estimated medium-term potential of the economy.⁵⁰ This, essentially, is to ensure that revenue windfalls are not spent but are instead allocated to debt reduction. This principle introduces a benchmark against which the fiscal plans, as expressed in the stability and convergence programmes, are examined.

Accordingly, a deviation from prudent fiscal policy-making shall be considered significant if an expenditure growth exceeds that which would be consistent with prudent fiscal policy-making and is not offset by discretionary revenue-increasing measures; or if discretionary revenue-decreasing measures are not offset by reductions in expenditure; or if the deviation has a total impact on the government balance of at least 0.5% of the GDP in one single year or of at least 0.25% of the GDP on average per year in two consecutive years.⁵¹ Any Member State exceeding the agreed rate of expenditure growth without implementing the respective revenue measures will be liable to a warning from the Commission. In the case of persistent and/or particularly serious failures to comply, the

Council may issue under Art. 121.4 TFEU a recommendation to take corrective action.⁵² In the context of prevention, and in accordance with Art. 3 of the Regulation on the effective enforcement of budgetary surveillance in the euro area,⁵³ such recommendation would be backed (for the first time and for euro area countries only) by an enforcement mechanism under Art. 136 TFEU, in the form of an interest-bearing deposit amounting to 0.2% of GDP.⁵⁴

For the imposing of the interest-bearing deposit, a procedure of “reverse voting” is introduced. Upon the issuing of a recommendation, the deposit would become due on the Commission’s proposal, unless a qualified majority within the Council decides to the contrary within ten days.⁵⁵ The Council could reduce the amount of the deposit only unanimously or based on a Commission proposal and a reasoned request from the Member State concerned.⁵⁶ The deposit will be returned with the accrued interest once the Council is satisfied that the situation giving rise to it has come to an end.⁵⁷

4.1.2 Reform of the corrective part

4.1.2.1 The debt criterion

According to the Commission, the weakness of the corrective part of the SGP is that in practice the “3% of GDP” threshold has been the almost exclusive focus of the excessive deficit procedure (EDP).⁵⁸ Thus, with the reform the overall debt level will be given a more prominent role compared to the “deficit” criterion and the criterion of overall sustainability. The debt criterion of the EDP is to be made operational through the adoption of a numerical benchmark to gauge whether the debt ratio is sufficiently diminishing toward the 60% of GDP threshold. This “1/20 rule” will be enshrined in the new provisions of the SGP. Specifically, a debt-to-GDP ratio above 60% is to be considered sufficiently diminishing if its distance with respect to the 60% of GDP reference value has reduced over the previous three years at a rate of the order of one-twentieth per year.⁵⁹ Non-compliance with this numerical benchmark is not, however, necessarily expected to result in the State concerned being placed in excessive deficit, as this decision would need to take into account in a “flexible approach” all relevant factors, especially for the assessment of debt developments. This includes developments in the medium-term economic position (especially potential growth, prevailing cyclical conditions, inflation, excessive macroeconomic imbalances) and developments in the medium-term budgetary position (fiscal consolidation efforts and the overall quality of public finances). The examination shall also analyse developments in the medium-term debt position, including private debt and (explicit and implicit) liabilities related to demographic ageing.⁶⁰

4.1.2.2 Sanctions of the ‘reverse voting’ mechanisms

The enforcement of the EDP is strengthened by introducing a set of financial sanctions against euro area members – sanctions that would apply much earlier in the process than in the past according to a graduated approach. The Council Regulation “on speeding up and clarifying the implementation of the excessive deficit procedure” tightens the procedure of Art. 126 TFEU, especially with regard to the imposition of sanctions. Upon a decision to place a Member State in excessive deficit, a non-interest-bearing deposit of 0.2% of the GDP becomes due. This would be converted into a fine in the event of non-compliance with the initial recommendation to correct the deficit.⁶¹

To reduce discretion in imposing these sanctions, the new “reverse voting” mechanism will apply here as well. At each step of the EDP, the Commission will make a proposal for the relevant sanction. This proposal will be considered adopted, unless a qualified majority within the Council decides to reject the proposal within ten days of the Commission adopting it.⁶² The size of the non-interest-bearing deposit or the fine could only be reduced or cancelled by the Council unanimously or when based on a specific proposal from the Commission on grounds of exceptional economic circumstances or following a reasoned request by the Member State concerned.⁶³ The State shall also forward to the Council and the Commission a progress report, including information on measures taken to correct the excessive deficit.⁶⁴ This procedure enhances the role of the Commission in the decision-making, as it drastically reduces the period of time that passes between the statistical detection of a deficit and the political decision of the Council that an excessive deficit exists. Moreover, the procedure is tightened at every other stage, while the suspension of a Commission decision requires a qualified majority decision by the Council within ten days.

4.1.2.3 Design of the of the Member States’ budgetary framework

In addition to stepping up the sanctions, the reform will focus more on the design of the of the Member States’ budgetary framework. The national budgetary framework is the set of elements that form the basis of national fiscal governance (i.e., the country-specific institutional policy setting that shapes fiscal policy-making at national level).⁶⁵ The devolution of budgetary powers to sub-national governments has led to fiscal decentralisation at national level. Thus, a Council Directive sets out detailed rules concerning the characteristics of the Member States’ budgetary frameworks to ensure the effectiveness of the EDP according to Art. 126 TFEU.⁶⁶ The minimum requirements that a national budgetary framework must meet refer to public accounting systems, statistics, forecasting practices, numerical fiscal rules, budgetary procedures governing all stages of the budget process, and medium term budgetary frameworks, as well as due coverage of public finances.⁶⁷ Only by including these aspects can a uniform quality standard and conformity with the overall budgetary rules of the EMU be ensured.

4.1.2.4 Macroeconomic surveillance

Surveillance of the fiscal policies of Member States in the framework of the Stability and Growth Pact is enhanced by the Commission’s comprehensive package of legislative measures, which provides for macroeconomic surveillance.⁶⁸ The Commission, in close cooperation with the Task Force on Economic Governance, designed this instrument for prevention and correction of macroeconomic imbalances.⁶⁹ It provides for reinforced surveillance, particularly in the areas of external competitiveness and current account balances, and supplements the multilateral surveillance laid down in Art. 121.3 and 4 TFEU. The procedure is based on two proposed regulations and is composed of a preventive⁷⁰ as well as a corrective⁷¹ part.

- **Scoreboard**

The preventive component includes an alert mechanism for early detection of macroeconomic imbalances. This mechanism is based on a transparent scoreboard that by means of certain thresholds provides a limited set of economic and financial

indicators. They help the Commission detect potential imbalances that jeopardise the proper functioning of the EMU. The compilation of the scoreboard is to be made public by the Commission in a separate document.⁷² The list of possible macroeconomic indicators includes current accounts, net external debt, real effective exchange rates, and private and public sector debt.⁷³ If due to crossing of the thresholds severe imbalances jeopardising the functioning of the EMU should exist, the Commission shall inform the Council and prepare an in-depth review of the fiscal policy of the Member State concerned. On the basis of this review the Council may, on a recommendation from the Commission, address to that Member State the necessary recommendations to reduce the imbalances and risks.⁷⁴ In case of severe and excessive macroeconomic imbalances the Council may, on a recommendation from the Commission, decide to open an “excessive imbalance procedure” (EIP). Moreover, the Member State whose fiscal policy is jeopardised is requested to implement proper corrective action.⁷⁵

- Corrective action and financial sanctions

For the purpose of the correction of such imbalances, the Member State has to elaborate and submit to the Council and the Commission a corrective action plan. Within two months after submission, the Council shall assess the plan.⁷⁶ When implementing the corrective action the Member State concerned shall at regular intervals compile progress reports and submit them to the Commission.⁷⁷ On the basis of a Commission report the Council shall assess whether the Member State concerned has taken the recommended corrective action. If so, the EIP shall be held in abeyance. The procedure is closed once the Council, on a recommendation from the Commission, concludes that the Member State is no longer affected by excessive imbalances.⁷⁸ Where, on the other hand, the Council concludes that the Member State has not taken the recommended corrective action, it shall, on a recommendation from the Commission, adopt revised recommendations and set another deadline for conduction of that respective corrective action.⁷⁹

If the Member State once again fails to act on the Council recommendations to address excessive macroeconomic imbalances, the Council may impose financial sanctions in accordance with the Regulation “on enforcement measures to correct excessive macroeconomic imbalances in the euro area”. This applies in two situations. If a Member State repeatedly fails to take the recommended action for effective correction of macroeconomic imbalances, the Council, acting on a proposal by the Commission may impose a yearly fine. Furthermore, a yearly fine shall be imposed if the Member State repeatedly fails to submit a sufficient corrective action plan.⁸⁰ To take account of the principle of equal treatment between Member States, the fine shall be identical to 0.1% of the GDP of the Member State concerned in the preceding year.⁸¹

4.1.2.5 Evaluation

The reform proposals of the Commission broaden and reinforce the framework for budgetary surveillance. Particularly the extension of sanctions within the preventive and corrective component of the SGP, the introduction of the principle of prudent fiscal policy in order to make operational the medium-term budgetary objectives, and the introduction of the reverse voting mechanism all lead to the stepping up and speeding up

of the procedure. Another important step towards a closer Economic Union is the new procedure for detection and prevention of macroeconomic imbalances that supplements the SGP.

The enhancement of the SGP is achieved in particular by the extension of the sanction mechanisms, ranging from further report-back obligations to interest-bearing and non-interest-bearing deposits and fines. This set catalogue of potential measures is suitable to gradually step up pressure on a State to effectively limit budget deficits. However, the sanctioning by means of non-interest-bearing deposits and fines is controversial. The outflow of financial resources will make it even harder for the Member State concerned to meet the Maastricht criteria. Accordingly, it was politically impossible to push through the proposal of the German Federal Government to suspend for one year the voting rights in the Council of those Member States with euro currency that grossly violate the rules of the Monetary Union.⁸² The suspension of voting rights would be a drastic invasion upon the rights of a Member State, which is only allowed by the treaties in case of a serious and persistent breach of the Union's values (Art. 7 TEU).

These reforms, however, do not go far enough to ensure adequate domestic budgetary policy. When issuing recommendations or imposing sanctions, the institutions involved may use their margin of appreciation to an unduly high degree, thus reducing the determination and credibility of the procedure. Particularly the decision that an excessive deficit exists (Art. 126.6 TFEU) and that there has been no effective corrective action (Art. 126.8 TFEU) can only be taken by the ECOFIN with qualified majority. The Commission's competence, too, to impose sanctions following those findings is dependent on a qualified majority decision within the Council and is hence no mere "automatism". A blocking minority to prevent a qualified majority is easily imaginable. Especially states, which are potentially in breach of the deficit criteria, have no interest in successfully executing the procedure and may influence it with politically motivated voting behaviour. It was, therefore, a logical step as the Heads of States or Government – with the exception of the UK – in December 2011 on a peak of the debt crisis, agreed on the introduction of such 'automatism'. According to their decisions, as laid down in the statement of 9 December, the rules governing the EDP were reinforced for euro area Member States. As soon as a Member State is recognised to be in breach of the 3% ceiling (Maastricht) by the Commission, there will be automatic consequences unless a qualified majority of euro Member States is opposing. Steps and sanctions proposed or recommended by the Commission will be adopted unless a qualified majority of the euro Member States is opposing.

A similar conclusion could be drawn with regard to the detection and prevention of macroeconomic imbalances. Here, too, a stronger automatism in the procedure is desirable. The Commission's proposals in contrast grant to the Council a considerable margin of appreciation with respect to the issuing of political recommendations or the amount of the sanctions. Such a margin will jeopardise measures toward macroeconomic surveillance. Thus, the possibility to reduce or suspend financial sanctions due to economic exemptions or the request of a Member State should be excluded. Instead, the principle of reverse majority voting (according to which any of the Commission's proposals and recommendations will be considered adopted by the Council unless the latter decides to the contrary by qualified majority) should apply to more cases.

4.1.3 The compromise between the European Parliament, the Council and the Commission in June and September 2011

During the discussions on the “Economic Governance” reform package, the European Parliament, the Council and the Commission agreed that

- 1 the EP will be involved in the European Semester through the whole economic cycle⁸³
- 2 the “economic dialogue” among European institutions, including the EP and the Council and individual Member States will be institutionalised⁸⁴
- 3 the EP will be involved in the establishment and functioning of the scoreboard to forecast macroeconomic imbalances⁸⁵
- 4 the independence of statistical authorities will be enhanced and a fine will be introduced for Member States who falsify their fiscal statistics⁸⁶
- 5 the application of reverse qualified majority voting will be expanded and more transparent, reinforcing the already-existing “comply or explain” procedure⁸⁷
- 6 additional sanctions will be introduced for Member States in the EIP⁸⁸
- 7 the Commission is invited regularly to review the effective function of the regulation and the progress in ensuring closer coordination of economic policies, and to report on the issue of Euro-securities.⁸⁹

In this “trilogue” a consensus was found in September 2011⁹⁰ on some further issues that include

- 1 strengthening the decision-making process in the preventive arm of the SGP
- 2 improving the dialogue between European institutions on macroeconomic issues
- 3 surveillance of excessive macroeconomic imbalances, covering countries with both current account deficits and surpluses, and their appropriate treatment.⁹¹

4.1.4 A new fiscal rule of European Economic Government

The legally binding effect (Sub. 4.1.2) and economic sustainability of the reformed SGP has been questioned. In the enhancement of the debt criterion as a parameter for introducing a deficit procedure, the analysis of fiscal policy does not clarify the allegations brought forward against the 3% new borrowing criterion as instrumental in the management of domestic economic and financial policy: When the Member States are supposed to save money, i.e., in times of economic upswing, the Pact does not take effect, as it is easier for that States to comply with the deficit criterion. Instead of applying the 3% deficit criterion, the Union – as part of the coordination of economic policies – could set limits to domestic public spending. Such “expenditure targets” would be effective even in times of economic upswing and would lead to the Member States’ being required to consolidate their budgets even in times of sound economic developments. With this concept the USA has in the early 1990s successfully reformed its budget. The problem is, however, that these expenditure targets do not register tax reliefs for the citizens, although they have the same effect on the national budget as public spending.

A point of orientation for the limitation of national public spending was identified by the Heads of State or Government of the euro area – together with nine other Member States – in the structural and economic component of the balanced budget amendment added to the German Basic Law in 2009, the so called “debt brake”. Without undermining the budgetary rule of Art. 123 TFEU the Member States themselves committed that the annual structural deficit of the national budgets does not exceed 0.5% of nominal GDP. Such a rule will also be introduced in Member States’ national legal systems at constitutional or equivalent level. The rule will contain an automatic correction mechanism to be triggered in case of deviation. At the same time the 26 Member States recognised on 9 December 2011 “the jurisdiction of the Court of Justice to verify the transposition of this rule at national level”.

The German Constitution had set this limit before to 0.35% in relation to the nominal GDP (structural component). To regulate anti-cyclical economic policy, the German body legislating on the budget needs to take into account the “effects on the budget in periods of upswing and downswing” (economic component) symmetrically when determining the level of permitted borrowing. With regard to the obligatory return, a threshold related to the national GDP would need to be introduced (Art. 109.3 sentence 2 and Art. 115.2 sentence 3 and 4 second clause of the Basic Law).⁹² The French Government, too, already seems to be determined to introduce in the Constitution a debt break for the public budgets, being a model for the other euro area members.⁹³ This, however, affects the constitutional autonomy of the Member States and is thus primarily subject to decisions by the domestic legislative authorities. The constitutional legislators of the Member States could possibly be convinced if the commitment to austerity anchored in the national legal order would be made a condition for the medium-term introduction of Euro-securities (Euro bonds).⁹⁴ A commitment only at Union level would in contrast have been beyond the scope of the framework for the coordination of economic policies and meant a transition to communitised economic and financial policy.

The adopted reforms as well as the rescue packages for debtor nations have led to the proclamation of a European Economic Government. On the occasion of an informal European Council meeting on 11 June 2010, German Chancellor *Angela Merkel* declared that “the Heads of State or Government regard themselves as an economic government of the 27 Member States. This means that we coordinate better and can act better in public.” By that she accepted the French concept of an “economic government”, although not as a new institution of the States of the euro area but rather as a requirement for coordination and cooperation between all Member States of the Union. The European Economic Government is the European Council of the 27 Heads of State or Government.⁹⁵ Meanwhile, the Commission under its President *M. Barroso* claims to be the Economic Government of the European Union. The shaping of the economic government has then been specified in a Franco-German dialogue in August 2011. In such a “budgetary Union” (*J-C. Trichet*) the “key figures of the national budgets of the Member States” are to be governed by means of “monitoring” or the imposition of sanctions, for the sake of a new transparency and in order to be able to proceed more quickly against those Member States that do not comply with the SGP.⁹⁶ Such enhanced cooperation between the Member States, in connection with the obligation to provide the Statistical Office of the EU with data on their fiscal policies, is covered by the Treaties in Art. 119.1 and 121 TFEU. However, their role as dialogue partners of the ECB remains unclear – particularly with regard to the calls, especially by the French executive – for strengthening the primacy of politics in the field of monetary and budgetary policy.

4.2 The budgetary rules

Contractual arrangements guaranteeing a market-based development of Member States' fiscal discipline are a third pillar ensuring the stability of the euro.⁹⁷ The Union Treaty, particularly with the so-called "budgetary rules", imposes legal requirements on the Member States, intended to ensure monetary stability even beyond the ban on excessive deficits (Art. 126 TFEU). These rules establish an equally binding prohibition for the Union and the Member States, regardless of whether or not they are (yet) part of the euro area (arg.: Art. 139 TFEU). They are not allowed to finance public budgets by credits with the national central banks or by measures that have the same money-creating effect as those credits (Art. 123 TFEU). This article of the TFEU prohibits with *direct* effect any monetary financing of the budget, thereby exposing the Member States to the market forces. Central banks may not directly grant credits to the Union or the Member States or *directly* purchase their debt instruments. A direct purchase means that the central bank assumes these titles directly from the public issuer itself. The Member States are particularly barred from financing with their central banks.

This is supplemented by Art. 124 TFEU, which prohibits the Union and the Member States from avoiding capital markets in other ways, i.e., by privileged access to financial institutions. Art. 125 TFEU excludes liability of the Union and the other Member States for the commitments of an individual member state. In this context, it is controversial whether this *no bail-out* clause is a mere exclusion of liability or an absolute prohibition to any form of assistance. A limitation to an exclusion of liability does not make much sense since not even in a federation – without express statutory or constitutional basis – a Member State is liable for the commitments of another Member State.⁹⁸ It follows from the *ratio legis* of Art. 125 TFEU that a highly indebted Member State cannot reckon to be granted the same good financial conditions as Member States with sound public finances. Rather, it needs to fear being charged higher interest rates at the capital market. The demand for self-responsibility of a Member State leads to higher risk premia with a rise in debt levels as the markets adjust their financial conditions to the financial policy of a Member State, and thereby exerts a regulating influence on the budgetary discipline. Thus, the Member States are also exposed to the capital markets in this assessment of their creditworthiness. An ever stronger opinion in the literature that so far agrees with the central Union authorities' line of reasoning, argues that Art. 125 TFEU does not apply to the bilateral granting of credits between Member States; this was merely a "shift in the creditor position."⁹⁹ Nonetheless, this interpretation is also not consistent with the *no bail-out* clause, since *no bail-out* policies for third-party liabilities are interpreted in the context of financial market legitimacy, and also include a prohibition on euro area members providing loans below market interest rate.¹⁰⁰

4.3 The (economic) solidarity clause (Art. 122 TFEU)

Between the provision on coordination of economic policies (Art. 121 TFEU) and the budgetary rules (Art. 123–125 TFEU) is the Treaty's (economic) solidarity clause. According to Art. 122.1 TFEU, the Council may decide, "in a spirit of solidarity between Member States, upon the measures appropriate to the economic situation", particularly if severe difficulties arise in the supply of certain products. These situations are described in economics as "shocks". This is often used synonymously with "acute debt crisis".¹⁰¹ Sometimes it is even underlined that the question of whether or not the problems are self-

inflicted is without relevance to the possibility of granting financial aid to the Member State concerned.¹⁰²

The first rescue package for Greece (2010), however, was based on the emergency clause of Art. 122.2 TFEU.¹⁰³ According to this provision, “[w]here 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 [...] may grant [...] Union financial assistance to the Member State concerned” (Art. 122.2 sentence 1 TFEU).¹⁰⁴ The over-indebtedness of Greece, however, is not an occurrence comparable with a natural disaster, but the result of a kind of financial policy for which, according to the Treaties, the Member States themselves are to a high degree responsible, even despite the exacerbating influences – shocks – of the financial crisis.¹⁰⁵ The “umbrellas” – at least with regard to the second rescue package for Greece, and from 2013 onward in form of the institutionalised crisis mechanism – lead to the collapse of one of the cornerstones of the EMU’s structure as they violate the no bail-out clause.

It has to be stressed that the original design of the European Economic Community, with the exception of the so called Social Fund, which was intended to co-finance measures of labour market policy among the Member States, particularly Italy, did not provide for fiscal equalisation or financial resource transfer between Member States. The “no bail-out” created by both the Maastricht reforms and the economic solidarity clause confirm these findings and retain them for the EMU. A Regional Fund, funds for structural expenditure for agriculture and for fishery, and eventually (with the Treaty of Maastricht) a Cohesion Fund, designed to facilitate accession to the new EMU (especially for Member States of Southern Europe), have all been set up in the course of European integration, by means of increasing the Social Fund. These funds were characterised by a policy-making of economic and social cohesion and mark the gradual transition from an economic Community to a political Union of the citizens of Europe – a step that has been reconstructed on a normative level by the Treaty of Maastricht. Hence, the EU also regards itself as a community of solidarity, in which wealthier States and regions assist the economically weaker States to catch up. Solidarity basically is a federal principle of “vouching” and “standing up” for each other, which – complementary to financial autonomy – is a founding principle of federal financial constitution.¹⁰⁶ It is an enhanced commitment of the European Union to strengthen ties between Member States not only economically but also in a broader sense. These ties are of an “economic” as well as of a “social” nature and aim at a harmonic development of the “Union as a whole”.

The cohesion and structural policy, a central policy area making up more than a third (35%) of the Union’s budget,¹⁰⁷ can be embedded in the constitutional framework of the European Union without causing it to mutate to a transfer union. On the other hand, financial assistance from the rescue-packages for those Member States facing crisis-level national debt amount to a break with the system and requires special justification. This can only be the continued existence of the euro as an indispensable factor of European integration that ensures prosperity brings about unity. At least since the second rescue package for Greece (2011) and the conditions proposed by the Council for future EFSF loans, the steps taken toward a transfer union – and thus an elimination of the principle of individual responsibility among the Eurozone members – need to be justified.¹⁰⁸

5 A permanent crisis mechanism as response to the permanent crisis

5.1 Establishment of a European Stability Mechanism

The managing of a debt crisis (“restructuring”), despite numerous crisis scenarios that have occurred since the end of the 1990s, still lacks a robust legal framework that is sufficiently penetrated by academic knowledge from the field of finance.¹⁰⁹ In the European Union there is only the deficit procedure of Art. 126 TFEU, which is a preventive instrument against economic and budgetary aberrations, rather than a procedure for crisis management. Strengthening the financial policy framework at the national and Union level, the establishment of an early warning mechanism for grave macroeconomic imbalances in the Member States, and the establishment in the medium-term of an effective crisis management system, are advocated as a decisive starting point for the stabilisation of the European currency area that aims at the consolidation of national debts and the restoration of the State’s ability to act.

The European Council of 28/29 October 2010, on the basis of the Task Force report, “Strengthening Economic Governance in the EU”, has agreed to set up a robust framework for crisis management for the euro area that supports financially struggling States and prevents a spread of the sovereign debt crisis to other Member States.¹¹⁰ It decided to establish a European Stability Mechanism (ESM) that is due to be launched already in July 2012 and will succeed the temporary EFSF and the EFSM, thus continuing these activities in an institutionalised framework. The ESM is intended to complement the reinforced economic governance, which will focus on crisis prevention and basically aims at an effective and rigorous economic surveillance of Member States’ policies.¹¹¹ Like the IMF, the ESM “will provide financial assistance to an ESM Member when its regular access to market financing is impaired.”¹¹² It is thus an “insolvency insurance” for Member States of the euro area and their creditors. As with the overall reform of the EMU, the introduction of the ESM reveals the clash of law and politics, as it requires decisions along the borders of international monetary and economic policy on the one hand and of constitutional¹¹³ and European law on the other hand.

According to the Conclusions of the European Council of 24/25 March 2011 and to the Statement by the euro Heads of State or Government of 9 December 2011, all Member States shall ratify the Treaty amendment that serves as the legal basis for the ESM, using the simplified revision procedure of Art. 48.6 TEU.¹¹⁴ A new paragraph 3 shall be added to Art. 136 TFEU. As a general clause it provides that “[t]he 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.”¹¹⁵ Thus, not the European Union but “the Member States” are authorised, so that the ESM will retain the intergovernmental orientation that is already characteristic of the EFSF. Recourse to Art. 122.2 TFEU¹¹⁶ – and thereby to a supranational component – in order to justify financial assistance to pre-insolvent States is thus no longer required.¹¹⁷ At the same time the Member States of the euro area conclude an international treaty establishing “among themselves an international financial institution, to be named the ‘European Stability Mechanism’”,¹¹⁸ which according to the European Council Conclusions of 24/25 March will be “an intergovernmental organisation under public international law”, i.e., an international organisation.¹¹⁹

Germany's participation in the ESM requires an authorisation by the legislative body according to Art. 115.1 of the Basic Law, as well as the adoption of several national legislative acts.¹²⁰ However, their design must bear up against the procedures of the Federal Constitutional Court. In its decision to help Greece, in reference to the EFSF, a ban on the alienation of the German *Bundestag*'s budget responsibility was formed. The budget authority should not be transmitted to other actors through an indefinite budgetary policy. In particular, the *Bundestag* should "not extradite any financially effective mechanisms that could lead to [...] significant and unmanageable budgetary burdens without prior constitutive approval. [...] If the *Bundestag* were to be authorised (by a national act of transposition) to guarantee takeovers of significant lump sums, the fiscal dispositions of other Member States could lead to irreversible [...] restrictions on the leeway of national policy-making."¹²¹ As a result, the constitutional judges favour a ban on the foundation of international legal mechanisms that lead to any assumption of liability for other Member States' debts, particularly if that assumption is associated with unpredictable consequences. "Every expenditure-related [...] relief effort of large-scale, federal implication [...] must be approved by the *Bundestag* in detail."¹²² These requirements must leave such national acts of transposition as have German involvement up to ESM calculation.

5.2 *Design of the European Stability Mechanism*¹²³

The ESM's authorised capital stock shall be EUR 700 billion. While EUR 620 billion is made up of a combination of committed callable capital and of guarantees, EUR 80 billion will be in the form of actual paid-in capital provided by the euro area Member States. This amount has been criticised as being "not too little, but too much" with regard to the "incentive to a *laissez faire* debt-making with the prospect of a soft landing in the ESM".¹²⁴ The contribution key for each Member State in the total subscribed capital of the "umbrella" is based on the paid-in capital key for the ECB.¹²⁵ According to its share of 27.1%, Germany will have to pay in a contribution of EUR 21.68 billion. It is due between 2013 and 2017, in five equal annual instalments of EUR 4.4 billion. The German share of callable capital is EUR 167.4 billion. The ESM's effective lending capacity ('overall ceiling') is EUR 500 billion (planned to be reassessed in March 2012).

Financial assistance from the ESM will be activated on a request from a Member State to the Euro Group.¹²⁶ Due to reasons of sovereignty, the actual initiation of the procedure can only be a matter for the debtor nation itself,¹²⁷ unless the competence for the determination of a State's insolvency would be transferred to the international community on a Treaty basis.¹²⁸ The Euro Group will then inform the Council that a request for activation of support has been made. The granting of financial assistance will be subject to a rigorous analysis of public-debt sustainability and provided on the basis of a strict adjustment programme of economic and financial policy. Upon authorisation by the ESM's Board of Governors, they are elaborated and conducted by the European Commission and the IMF in liaison with the ECB.¹²⁹ The Commission will propose to the Council a decision endorsing the macroeconomic adjustment programme. The Board of Governors will decide on the granting of financial assistance and the terms and conditions under which assistance is provided. When the Council has adopted the programme, the Commission will sign the Memorandum of Understanding (MoU) on behalf of the euro area Member States subject to prior mutual agreement by the Board of Governors.¹³⁰ The loans granted will enjoy preferred creditor status, while accepting

preferred creditor status of IMF over ESM. This will send a clear signal to the private creditors that their credits are redeemed only after those of the public sector.¹³¹

Following this and depending on the severity of the financial difficulties of the State concerned domestic measures for the restructuring of the debts will be conducted. A differentiation will be made on a case-by-case basis between sustainable debt (temporary liquidity crisis) and an actual sovereign default of that State (as a result of which private sector involvement will be expected).¹³² While in the case of a temporary liquidity crisis the national measures for debt restructuring would merely be accompanied by a request to the private sector to maintain their exposures in accordance with international rules and in line with IMF practice, private-sector creditors would be committed to (adequate and proportionate) involvement in the restructuring process in the event of an actual insolvency.¹³³ This procedure will ensure that in order to restore debt sustainability the beneficiary State will first of all have to rely on itself, then on the private creditors and as *ultima ratio* on the international community.¹³⁴ Without the introduction of concrete insolvency rules for States with euro currency private creditors will have no incentives to monitor better than before the financial policy of sovereign debtors and thus from the very beginning consider the possibility a partial sovereign default. Moreover, this part of the reform is indispensable since at European level there is neither a procedural framework nor are there appropriate instruments to counteract defaults of Member States.¹³⁵

From 2012 onward, all new euro area government securities will include standardised and identical collective action clauses (CAC) in their terms and conditions, in order to facilitate the restructuring process. This would enable the creditors, in case of insolvency of the debtor, to agree with the qualified majority on a binding amendment of the payment terms.¹³⁶ These clauses are already used by some States for their international loans in order to make possible any binding majority decisions of the creditors.¹³⁷ Private-sector involvement would give this part of the procedure a preventive effect since in the future this would create an incentive for creditors to enter into risky engagements only with greatest caution. Nonetheless, even after the implementation of CACs, the restructuring still bears some risks. One especially has to question if the restructuring will in fact lead to a restoration of insolvent State's financial strength. Critics point out the necessity for the creditors to waive a considerable amount of debts in order to achieve the desired results.¹³⁸

5.3 Sustainability of the stability mechanism

The establishment of a permanent crisis mechanism dominated the political debate accompanying the negotiations on Greece's second "rescue package" – including a (financial) haircut.¹³⁹ Its design shall be dependent on certain pre-requisites that ensure the primary objective of creating a sustainable and robust framework for crisis management.

5.3.1 Financial reservations

The establishment of a sustainable framework for crisis management is essential setting up the mechanism for the granting of financial assistance in a way that minimises the risk of *moral hazard*, i.e., the unjustifiable "insurance" at the expense of the citizens against a risk that actually would have to be borne by the debtor nation itself. The crisis

management framework needs rigorous and binding rules for fiscal disciplining and should not be an “attractive option” for the Member States. In order to ensure prompt action for the restoration of public debt sustainability, financial assistance should be made subject to strict conditionality. In principle the ESM is suitable to help Member States escape a spiralling debt. In order to avoid disincentives due to soft loans (i.e., loans with low interest rates) from the ESM, and to eliminate the risk of a debt policy at the expense of the “community of solidarity”, it is indispensable in the procedure to require the debtor nation to conduct a strict policy of austerity, by means of adjustment programmes. To avoid insolvency the constraints attached to the granting of loans need to be met by the beneficiary State.

Another essential element for a robust crisis management framework is the binding involvement of private creditors in the restructuring of public debt pursuant to the established IMF principles. The recent agreement thus seems to be insufficient, as private sector involvement is no pre-requisite for ESM assistance. Private creditors – as the second rescue package for Greece (2011) shows – will bear parts of the costs of their economic decisions only in individual cases, i.e., “on a case by case basis”.¹⁴⁰ It follows from the European Council Conclusions that in case of a temporary liquidity crisis, private investors shall merely be “encouraged” to maintain their exposures. Only in the event of sovereign default will private creditors be involved – within the London Club – in a debt relief in the course of restoring debt sustainability (restructuring of public debt).¹⁴¹ Real private sector involvement thus seems unlikely since in the latest sustainability analysis on Greece, the State was still considered “solvent”. Accordingly, even in the future, loans of a highly indebted State will not be traded with an adequate risk premium that mirrors the actual need for reforms. This will significantly decrease the pressure to initiate reforms.

A *de facto* non-involvement of the private sector would at the outset eliminate the setting up of a resolvency procedure for debtor nations. Only actual involvement will create incentives for private creditors to monitor better than before the financial policy of sovereign debtors; banks and other financial institutions will from the very beginning have to include in the price the possibility a partial sovereign default. This must cause them to permanently reduce the share of debt instruments issued by public bodies, or charge respective risk premia. The lack of effective rules for managing sovereign default would encourage trust of debtor nations and their creditors in financial assistance by other Member States, thus paving the way to a real transfer union. Therefore, it is indispensable that the granting of ESM loans be made conditional upon insolvency or a restructuring, and that all creditors noticeably contribute to the costs of restoring sound public finances.

5.3.2 *Legal basis*

Meanwhile, the new use of paragraph 3 of Art. 136 TFEU as legal basis for the ESM is criticised for circumventing the no bail-out clause (Art. 125.1 TFEU). Technically, ESM borrowing at the capital markets is not “assuming of commitments” in the sense of Art. 125.1 TFEU, as the joint assuming of commitments by the shareholders of the ESM applies only to these liabilities, and has no connection to any liabilities of the debtor nation to whom loans composed of those ESM-raised resources will be granted.¹⁴²

Still, doubts remain whether this legal vehicle will not circumvent the budgetary rules of Art. 123 through 125 TFEU.¹⁴³ As a result, the provision of Art. 136.3 TFEU, which is

modelled on the procedure of enhanced cooperation between Member States (Art. 20 TEU), codifies an opening of the no bail-out clause. The ESM leads to the establishment of a safety net that will decrease the motivation of potential debtor nations to comply with the reference values of Art. 126.6 TFEU as well as with the provisions of the Stability and Growth Pact. This relationship of rule and exception¹⁴⁴ is decisive for the interplay of Art. 125.1 TFEU and Art. 136.3 TFEU in the sense that an interpretation of this new institution is in conformity with Union law, and is threatened to be changed to the contrary.¹⁴⁵ In that case, however, Art. 136.3 TFEU would be “unconstitutional constitutional law” (*verfassungswidriges Verfassungsrecht* in German dogmatic),¹⁴⁶ particularly as this provision – as opposed to Art. 122.2 TFEU – does not contain any conditionality or reservations (“beyond its control”).¹⁴⁷ As for the relationship of Art. 122.2 TFEU to Art. 125 and 126 TFEU, a similar interplay of rule (Art. 125, 126 TFEU) and exception (Art. 122.2 TFEU) – and in terms of reconciling conflicting constitutional principles, it has been correctly pointed out that the rule may only be limited in accordance with the principle of proportionality, i.e., namely with regard to the suitability of the crisis mechanism.¹⁴⁸

6 Prospects: between transfer union and fiscal union

In the light of the totality of primary law parameters, rules, and instruments that form the basis for the Member States’ responsibility for stability, the German Federal Constitutional Court, in an *ex ante* review of the Treaty of Maastricht, has qualified the Monetary Union as a “community based on stability”.¹⁴⁹ It adds that “the fear that efforts towards stability will fail to materialise, with the consequence that the member-States could make further concessions on financial policy, is insufficiently plausible to ground the conclusion that the Treaty is legally uncertain.”¹⁵⁰ Nonetheless, the factual convergences that the treaties presuppose cannot be enforced on a treaty basis. This fact has been underlined by the *Bundesverfassungsgericht* when it explained that “the economic and monetary union [...], because of the reciprocal basis of the monetary Union agreed under the Treaty and of the assumed development into an economic union as well, will only be realised if there is a continuing and serious readiness for completion on the part of all member-States”. In the opinion of the Karlsruhe judges, if the Monetary Union were not able to maintain stability it “would be abandoning the Treaty conception”.¹⁵¹

Meanwhile, the “serious readiness for completion” of some Member States remains doubtful. The judges of the Second Senate of the *Bundesverfassungsgericht* – in some way anticipating this situation – have thus stated that the Federal Republic of Germany has a right to withdraw in the event that the Monetary Union cannot ensure stability.¹⁵² This reservation can even be regarded as an early sign of doubt whether in fact the reference values and the convergence criteria can effectively ensure monetary stability in the macroeconomic reality of domestic budgetary and financial policy. Meanwhile, not even in European politics, but also in (German) academic literature on European law one recognises as a response to the crisis a tendency towards a less restrictive interpretation of the Treaty of Maastricht’s reservations intended to serve economic and financial autonomy and responsibility of the Member States.

However, due to the unconvincing exit-strategies, it would only be consequent to provide a Treaty basis for the steps already taken towards a transfer union and confer

upon the Union the necessary competences. This would entail a severe loss of national budgetary sovereignty of all Member States. States in a chronic financial “state of emergency” would even be placed under a sort of trusteeship by Council and Commission. Thus, for the long-term stabilisation of the European currency, the pressing question is the transition of the Union from an association of sovereign States (*Staatenverbund*) to a real federal State or at least its procedures.¹⁵³

The need to reform of the EMU that became evident in the course of the financial and debt crisis could lead to inevitable shifts of budgetary, fiscal, economic and social policy competences from the Member States to the Union. This, however, cannot leave unaffected the national constitutions or the “compound system” of Union and Member States: in this process the supranational Union is likely to be modified by structures of a European federation – including a transfer and a joint debtor system. At the same time national constitutions may reach their limits regarding (democratic) legitimation in the course of European integration while the interpretation of domestic constitutions will more and more be influenced by the dynamics of political developments.¹⁵⁴ Not even two years after the entry into force of the Treaty of Lisbon the dictum of the Member States as “sole masters of the Treaties” thus loses significance and credibility in this subtle process of political predicaments. Lacking other political options, sovereignty will be an empty shell. As a result, the polycentric design of the Union will change to more unitarily organised structures.

Due to the irrevocable transfer of sovereignty to a new subject of legitimation that goes with it, this step would require a new constitutional basis in all the Member States and would be reserved to the directly declared will of the peoples of the Union in a national referendum.¹⁵⁵ At the moment the Heads of State or Government of the Member States intend only “limited” Treaty changes for “further strengthening economic convergence within the euro area, improving fiscal discipline and deepening economic union.”¹⁵⁶ Meanwhile, such a centralisation of powers which still form part of the *domaine réservé* of the Member States will lead to a loss of the national competitive dynamics and innovation of the Member States.

The aid packages, ultimately resulting from the weakness of the contractual and economic construction of the EMU, were approved by the judges of the Federal Constitutional Court in its decisions regarding “aid to Greece” and “euro aid package”¹⁵⁷ in respect for the Executive’s political decisions (not fully legally justifiable), though this at the same time required a strict conditionality and time limitation, and necessitated that the federal government increase the participation of the *Bundestag* in decisions on the relief efforts – including the disbursement of each tranche.¹⁵⁸ Again, the Federal Constitutional Court has strengthened the participation rights of the *Bundestag*, and thus the democratic legitimacy of European policy decisions – now in the “European financial policy”. According to the previous form of the law on the takeover of warranties as part of a European stabilisation mechanism (StabMechG), the obligation of the federal government becomes limited in efforts to ensure parliamentary participation, only in an attempt to produce a consensus with the budget committee of the *Bundestag*.¹⁵⁹ Future decisions on the establishment of a German budget to stabilise the single currency require the approval of the Budget Committee of the German *Bundestag* – but not the whole of the *Bundestag*.¹⁶⁰

Even during the so called “euro crisis” the euro has remained surprisingly stable. The trend of the markets is largely independent from the sovereign debt crisis of some Member States of the euro area and the erosion of the treaty basis of the EMU connected

with it. That is not only the result of a number of market-influencing factors such as the ECB's interest rate policy, the US economic development or the severe public debt of the USA, but mostly due to the fact that "the crisis does not harm the markets but instead spurs them". Accordingly, the depth of the crisis entails the danger that some debtor nations will not survive as Eurozone members. This "euro paradox" has been characterised as an expression of a Monetary Union in which the Member States have not yet grown together as would be expected to be the case with a single currency.¹⁶¹ At least in Germany, the crisis of the Eurozone has conveyed a mental re-nationalisation of the people.¹⁶²

Notes

- 1 Bergsten, F.C. (1997) 'The impact of the Euro on exchange rates and international policy cooperation', in Masson, P.R., Krueger, T.H. and Turtelboom, B.G. (Eds.): *EMU and the International Monetary System*, p.17, Washington DC.
- 2 Glomb, W. (1998) 'Bedarf die WWU einer gemeinsamen „Wirtschaftsregierung“?', in Caesar, R. and Scharrer, H-E. (Eds.): *Die Europäische Wirtschafts- und Währungsunion. Regionale und globale Herausforderungen*, p.15, Bonn.
- 3 Straubhaar, Th. (1998) 'Regionale Wirkungen der WWU', in Caesar, R. and Scharrer, H-E. (Eds.): *Die Europäische Wirtschafts- und Währungsunion. Regionale und globale Herausforderungen*, p.45, Bonn.
- 4 Caesar, R. (1998) 'WWU und innereuropäischer Finanzausgleich', in Caesar, R. and Scharrer, H-E. (Eds.): *Die Europäische Wirtschafts- und Währungsunion. Regionale und globale Herausforderungen*, pp.124–146, Bonn.
- 5 Steuer, W. (1998) 'Der Europäische Stabilitäts- und Wachstumspakt', in Caesar, R. and Scharrer, H-E. (Eds.): *Die Europäische Wirtschafts- und Währungsunion. Regionale und globale Herausforderungen*, p.87, Bonn.
- 6 Affirmative Seidel, M. (1995) 'Probleme der Währungsordnung der Europäischen Union, Die Verantwortung der Mitgliedstaaten für die Haushaltspolitik', in Baur, J.F. et al. (Eds.): *Festschrift für R. Vieregge*, p.793 at 810, Berlin.
- 7 Cf. Paulus, Ch. G. (2011) 'Die Eurozone und das größere Thema eines Staatsinsolvenzrechts', in Staateninsolvenz, Kodek, G.E. and Reinisch, A. (Eds.), Vienna, p.9 at 13 et seq.; Paulus, Ch. G. (2010) 'Ein Regelungssystem zur Schaffung eines internationalen Insolvenzrechts für Staaten', *Zeitschrift für Gesetzgebung (ZG)*, p.313 at 322 et seq.
- 8 Part of the cause of the Irish budgetary situation is the corporation tax of only 12.5%. In comparison, Germany levies a tax of 15% for capital companies; in addition to the local business tax, earnings of undertakings are thus taxed with 30%. One has to take in to account the basis of assessment for the tax, i.e., how taxable profits are defined.
- 9 Cf. statement by the Euro Group and ECOFIN Ministers of 28 November 2010, available at http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ecofin/118051.pdf.
- 10 The EFSM was established on 11 May 2010 by Council Regulation (EU) No. 407/2010 establishing a European financial stabilisation mechanism, O.J. 2010 L 118/1.
- 11 Cf. press release IP/10/1768 of 21 December 2010.
- 12 IMF Country Report No. 11/109 (May 2011), available at <http://www.imf.org/external/pubs/ft/scr/2011/cr11109.pdf>.
- 13 Cf. press release of the Euro Group and ECOFIN of 16 May 2011, available at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/122011.pdf.
- 14 Cf. decision of the ECB of 9 May 2010 and 14 May 2010 establishing a securities markets programme (ECB/2010/5 and 2010/281/EU), O.J. 2010 L 124/8.

- 15 Cf. on the criticism: first of all Kerber, M. (2010) as well as Mandler, M. and Tillmann, P. (2010) 'Ankauf von Staatsanleihen durch die EZB: Wie ist die neue Offenmarktpolitik der Europäischen Zentralbank zu bewerten?', *ifo Schnelldienst*, No. 21, p.3 and p.8; again Kerber, M. (2011) 'Institutionelle Unabhängigkeit als Freiheit vom Recht?', *Wirtschaftsdienst*, p.625; later by former President of the German Bundesbank, *A. Weber*, available at <http://www.welt.de/finanzen/article7861947/Bundesbank-Chef-Weber-kritisiert-EZB.html>; finally by the President of the Federal Republic of Germany, *Ch. Wulff* in a speech given on the occasion of the 4th Nobel Laureate Meeting (24 August 2011) with reference to Art. 123 TFEU: "In my opinion, the extensive purchase of bonds of individual State by the European Central Bank is a legally worrying state of affairs" (our translation).
- 16 Statement by the Heads of State or Government of the euro area and EU institutions of 21 July 2011, Nos. 2, 3, 5 and 6; available at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/123978.pdf.
- 17 Statement by the Heads of State or Government of the euro area of 26 October 2011, No. 12 and Annex II No. 4, available at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/125644.pdf.
- 18 Cf. Statistical data by the EBA, available at <http://www.eba.europa.eu/News--Communications/Year/2011/The-EBA-details-the-EU-measures-to-restore-confidence.aspx>.
- 19 Cf. Commission Communication of 12 May 2010, COM (2010) 250, p.10.
- 20 Cf. press release 9596/10 (Presse 108) of 9/10 May 2010, available at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/114324.pdf.
- 21 Cf. statement of 21 July 2011, *supra* note 16, No. 8, third indent.
- 22 Cf. conclusions of the Heads of State or Government of the euro area of 11 March 2011 ("Instruments").
- 23 European Council, 24/25 March 2011, Conclusions, Doc. EUCO 10/11 of 25 March 2011, Annex II ("Instruments").
- 24 Cf. statement of 21 July 2011, *supra* note 16, No. 8.
- 25 Cf. Gesetz zur Änderung des Gesetzes zur Übernahme von Gewährleistungen im Rahmen eines europäischen Stabilisierungsmechanismus (Stabilisierungsmechanismusgesetz – StabMechG – German Euro Stabilisation Mechanism Act), BR-Drs. 569/11 of 29 September 2011.
- 26 With this view Nettessheim, M. (2011) 'Euro-Rettung und Grundgesetz', *EuR* No. 6 (forthcoming) according to whom both the establishing of the insurance solution in principle and the deployment in the individual case requires participation by parliament.
- 27 Statement by the Heads of State or Government of the euro area of 26 October 2011, *supra* note 17, No. 12 et seq. For the two approaches to maximise the capacity of the EFSF cf. the EFSF-document 'Maximising the capacity of the EFSF – terms and conditions' of 29 November 2011.
- 28 On the debt level of the Member States see Monthly Report of Deutsche Bundesbank, July 2011, p.57.
- 29 Cf. Starbatty, J. (2010), 'Der Euro könnte zur Ramschwährung verkommen', available at <http://www.wiwo.de> (15 May 2010); 'Auftrieb oder Absturz: EUROPA – Sind die Euro-Hilfspakete ökonomisch sinnvoll und mit dem EU-Recht vereinbar? Vier Positionen', *Das Parlament* No. 20.
- 30 Keynes, J.M. (1936) *The General Theory of Employment, Interest and Money*, London.
- 31 In this sense the accusations by *J-C. Trichet*, reproduced from an interview with '*Die Welt am Sonntag*' in: *Die Zeit*, available at <http://www.zeit.de/politik/ausland/2010-06/ezb-trichet> (accessed 20 June 2010); cf. also Peffekoven, R. (2004) 'Muß der Stabilitäts- und Wachstumspakt reformiert werden?', *Wirtschaftsdienst*, p.7.
- 32 German Federal Constitutional Court, 2 BvR 2134, 2159/92 (Judgment of 12 October 1993) para 144 (in: BVerfGE 89, 155) – *Maastricht* (English translation in [1994] 1 C.M.L.R. 57).

- 33 Cf. Hentschelmann, K. (2011) 'Finanzhilfen im Lichte der No Bailout Klausel – Eigenverantwortung und Solidarität in der Währungsunion', *Europarecht (EuR)*, p.282.
- 34 Horn, N. (2011) 'Die Reform der Europäischen Währungsunion und die Zukunft des Euro', *Neue Juristische Wochenschrift (NJW)*, p.1398 at 1399, calls this the 'cardinal sin' of the EMU.
- 35 An EMU that significantly exceeds the project of the internal market "will require further major steps in all areas of economic policy-making [...]. For this reason it would not be possible simply to follow the example of existing federal States; it would be necessary to develop an innovative and unique approach"; cf. Committee for the Study of Economic and Monetary Union 1989, p.15; cf. also Baum-Ceisig, A. (2002) 'Lohnpolitik unter den Bedingungen der Europäischen Wirtschafts- und Währungsunion', PhD thesis, p.34; Wendt, V. (2002) 'Die Schaffung der Europäischen Wirtschafts- und Währungsunion: Spill-over und internationale Entscheidung? Eine Analyse für Deutschland und Frankreich', PhD thesis, p.112.
- 36 Cf. Seidel, M., *supra* note 6, at 796.
- 37 European Council, 24/25 March 2011, Conclusions, Doc EUCO 10/11, Annex I, available at http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ec/120296.pdf.
- 38 Cf. Seidel, M., *supra* note 6, at 795 et seqq.
- 39 Final Act to the Treaty on European Union, II No. 5, German Federal Gazette II 1992, p.1309.
- 40 First indent of Council Regulation (EC) No. 1466/97 and Council Regulation (EC) No. 1467/97.
- 41 Third indent of Council Regulation (EC) No. 1466/97 and Council Regulation (EC) No. 1467/97.
- 42 O.J. 1997 L 209/1 and L 209/6. It also includes the Resolution of the European Council on the Stability and Growth Pact of 17 June 1997.
- 43 Cf. COM (2010) 526, COM (2010) 522 and COM (2010) 524.
- 44 See the following six regulations: (1) the Parliament/Council Regulation amending Regulation (EC) No. 1466/97 on the strengthening of budgetary positions and the surveillance and coordination of economic policies; COM (2010) 526 final; (2) the Council Regulation amending Regulation (EC) No. 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure, COM (2010) 522 final; (3) the Council Directive on requirements for budgetary frameworks of the Member States, COM (2010) 523 final; (4) the Parliament/Council Regulation on the effective enforcement of budgetary surveillance in the euro area, COM (2010) 524 final; (5) the Parliament/Council Regulation on enforcement measures to correct excessive macroeconomic imbalances in the euro area, COM (2010) 525 final; (6) the Parliament/Council Regulation on the prevention and correction of macroeconomic imbalances, COM (2010) 527 final. See for the two additional regulations: (1) the Parliament/Council Regulation 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; COM (2011) 821 final; (2) the Parliament/Council Regulation on the strengthening of economic and budgetary surveillance of Member States experiencing or threatened with serious difficulties with respect to their financial stability in the euro area; COM (2011) 819 final.
- 45 Art. 2a of Regulation No. 1466/97/EC.
- 46 Art. 5.1 (1) of Regulation No. 1466/97/EC.
- 47 Art. 121.3 (2) TFEU in conjunction with Art. 3.2 lit. a of Regulation No. 1466/97/EC.
- 48 Art. 121.3 (2) TFEU in conjunction with Art. 7.2 lit. a of Regulation No. 1466/97/EC.
- 49 Art. 5.2 and Art. 9.2 of proposed Regulation amending Regulation No. 1466/97/EC; cf. Blanke, Herm.-J. (2012) 'The Economic Constitution of the European Union', in Blanke, Herm.-J. and Mangiameli, St. (Eds.), *The European Union after Lisbon*, 2012, p.369 (404 et seqq).
- 50 Art. 5.1 (3) of proposed Regulation amending Regulation No. 1466/97/EC.

- 51 Art. 6.2 (2), Art. 5.1 (3) of Regulation amending Regulation No. 1466/97/EC.
- 52 Art. 121.4 in conjunction with Art. 6.2 and 6.3 and Art. 10.3, Art. 5.1 (3) of proposed Regulation amending Regulation No. 1466/97/EC.
- 53 Cf. COM (2010) 524, *supra* note 41.
- 54 Art. 3.1 and 3.2 of proposed Regulation on effective enforcement of budgetary surveillance in the euro area.
- 55 Art. 3.1 of proposed Regulation on effective enforcement of budgetary surveillance in the euro area.
- 56 Art. 3.1 sentence 3 and 3.4 of proposed Regulation on effective enforcement of budgetary surveillance in the euro area.
- 57 Art. 3.5 of proposed Regulation on effective enforcement of budgetary surveillance in the euro area.
- 58 COM (2010) 522, *supra* note 41, at 4.
- 59 Art. 126.2 in conjunction with Art. 2.1a of proposed Regulation amending Regulation No. 1467/97/EC.
- 60 Art. 126.3 in conjunction with Art. 2.3 and 2.4 of proposed Regulation amending Regulation No. 1467/97/EC.
- 61 Art. 4.1 sentence 1 and 4.2 of proposed Regulation on effective enforcement of budgetary surveillance in the euro area.
- 62 Art. 4.1 sentence 2 of proposed Regulation on effective enforcement of budgetary surveillance in the euro area.
- 63 Art. 4.1 sentence 3 and 4.4 of proposed Regulation on effective enforcement of budgetary surveillance in the euro area.
- 64 Art. 3.4a and 3.5, Art. 5.1a and 5.2 of proposed Regulation amending Regulation No. 1467/97/EC.
- 65 Art. 2 of Council Directive on requirements for budgetary frameworks of the Member States.
- 66 Art. 1 of Council Directive on requirements for budgetary frameworks of the Member States.
- 67 Art. 3 through 9, Art. 10 et seqq. of Council Directive on requirements for budgetary frameworks of the Member States.
- 68 Cf. press release IP/10/1199 of 29 September 2010.
- 69 Final Report of the Task Force of 21 October 2010, para 32 et seqq., available at http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ec/117236.pdf.
- 70 COM (2010) 527, *supra* note 41.
- 71 COM (2010) 525, *supra* note 41.
- 72 Art. 2 and 3 of proposed Regulation on the prevention and correction of macroeconomic imbalances.
- 73 COM (2010) 527, *supra* note 41, at 4.
- 74 Art. 4.3, 4.4, 5.1 and 6.1 of proposed Regulation on the prevention and correction of macroeconomic imbalances.
- 75 Art. 7 of proposed Regulation on the prevention and correction of macroeconomic imbalances.
- 76 Art. 8 of proposed Regulation on the prevention and correction of macroeconomic imbalances.
- 77 Art. 9 of proposed Regulation on the prevention and correction of macroeconomic imbalances.
- 78 Art. 11 of proposed Regulation on the prevention and correction of macroeconomic imbalances.
- 79 Art. 10 of proposed Regulation on the prevention and correction of macroeconomic imbalances.
- 80 Art. 3.1 No. 1 and 2 of proposed Regulation on enforcement measures to correct excessive macroeconomic imbalances in the euro area.

- 81 Art. 3.2 of proposed Regulation on enforcement measures to correct excessive macroeconomic imbalances in the euro area.
- 82 A suspension of voting rights for deficit States has been put on the agenda of the European Council Meeting of 28/29 October 2010 on German initiative. Since this would require an extensive amendment of the Treaties, it has been postponed. Cf. on this Final Report of the Task Force of 21 October 2010, *supra* note 666, para 57.
- 83 Art. 2a. 4 of the Draft European Parliament legislative resolution on the proposal for a regulation of the European Parliament and of the Council amending Regulation (EC) No. 1466/97.
- 84 Art. 2a and 2b of the Draft European Parliament legislative resolution on the proposal for a regulation of the European Parliament and of the Council amending Regulation (EC) No. 1466/97.
- 85 Art. 3.1, 4.4, 6.1 and 6.2, 9.1 of the Draft European Parliament legislative resolution on the proposal for a regulation of the European Parliament and of the Council on the prevention and correction of macroeconomic imbalances.
- 86 Art. 3.1c and 6a.2 of the Draft European Parliament legislative resolution on the proposal for a Council Directive on requirements for budgetary frameworks of the Member States.
- 87 Art. 10 of the Draft European Parliament legislative resolution on the proposal for a regulation of the European Parliament and of the Council amending Regulation (EC) No. 1466/97.
- 88 Report of the Hungarian Council Presidency of 21 June 2011, available at <http://www.eu2011.hu/news/package-six-proposals-council-offers-compromise-parliament>.
- 89 Report of the Hungarian Council Presidency of 21 June 2011, *supra* note 84.
- 90 Cf. press release 14998/11 (Presse 344) of 4 October 2011, available at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/124882.pdf.
- 91 Report of the Polish Council Presidency of 16 September 2011, available at: http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/124640.pdf.
- 92 Art. 115.2 sentences 1 to 4 of the Basic Law read as follows: “Revenues and expenditures shall in principle be balanced without revenue from credits. This principle shall be satisfied when revenue obtained by the borrowing of funds does not exceed 0.35 percent in relation to the nominal gross domestic product. In addition, when economic developments deviate from normal conditions, effects on the budget in periods of upswing and downswing must be taken into account symmetrically. [...]; debits exceeding the threshold of 1.5 percent in relation to the nominal gross domestic product are to be reduced in accordance with the economic cycle.”
- 93 Cf. the results of the Franco-German consultations of 16 August 2011.
- 94 Euro bonds are characterised by a *joint* raising of funds at the financial market by the EU Member States and a liability as *joint and several debtors* for repayment and interests. Its introduction would be an evident violation of the no bail-out clause of Art. 125 TFEU (see Section 4.2).
- 95 Cf. statement by Chancellor A. Merkel and President Sarkozy at a press conference on 11 June 2010 (transcript).
- 96 Cf. Busch, K. (2010) ‘Europäische Wirtschaftsregierung und Koordinierung der Lohnpolitik’, available at <http://library.fes.de/pdf-files/id/ipa/07108.pdf>, March 2010, at 3 et seq., who favours a “mix of monetary and fiscal policy”; cf. Blanke, Herm.-J. (2012) ‘The Economic Constitution of the European Union’, in Blanke, Herm.-J. and Mangiameli, St. (Eds.), *The European Union after Lisbon*, p.412 et seq.
- 97 Cf. Hentschmann, K. *supra* note 33, at 282.
- 98 Cf. Seidel, M. (2011) ‘Die „No-Bail-Out“-Klausel des Art. 125 AEUV als Beistandsverbot’, *Europäische Zeitschrift für Wirtschaftsrecht (EuZW)*, p.529 et seq; fundamental Hentschmann, *supra* note 33, at 291; the interpretation of Art. 125 TFEU as an restrictive prohibition to any form of assistance can be found in European academic literature as well: cf. Pipkorn, J. (1994) ‘Legal arrangements in the Treaty of Maastricht fort the effectiveness of the Economic and Monetary Union’, *Common Market Law Review* 31, p.263 at 275; Townsend,

- M. (2007) ‘*The Euro and Economic and Monetary Union*’, p.107; Morris, R., Ongena, H. and Winkler, B. (2007) ‘*Fiscal Policy*’, in Artis, M. and Nixon, F. (Eds.) *The Economics of the European Union*, Oxford, p.280 at 293; Padoa-Schioppa, T. (2004) ‘*The Euro and its Central Bank*’, London, p.54; Louis, J.V. (2010) ‘The No-Bailout Clause and Rescue Packages’, *CMLR* 47, p.971 at 977.
- 99 Cf. Nettesheim, M. (2011) ‘Finanzkrise, Staatshilfen und “Bail-out”-Verbot’, *EuR* No. 4 (forthcoming), p.15 (manuscript on file with the author, our translation), with reference to the statements by the President of the Euro Group, *J-C. Juncker* and by the President of the ECB, *J-C. Trichet*.
- 100 Also Hentschelmann, *supra* note 33, at 293.
- 101 Cf. first of all Heinemann, F. (1995) ‘Bailout und Bonitätseffekte in der WWU’, *Zeitschrift für Wirtschafts- und Sozialwissenschaften* 115, p.605 at 609, who qualifies an acute debt crisis as an evident “exceptional occurrences beyond the States control”; this is affirmed by Häde, U. (2009) ‘Haushaltsdisziplin und Solidarität im Zeichen der Finanzkrise’, *EuZW*, p.399 at 401; see also Louis, J.V., *supra* note 98, at 984 et seq., who expressly assumes this for “Greece, Ireland and potentially for other States” in 2010. Kempen, B. (2003) in *EUV/EGV* Streinz, R. (Ed.) Art. 100 EGV para 3, underlines the character of Art. 122.2 TFEU as an exception.
- 102 Cf. Häde, U (2011) *EUV/AEUV*, Calliess, Ch. and Ruffert, M (Eds.), 4th ed., Art. 122 AEUV para 9.
- 103 Regulation 407/2010, *supra* note 10.
- 104 Second consideration of Regulation 407/2010: “Such difficulties may be caused by a serious deterioration in the international economic and financial environment.”
- 105 With a different view the research paper published by the Research Services of the German *Bundestag*, ‘Finanzielle Hilfen für die Mitgliedstaaten insbesondere nach Art. 122 des Vertrags über die Arbeitsweise der Europäischen Union’, *WD 11/3000-30/10*, p.6; this is affirmed by Nettesheim, M., *supra* note 99, p.17 (manuscript), who regards the “extreme volatility of interest rates of government bonds of States that are inflicted by the crisis” as an exceptional occurrence. At the same time he refuses to interpret “the Treaty biasedly in the light of specific political ideas” (our translation). Sharing the view of this paper Seidel, M. (2010) ‘Der Euro – Schutzschild oder Falle?’, *ZEI Working Paper* (B 01), p.8. Vaubel, R., ‘*Die Politische Ökonomie der Bail-out-Politik in der Eurozone*’, p.2, correctly notes that “in spite of the crisis of the financial markets it has been possible to avoid a sovereign debt crisis such as that of Greece”, available at <http://www.vwl.uni-mannheim.de/vaubel/pdf-Dateien/pdf>; our translation.
- 106 Cf. Waldhoff, Ch. (2007) in Isensee, J. and Kirchhof, P. (Eds.): *Handbuch des Staatsrechts*, Vol. V, 3rd ed., §116 para 73.
- 107 Council Regulation (EC) No. 1083/2006 of 11 July 2006 *laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund*, O.J. 2006 L 210/25.
- 108 As stated by Chancellor *A. Merkel* on 21 July 2011: “For Germany, the EU and the Euro are the foundations of prosperity and peace. What we invest these days we will receive in return many times over,” available at <http://www.bundeskanzlerin.de/Content/DE/Mitschrift/Pressekonferenzen/2011/07/2011-07-21-statement-merkel-bruessel.html>.
- 109 Aden, M. (2010) ‘Insolvenzverfahren über Fiskalvermögen eines Staates’, *Zeitschrift für Rechtspolitik (ZRP)*, p.191; a proposal that, however, has never been put into practice has been made in 2002 by then Managing Director of the IMF, Krueger, A.O. (2002) ‘A new approach to sovereign debt restructuring’, IMF. The proposal failed as numerous Member States considered the adoption of s restructuring mechanism as a threat to their national autonomy.
- 110 European Council, 28/29 October 2010, Conclusions, Doc. EUCO 25/1/10 of 30 November 2010, para 2.

- 111 European Council, 16/17 December 2010, Conclusions, Doc. EUCO 30/1/00 of 25 January 2011, Annex II (Declaration on the Euro Group Statement of 28 November 2010).
- 112 Cf. 11th indent of the preamble of the draft Treaty establishing the European Stability Mechanism (ESM), available at <http://consilium.europa.eu/media/1216793/esm%20treaty%20en.pdf>.
- 113 Cf. on this Nettesheim, M., *supra* note 99, p.20.
- 114 European Council, 24/25 March 2011, *supra* note 23, para 16.
- 115 European Council, 24/25 March 2011, *supra* note 23, Annex II, p.21; see also Art. 12 of the draft Treaty establishing the European Stability Mechanism (ESM), *supra* note 108.
- 116 In particular Häde, U., *supra* note 101, at 401; similar Frenz, W. and Ehlenz, C. (2010) 'Schuldenkrise und Grenzen der europäischen Wirtschaftspolitik', *Europäisches Wirtschafts- und Steuerrecht (EWS)*, p.211 at 212 et seq.; Kämmerer, J.A. (2010) 'Insolvenz von EU-Mitgliedstaaten', *Wirtschaftsdienst*, p.161 at 164 et seq.; Knopp, L. (2010) 'Griechenland-Nothilfe auf dem verfassungsrechtlichen Prüfstand', *NJW*, p.1777 at 1780 et seq. This justification for financial assistance for pre-insolvent Member States is controversial. Cf. with a critical view Kube, H. and Reimer, E. (2010) 'Grenzen des Europäischen Stabilisierungsmechanismus', *NJW*, p.1911 at 1914; Kerber, M. (2010) 'Währungsunion mit Finanzausgleich', p.9.
- 117 Cf. Thym, D. (2011) 'Euro-Rettungsschirm: zwischenstaatliche Rechtskonstruktion und verfassungsgerichtliche Kontrolle', *EuZW*, p.167 at 169 et seq.; for a legal analysis of the Greek rescue package and the umbrella for euro area members cf. Häde, U. (2011) 'Rechtsfragen der EU-Rettungsschirme', *ZG*, p.1.
- 118 Cf. Art. 1 of the draft Treaty establishing the European Stability Mechanism (ESM), *supra* note 112.
- 119 European Council, 24/25 March 2011, *supra* note 23, Annex II.
- 120 The decision of the German Bundestag is expected in January 2012.
- 121 Federal Constitutional Court (Bundesverfassungsgericht/BVerfG), 2 BvR 987/10 of 7 September 2011, para 125, 127 (our translation).
- 122 BVerfG, 2 BvR 987/10 of para 128 (our translation).
- 123 Cf. European Council, 24/25 March 2011, *supra* note 22, Annex II; Pilz, St. and Dittmann, H. (2011) 'Die Europäische Wirtschafts- und Währungsunion am Scheideweg', *Die Öffentliche Verwaltung (DÖV)*, p.438.
- 124 Cf. Horn, N., *supra* note 34, at 1403.
- 125 European Council, 24/25 March 2011, *supra* note 23, Annex II, p.24.
- 126 European Council, 24/25 March 2011, *supra* note 23, Annex II, p.27.
- 127 Steffek, F. (2009) 'Insolvenzgründe in Europa', *Zeitschrift für Insolvenzrecht (KTS)*, p.317 at 317; Kämmerer, J.A., *supra* note 116, at 162; Kämmerer, J.A. (2005) 'Der Staatsbankrott aus völkerrechtlicher Sicht', *Zeitschrift für ausländisches öffentliches Recht und Völkerrecht (ZaöRV)*, p.651 at 662. With a critical view to sovereignty as an obstacle for the application of rules of private law cf. Paulus, Ch. G. (2003) 'Ein Insolvenzverfahrensrecht für Staaten', in Dabrowski, M. (Ed.) *Die Diskussion um ein Insolvenzrecht für Staaten*, p.236; Paulus, Ch. G., 'Rechtlich geordnetes Insolvenzverfahren für Staaten', *ZRP* 2002, p.383 at 385.
- 128 Beck, H. and Wentzel, D. (2010) 'Eine Insolvenzordnung für Staaten', *Wirtschaftsdienst*, p.167 at 169.
- 129 The Board of Governors of the ESM shall be composed of the Finance Ministers of the Member States of the euro area as well as the Member of the European Commission in charge of economic and monetary affairs and the President of the ECB as observers.
- 130 European Council, 24/25 March 2011, *supra* note 23, Annex II, p.27.
- 131 European Council, 24/25 March 2011, *supra* note 23, Annex II, p.32.
- 132 European Council, 24/25 March 2011, *supra* note 23, Annex II, p.29.

- 133 A similar procedure, the so-called Sovereign Debt Restructuring Mechanism, was suggested by the IMF in 2001. Cf. on this IMF, ‘The Design of the Sovereign Debt Restructuring Mechanism – Further Considerations’, 27 November 2002, No. 14, available at <http://www.imf.org/external/np/pdr/sdrm/2002/112702.pdf>. Cf. also Krueger, A.O., *supra* note 105.
- 134 Sinn, H-W. and Carstensen, K. (2010) ‘Ein Krisenmechanismus für die Eurozone’, *ifo Schnelldienst, Sonderausgabe*, p.9.
- 135 With the same view Lewinski, K. von (2011) ‘*Öffentlichrechtliche Insolvenz und Staatsbankrott*’, p.454.
- 136 European Council, 24/25 March 2011, *supra* note 23, Annex II, p.27.
- 137 Ohler, C. (2005) ‘Der Staatsbankrott’, *Juristenzeitung (JZ)*, p.590 at 598.
- 138 In particular with regard to Greece, cf. Schrader, K. and Laaser, C-F. (2010) ‘Den Anschluss nie gefunden: Die Ursachen der griechischen Tragödie’, *Wirtschaftsdienst*, p.540 at 546.
- 139 On the questionable limitation of the possibilities for restructuring as a result of the ESM, cf. Horn, N., *supra* note 34, at 1402.
- 140 European Council, 24/25 March 2011, *supra* note 23, Annex II, p.29.
- 141 European Council, 24/25 March 2011, *supra* note 23, Annex II, p.30.
- 142 Kube, H. and Reimer, E., *supra* note 116, at 1913.
- 143 Kube, H. and Reimer, E., *supra* note 116, at 1913.
- 144 On the relationship of rule and exception with regard to rules of national constitutional law cf. Bachof, O. (1951) ‘Verfassungswidrige Verfassungsnormen?’, p.38. Rathke, H. (2011) ‘Von der Stabilitäts- zur Stabilisierungsunion: Der neue Artikel 136 Abs. 3 AEUV’, *Die Öffentliche Verwaltung (DÖV)*, p.753 at 758 et seq.
- 145 Under the EFSF the Heads of State or Government of the euro area and on the occasion of the adoption of the second rescue package for Greece (cf. Statement of 21 July 2011, *supra* note 17) have been aware of this risk; accordingly, “[a]ll other euro countries solemnly reaffirm their inflexible determination to honour fully their own individual sovereign signature and all their commitments to sustainable fiscal conditions and structural reforms” (No. 7).
- 146 On the (theoretical) possibility of “unconstitutional constitutional law” cf. from the early rulings of the German Federal Constitutional Court BVerfGE 1, 14 (32) following the ruling of the Bavarian Constitutional Court (BayVerfGH) 3, 28 (47); on the practical impossibility of originally unconstitutional provisions of constitutional law cf. BVerfGE 3, 225 (232 et seq.).
- 147 Cf. Paulus, Ch. G., *supra* note 7, at 18 (with note 24), who wants to make a bail out as an exception “for political reasons” – with regard to Art. 122 TFEU – conditional upon “clearly defined elements which leave virtually no room for interpretation” (our translation); with a different view Thym, D., *supra* note 113, at 170, who holds that “due to the amendment of the Treaty the permanent crisis management is rests on a solid legal foundation” (our translation).
- 148 Cf. J-V. Louis, *supra* note 98, at 984, who, however, regards ESM and EFSF in conformity with Union law.
- 149 Cf. BVerfGE 89, 155, (*supra* note 32) para 138-139: “The monetary union is conceived under [the EC Treaty] as a community based on stability (*Stabilitätsgemeinschaft*), which has to guarantee price stability as a matter of priority [...]. For that reason every Member State is obliged [...] to establish long-term programmes in so far as necessary even before the commencement of the second stage for the realisation of economic and monetary union, which are to guarantee the necessary lasting convergence, especially as regards price stability and sound public finances. The Council will assess the progress made towards convergence in the economic and monetary sphere [...]. The standards for the progress towards economic and monetary union are factually clarified in Article 109j(1) and are quantified in more detail in the Protocol on the convergence criteria. Article 6 of that Protocol reserves the making of a detailed definition of the criteria to a unanimous decision of the Council. [...] Even though it is not foreseeable at present how the monetary union will develop in its specific stages as

regards its economic significance, the Member States participating and the timetable, the Act of Accession to the Union Treaty satisfies the requirements of Parliamentary responsibility.”

- 150 Cf. BVerfGE 89, 155 (*supra* note 32) para 147.
- 151 Cf. BVerfGE 89, 155 (*supra* note 32) para 140, 148.
- 152 Cf. the somewhat ambivalent wording BVerfGE 89, 155 (*supra* note 32) para 147: “The Treaty sets up long-term targets which impose the objective of stability as the standard for monetary union, which seek to achieve that objective through institutional arrangements, and which finally, as the last resort, do not prevent withdrawal from the Community in the event of the community based on stability failing to materialise.”
- 153 Cf. in this regard Brok, E. ‘Mehr Kompetenz für die EU’, Interview, *Das Parlament* 43 of 24 October 2011.
- 154 On the “capacity of the German Basic Law” see Nettesheim, M. (2012) ‘Wo endet das Grundgesetz? Das BVerfG und die Grenzen der europäischen Integration’ (forthcoming; manuscript on file with the authors).
- 155 See for these constitutional needs in Germany BVerfGE 123, 267 para 228 – Treaty of Lisbon.
- 156 Statement by the Heads of State or Government of the euro area of 26 October 2011, *supra* note 17, No. 35. An agreement on how to move towards a stronger Economic Union with the Heads of State or Government of 26 Member States have reached on 9 December 2011: cf. Statement by the euro area Heads of State or Government, 9 December 2011. Cf. also the draft of an International agreement on a reinforced Economic Union, http://www.europeanvoice.com/CWS/GED/pop_View.aspx?ID=28035. The (even further-reaching) motion for a resolution by the parliamentary group of Bündnis 90/Die Grünen (Green Party) of 26 October 2011 (Drs. 17/7501, No. 2) that has been rejected by the German *Bundestag* call for the convening of a European Convention on the topics economy, budget, finance, social policy and democracy.
- 157 Cf. the “pilot process” of BVerfG 2 BvR 987/10, 2 BvR 1099/10 and 2 BvR 1485/10, decision of 7 September 2011.
- 158 BVerfG, 2 BvR 987/10, *supra* note 121, para 128.
- 159 Cf. §1 Paragraph 4 of the German Euro Stabilisation Mechanism Act.
- 160 BVerfG, 2 BvR 987/10, *supra* note 121, para 141.
- 161 Cf. Hüfner, M.W., ‘Das Euro-Paradoxon’, <http://www.risknet.de/risknews/das-euro-paradoxon/1ef222ee60f19a810a466d948162d91c/>; cf. also Seidel, M., *supra* note 94, at 529 f.
- 162 Cf. Petersen, Th. (2011) ‘Eine Renationalisierung des Denkens’, *Frankfurter Allgemeine Zeitung* of 20 July 2011, p.5.