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Prof. Dr. Christian Calliess, LL.M. Eur
Freie Universität Berlin

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Christian Calliess:
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Options Linking Stability, Solidarity and Democracy**

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Prof. Dr. Christian Calliess, LL.M.Eur¹

Resilience and Reform in the Euro Area: Options Linking Stability, Solidarity and Democracy

Abstract:

The crisis in the Eurozone is still far from being solved. The current institutional setting of the European Treaties was not capable of dealing efficiently and legitimately with the fundamental issues of the crisis: the banking crisis, the sovereign debt crisis and the competitiveness crisis, that led at the same time to a crisis of European democracy. It has proven to be insufficient to prevent or to resolve a financial and economic crisis in a sustainable manner. Against this backdrop the Five Presidents' Report on Completing Europe's Economic and Monetary Union from 22 June 2015 highlighted the need 'to move from a system of rules and guidelines for national economic policy making to a system of further sovereignty sharing within common institutions' till 2025. This contribution discusses possible options that range from rather intergovernmental concepts with the Council and the Euro Group at its heart to more supranational concepts based with the Commission, ranging from a European Economic Government to a European Economic and Finance Minister. With regard to the principle of democracy it elaborates on different options on the role of the European Parliament and national parliaments.

I. Introduction

The financial and economic crisis has confronted the European Union and more precisely the Eurozone with its structural and political deficiencies. Existing mechanisms have failed to provide for collective solutions. Decision-making was shifted to a bilateral and international level. The complex, mostly intergovernmental arrangements that have been reached have been criticised for their lack of democratic and constitutional legitimacy.

The fact that the Maastricht Treaty favoured the implementation of a Monetary and Economic Union over a Political Union explains the lack of competence for common

¹ Christian Calliess is Professor for Public and European Law at Free University of Berlin and holder of an Ad Personam Jean Monnet Chair for European Integration (Freie Universität Berlin, Fachbereich Rechtswissenschaft, Boltzmannstr. 3, 14195 Berlin, c.calliess@fu-berlin.de). From 2015-2018 he was on leave from his chair and Legal Adviser to the European Political Strategy Center (EPSC), the In-House-Think-Tank of the President of the European Commission, and Head of the Institutional Team. He has been an external adviser to the German Parliament (Bundestag) and was representing it before the German Constitutional Court and the Court of the EU (ECJ) in the ESM and OMT cases. Disclaimer: The views expressed in this contribution are those of the author and do not necessarily correspond to those of the European Commission.

policies in the fields of finance and economics. It is the reason why the institutional setting for the Economic and Monetary Union (EMU) is based on an **asymmetric structure**: with the introduction of the Euro the competences for monetary policy have been transferred to the Euro area level (Art. 127 et seq. TFEU), while the competences for economic as well as fiscal policy have largely remained in the responsibility of national policy makers (Art. 4 (1) and 5 (1) and (2) TEU, Art. 5 TFEU, Art. 121 et seq TFEU).

As the Maastricht Treaty of 1992 did not establish a supranational European economic and fiscal policy compatible with the common European monetary policy, Member States agreed on a **dual system to defend the stability** of the Euro and the Euro Area:

- **On the one hand they established – as a “first ring of defense” – a rules based approach:** Art. 121 TFEU contains the **preventive** measures trying to ensure sound public finance by multilateral surveillance. The key concept of this provision is the coordination of national economic policies within a framework set by the Council, today implemented by the European Semester and Country Specific Recommendations (CSRs). Additionally Art. 126 TFEU contains the **corrective** measures, implementing the Excessive Deficit Procedure (EDP). The Commission is supposed to monitor the development of the budgetary situation as well as the stock of government debt in the Member States having regard to the ratio of government deficit and government debt to gross domestic product.
- **On the other hand – as a second “ring of defense” – Member States agreed on a market based approach.** The so called ‘No-Bail-Out-Clause’ in Article 125 TFEU stating that neither the Union nor the other Member State may be made liable for the debts of a particular Member State. The intention of this clause, together with Art. 123 and 124 TFEU, is to ensure that Member States of the Eurozone are **sanctioned through the financial markets** by higher interest rates on their government bonds in case of an increasing government debt.

With the crisis in the Euro Area it has become obvious that both, the rules based as well as the market based tools were **incapable of fulfilling their function**, which was to prevent a systematically relevant excess indebtedness of Eurozone Member States. Furthermore, the mere coordination of the national economic policies was insufficient to achieve the — due to the existing monetary and economic interdependencies — in a Monetary Union by all means necessary policy adaptation with regard to the common monetary policy of the ECB.

Against this backdrop reforms have to address both, the rules based as well as the market based tools.

In this regard the so called **Five Presidents' Report on Completing Europe's Economic and Monetary Union from 22 June 2015 (FPR)** and the accompanying **communication of the European Commission from 21 October 2015 (COM(2015) 600 final)** among others point out the urgent need '*to move from a system of rules and guidelines for national economic policy making to a system of further sovereignty sharing within common institutions.*'

The FPR further states that a

*„genuine Fiscal Union will require more joint decision-making on fiscal policy. This would not mean centralisation of all aspects of revenue and expenditure policy. Euro area Member States would continue to decide on taxation and the allocation of budgetary expenditures according to national preferences and political choices. However, as the euro area evolves towards a genuine EMU, some decisions will increasingly need to be made collectively while ensuring democratic accountability and legitimacy. A future **euro area treasury** could be the place for such collective decision-making“.*

The **Treasury of the Euro Area (TEA)** is to be understood as a **placeholder**, that allows for different institutional concepts. These can range from an intergovernmental approach with the Council and the Euro group at its heart to supranational concepts based with the Commission, ranging from a European Economic Government to a European Finance Minister. However, a detailed concept of a TEA has not been outlined by the report. The FPR locates its creation in the second stage (developments until 2025) of the completion of Europe's Economic and Monetary Union (EMU).

Moreover the FPR might be read as intending a political package deal between the TEA and the fiscal stabilisation function of the Euro Area: The latter standing for more risk sharing, the first standing for more sovereignty sharing. By bringing these both aspects together the institutional dimension of the FPR enfolds.

II. Aspects of a reform to be taken into account

Hereafter, different reform proposals aiming at overcoming the deficiencies outlined above will be compared and analysed in terms of their approaches to the scope, institutional ties, mission and competences as well as democratic accountability and financing of a future TEA.

1. Competences

The FPR states that Member States will have to accept increasingly joint decision-making on elements of their respective national budgets and economic policies. This implies that the TEA would have to be competent to take all necessary fiscal, monetary and economic measures in order to establish a properly democratic common economic policy. Thus, the TEA would incorporate competences that generally fall within the tasks of both the finance ministry and the ministry of economics on a national level. It should have supervising and managing functions.

The TEA could have the **competence**

- **to oversee coordination of fiscal and economic policy, especially to scrutinize and enforce the European Semester**

- **to support reform processes in the Member States by administrative and financial means**
- **to negotiate reform packages with Member States undertaking structural reforms**
- **to ensure the provision of Euro Area public goods by proposing legislation with regard to the Fiscal- and Economic Union**
- **to enforce rules of the Euro Area**
- **to manage crises in the Euro Area and counterbalance asymmetric macroeconomic shocks by a fiscal capacity**
- **to decide on bank closures**
- **to chair the European Monetary Fund (EMF), a transformed version of the ESM**
- **to ensure the unified external representation of the Euro Area**

With regard to these competences the decision to establish a TEA must not exclude the development of the ESM into an EMF. On the contrary, it might be wise, that both institutions go hand in hand, when it comes to the monitoring, implementation and enforcement of the competences of the TEA: National reforms could be politically monitored by the TEA. At the same time they could be supervised, supported and (and where necessary ultimately) enforced by a future EMF, understood as a technical and politically independent institution equipped with the appropriate competences and expertise.

This “re-integration” of the ESM into the framework of the EU is explicitly mentioned in the FPR. The new EMF could replace the ESM and take over its functions, while simultaneously extending its mission to **preventive** action. The latter would be mainly based on financial, administrative and technical support in close cooperation with the Structural Reform Support Service (SRSS), established in 2016 and based with the Secretary General of the European Commission.

In addition to a short-term crisis management facility the TEA would therefore dispose over the EMF as a long-term support facility in exchange for reduced budgetary sovereignty. As a result, the TEA via the EMF would be able to support economic growth and further convergence by supervising and – where necessary – assisting structural reforms in the Member States.

In case of an infringement of the legal framework of EMU, especially the Stability and Growth Pact, the TEA together with the EMF should be equipped with graduated instruments of intervention in national budgets including – as ultima ratio – the preparation and implementation of the insolvency of a Member State. The development of a **state insolvency procedure** does not only represent the last resort of excessive sovereign debt but is also crucial for the credibility of the whole system. In the framework of an **institutionalized sovereign default** the EMF could grant time-limited credits in the case of the absence of debt sustainability in order to secure, in the interest of the financial stability of the Euro Area as a whole, a structured insolvency of the Eurozone Member State concerned.

Part of this approach (“**package deal**”) based on more control (sharing sovereignty) would then be more financial solidarity (risk sharing) based on the principle of conditionality (see Article 136 (3) TFEU). In concrete terms this would mean, that the involvement of the TEA together with the EMF in national reform programs could be supported through a **fiscal capacity**.

The establishment of a **fiscal stabilisation function** (for example some kind of “rainy day fund”) as part of the TEA might be complex from a political point of view. Some Member States would fear increased moral hazard, permanent transfers or mutualisation of debts. However, a fiscal stabilisation function could be designed in such a way that the net transfers to each Member State are in the long run close to zero. The definition of transparent operational criteria for triggering the cyclical support would also go a long way in conciliating moral hazard concerns. Finally, in this context, questions of democratic oversight and legitimacy inevitably arise. Against this backdrop the FPR emphasised that the establishment of a fiscal stabilisation capacity for the euro area needs to be preceded by achieving a significant degree of economic convergence. Therefore, the **convergence benchmarks to define eligibility** for the new fiscal instrument would have to be defined.

Finally any fiscal capacity should contribute to finance **European public goods**. Therefore a **European investment budget**, that provides an incentive for structural reforms identified by the European Semester and Country Specific Recommendations (CSRs) could support the investment in European public goods (e.g. in energy infrastructure, border management, security measures or reforms of the labour market). It corresponds to the mission of a euro area stabilisation function as outlined in the FPR.

The intended **combination of solidarity and conditionality with the objective to safeguard the stability** of the Euro Area mirrors the legal framework as well as the hereon-based political “package deal” that during the crisis was underpinning EMU. For the Euro area all principles are explicitly mentioned in Art. 136 (3) TFEU: the granting of any required financial assistance under a stability mechanism, which can be activated if it is indispensable to safeguard the stability of the euro area as a whole, will be made subject to *strict conditionality*. In his *Pringle* judgment the European Court of Justice stated, that “the reason why the granting of financial assistance by the stability mechanism is subject to strict conditionality under paragraph 3 of Article 136 TFEU, (...) is in order to ensure that that mechanism will operate in a way that will comply with European Union law, including the measures adopted by the Union in the context of the coordination of the Member States’ economic policies”.²

Art. 136 (3) TFEU’s full legal effect unfolds in the context of the so called No-Bail-Out Clause, stipulated in Art. 125 TFEU - as another core principle of the euro area. In short this means that any sort of financial assistance granted by the Union or by the Member States to another Member State is not generally prohibited by Art. 125 TFEU.³ However,

² ECJ, Case C-370/12, para. 69.

³ ECJ, Case C-370/12, para. 130: “It must be stated at the outset that it is apparent from the wording used in Article 125 TFEU, to the effect that neither the Union nor a Member State are to ‘be liable for the commitments’ of another Member State or ‘assume [those commitments]’, that that article is not intended to prohibit either

also a voluntary assistance is not generally allowed. As the objective of Article 125 TFEU is to prompt Member States to maintain budgetary discipline by remaining subject to the logic of the market when they enter into debt, the provision "prohibits the Union and the Member States from granting financial assistance as a result of which the incentive of the recipient Member State to conduct a sound budgetary policy is diminished".⁴ This means, that under Art. 125 TFEU any sort of financial assistance to a Member State is only compatible with EU law, if it is indispensable for the safeguarding of the financial stability of the euro area as a whole, while the Member State remains responsible for its commitments to its creditors and the strict conditions attached to such assistance are such as to prompt the Member State to implement a sound budgetary policy.⁵

Above these core competences of the TEA, the FPR also aims at establishing a unified **external representation** of the Euro on an international level, especially in the IMF. The 2004 Constitutional Treaty had already provided for this innovation in its draft Article III-90. On the one hand, this could attribute more political weight to the euro area and ensure that the interests of the Eurozone as a whole are being expressed. On the other hand, if the particular interests of the Member States are too different there is a risk that the formulated common position will only represent a weak compromise. This gives reason for concern, as the so found compromise could be less significant.

2. Scope

It is essential to determine whether a Treasury should only represent the **euro area or, potentially at least, the EU as a whole**, including those Member States which do not (yet) take full part in the EMU. The answer to this question depends notably on the mission and the competences attributed to this institution. Since the adhesion to the EMU is compulsory for every Member State fulfilling the criteria of convergence (except for those that concluded legal opt-outs), it seems logical to include all Member States in order to pave their way to the EMU. Considering the close coordination in both fiscal and economic policy which is to be established by the Treasury, an institution which represents euro area Member States only could create a deeper gap between euro and non-euro Member States and make accession more difficult. However, the goal of the reform will ultimately be the establishment of closer solidarity and sovereignty-sharing mechanisms. If a common European approach is chosen, the accountability of and the benefits for non-euro states would have to be evaluated separately.

3. Position of the TEA in the institutional framework

The position of a TEA in the institutional framework of the European Union has not been defined yet. However, the integration into the existing institutional framework – as opposed to decision-making on an intergovernmental level outside the EU as practised in the ESM or in the Fiscal Compact Treaty – is one of the main goals of the reform.

the Union or the Member States from granting any form of financial assistance whatever to another Member State."

⁴ ECJ, Case C-370/12, para. 137.

⁵ ECJ Case C-370/12, para. 136, 137.

Most proposals agree that the mechanisms that have been developed in the course of the financial crisis have to be reintegrated in the existing structures. The predominance of intergovernmental or supranational elements in the new institution has direct influence on the requirements for decision-making (qualified majority vote or veto rights).

There are **three principal approaches to the question of the institutional position of the TEA.**

- In the **first one**, the existing structures would be left broadly untouched and a new executive authority would be added as part of the Council. This authority could complement or even replace the Eurogroup and raise the profile of economic policy coordination. This approach is based on the understanding that the basis for common decision-making in fields as sensitive as fiscal and budgetary policy has not yet been built. For this reason, the so-called **Union Method** would be further pursued, although with important changes to the principle of unanimity: the cooperation in fiscal and economic policy could be modelled after the decision-making process in the EU's Common Foreign and Security Policy (CFSP), as both policy fields are of high political sensitivity. This would mean extending the principle of "constructive abstention" to EMU in order to prevent decisions from being blocked by the veto of a single Member State, i.e. the analogous application of Article 28 (2), 31 (1) and 36 TEU to the decisions of the economic government. At the same time this intergovernmental authority would not have any legislative functions but would be limited to the adoption of operational measures, after consultation with the European Parliament.
- **The second approach is to anchor the future euro area Treasury on the application of the Community Method**, with a supranational mechanism and a proper fiscal capacity safeguarding the interests of the EU and the Euro Area as a whole. The TEA would then be established at the **European Commission**. In this regard **two models** could be distinguished. One could be called the model of a European Finance Minister, the other could be called the model of a European Economic Government:

(1) The Treasury could comprise just the Commissioner responsible for monetary union, who then would become a kind of **European Finance Minister**. In order to enhance his coordinating role, the function could be "**double-hatted**" by combining his role of a member of the European Commission and President of the Eurogroup. The new institution would be modelled after the office of the High Representative for Foreign Affairs, representing a mixed administration drawn from the Commission, the Council and even Member States. This would imply the European Finance Minister to be elected by the Council by qualified majority vote. Merging the positions of an EU Commissioner and President of the Eurogroup could give more political weight to the office, particularly in the implementation of the Excessive Deficit Procedure and the Stability and Growth Pact.

(2) Alternatively, in a more expanded set up, the TEA could comprise the 5 Commissioners that deal with the relevant policy fields (e.g. the Commissioners

responsible for the Monetary Union, the Internal Market, Trade and Financial Stability) as well as the President of the Commission (this expanded alternative would be better described as not just a Treasury but an “**European Economic Government**” for the monetary union). The structure of the Commission would then have to be reformed to create a proper treasury facility endowed with the full spectrum of fiscal, financial and macro-economic functions.

- Based on this approach a **third approach** could be imagined, **combining the TEA as mentioned already above with a new EMF**. This would create a hybrid model which would see the Treasury emerge as part of the Commission, but with guarantees of institutional independence when it comes to control and enforcement by the EMF. The model for that functionality would be a little bit like that of the Single Supervisory Mechanism, being located at the ECB. The independent, yet Commission-anchored Treasury, would be primarily responsible for matters of budgetary surveillance and fiscal stabilisation where preventing political interference is particularly important.

4. Democratic legitimacy

An institution like the TEA has to be elected and scrutinized by a parliament. With regard to its envisaged competences questions of legitimacy and democratic accountability arise. In this context, the predecessor to the FPR, the Four Presidents Report, already mentioned that ‘*moving towards more integrated fiscal and economic decision-making between countries will (...) require strong mechanisms for legitimate and accountable joint decision-making.*’

a. The role of the European Parliament (EP)

If the purpose of the TEA is narrowed to the provision of public goods in the Euro area as outlined above, it is questionable if MEPs of non-Eurozone Member States should be allowed to vote on matters exclusively regarding the euro area. In this case, votes of non-Eurozone MEPs could be excluded.

There is also the possibility to staff the body with deputies from the European Parliament only representing Member States of the Eurozone. Such a **Euro Chamber** inside the EP however might conflict with Art. 10 (2) TEU according to which the European Parliament is the representative body of EU citizens and not of EU Member States.

Another possibility could therefore be the creation of a **formally separate parliamentary assembly**, made up of directly elected representatives of the national parliaments. However, this would further complicate the already complex decision-making mechanisms. The advantage of a Euro Chamber is that it is based on an existing institution and can be adapted quickly and flexibly.

Some concepts also aim at enhancing the role of the EP or a respective Euro Chamber in the legislative process and in the European Semester. The FPR emphasizes that the role of the EP in the European Semester has to be strengthened. The assignment of appropriate responsibilities to the EP could complement the decision making process in the European Council and the Eurogroup and endow it with new legitimacy.

b. National Parliaments

As certain competences of the TEA (especially proposing legislation with regard to Euro Area public goods) would **interfere** with – according to the national perspective – very **sensitive policy fields such as economic, fiscal, budget and social policy**, it might be politically wise and with regard to constitutional constraints in at least some Member States even **necessary to integrate national parliaments** in the decision making process. This would **compensate** them as well for the implied transfer of parliamentary competences affecting their budget autonomy.

In this context, the FPR emphasizes the need to strengthen inter-parliamentary cooperation and to involve national parliaments more closely in the adoption of National Reform and Stability Programs. Insofar there are **three different approaches how to integrate national parliaments** in the process. All of them would apply only in those policy fields, that are affected by the necessary transfer of new competences (e.g. in the field of fiscal, economic and social policy) to the European level.

- The first approach could be to establish a “Euro Chamber” consisting of Members of national parliaments beside the EU Parliament and the Council. This additional **Third Chamber** should get **involved only**, when framework-legislation is passed on matters, that touch new competences transferred to the European level in the field of economic, fiscal, budget and social policy. Arguably, it is likely that such an additional institution makes the European decision-making process even more complex. Nevertheless a Third Chamber would evolve the role of the national parliaments as it is currently funded in Article 10 (2), 12 TEU and Article 13 TSCG into a further integrated multi-level parliamentarism, which is necessary to get political and constitutional support for a Treaty Reform including a competence transfer in the field of economic, fiscal, budget and social policy. Such a Third Chamber would have to be implemented through a treaty change. This approach is also reflected in the proposal of a **bicameral parliamentary** system scrutinizing the European Economic Government. While the right to initiate new legislation would be conferred to the EP (possibly with only euro area MEPs eligible to vote), the second chamber consisting of Members of the national parliaments could take up a role comparable to the German Bundesrat.

- Another possibility that might even be achieved partly within the Treaty of Lisbon would be to establish a **veto** (orange or red card) of national parliaments specifically with regard to these sensitive policy fields. The basic idea of such a veto corresponds to the right of national parliaments to raise a subsidiarity complaint (Art. 12(b) TEU). Furthermore, it corresponds to the already existing so called emergency breaks, that do exist already in the field of judicial cooperation in criminal matters as another sensitive policy area (Art. 82(3) and 83(3) TFEU). In order to ensure that one national **veto cannot block** the whole European decision-making-process for an unlimited time, the veto might be of a suspending character. The European institutions would have to consider and take into account the reasons of the national parliament. If a compromise cannot be found after a time period of six month, there could be two possibilities: either a minimum of one third of the other national parliaments supports the veto, then the proposal is taken from the agenda, or, if this minimum is not reached, the European institutions could continue with the decision-making-process. In doing so, there would be need of an unanimous decision in the Council / Eurogroup.
- A third possibility would be to combine the above mentioned proposals concerning the Third Chamber and the veto card to the effect, that not the national Parliaments but the Third Chamber would have a veto right with regard to the sensitive policy fields of economic, fiscal, budget and social policy. This approach is reflected in the proposal of a Joint Committee comprising 28 delegates from the EP and 56 delegates from the national parliaments (two members from each national parliament and half the number of MEP). However, in order to ensure that one national veto cannot block the whole European decision-making-process for an unlimited time, the veto might be of a suspending character.
- For the means of the decisions of a future EMF possibly replacing the ESM, the need for direct decision-making involving the concerned Member States could be fulfilled by co-decision mechanism between the EMF board, voting by qualified majority, and the Joint Committee.
- Democratic accountability is even more crucial when it comes to the TEA's authority to intervene in national budgets. There is a consensus to this account that the budgetary autonomy of national parliaments has to be respected. **Therefore rights of intervention in the national budgetary autonomy** may be possible on the following conditions: as long as Member States comply with their obligations under the common debt rules, only **legally non-binding** recommendations are possible (as it is the case *de lege lata*). If a Member State, however, infringes the legally binding stability criteria (and therefore disregards European law), it must be possible to make **abstract, but legally binding** stipulations of **how much** the country has to save – however its government and parliament will keep the specific decision **where** to save. Only if a Member State is dependent on financial

assistance by the ESM (or a future EMF), **concrete legally binding** recommendations would be possible. In a case like this it is only fair to ask, to what extent a national parliament of a Eurozone Member State that receives money from the ESM (or a future EMF) voluntarily has given up its budgetary autonomy.

III. Implementation

According to the FPR the implementation of the so-called second stage of the completion of the EMU was intended until 2025. The experiences of the 2004 Constitutional Draft Treaty and the Treaty of Lisbon in 2009 have shown that a treaty revision can be politically difficult. Nevertheless – or even because of this – it is time to design a draft for an improved governance of the Euro Area that can be explained and discussed with Member States, citizens and civil society.

Citizens expect the EU and its policies to function properly. If the EU wants to regain their trust, it has to explain the need for reforms and to start a transparent debate on why we need a reform. The necessary narrative on this reform is obvious: It is about a choice citizens have to make. It is **not about "more Europe" but about a better functioning Europe**. If Member States and citizens want to keep the Euro, based on lessons learned from the crises, they should agree to reforms towards a better functioning and more resilient Euro Area.

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