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The Euro Crisis and European Integration

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Reader's Guide

This chapter discusses the European Union's (EU) response to the euro crisis that emerged in late 2009, two years after the global financial crisis struck. It identifies the challenges this crisis has posed to the existing institutional set-up of economic and monetary union (EMU) and shows that it had a lasting impact on discussions over the EU's future well beyond its most dramatic moments. A timeline of the euro crisis is provided and the main changes to the institutional framework of European economic governance at the time of writing are reviewed. The chapter considers whether the crisis was caused by a deficit of centralized decision-making and whether it has served, in turn, as a catalyst for deeper economic and political integration in the euro area and the Union more generally. The consequences of the crisis for the EU's legitimacy are also explored from competing theoretical perspectives.

Introduction

Looking back on the history of European integration, it is difficult to remember a time when the EU or its predecessors were not facing a crisis of one sort or another. The 1950s were marred by the political fallout from the failure of the **European Defence Community** Treaty, just as the **'empty chair' crisis** came to dominate the 1960s (see Chapter 2). The 1970s saw initial plans for economic and monetary union (EMU) abandoned following the collapse of the **Bretton Woods** system and the first oil shock. The side

effects of this economic turmoil lingered on in several member states in the 1980s, with the 1990s witnessing exchange rate crises, as well as a crisis of **legitimacy** for European integration after Denmark's 'no' vote against the **Maastricht Treaty**. Concerns over the EU's legitimacy merely intensified in the 2000s, with plans for a **Constitutional Treaty** rejected by voters in France and the Netherlands, and the **Lisbon Treaty** passed only after a second referendum in Ireland (see Chapters 3, 9, and 15).

In spite of these successive crises, European integration has stumbled onwards. The EU of the Lisbon Treaty is an altogether different animal than the **European Economic Community (EEC)** of the Rome Treaty. Indeed, major advances in European integration have often followed periods of profound crisis. The **Single Market** programme came after the economic malaise of the 1970s and early 1980s and progress towards EMU in the 1990s intensified after a series of crises in the functioning of the **European Monetary System (EMS)**. Some politicians have even sought to portray crises as the principal opportunity for further cooperation between member states. **Jean Monnet** memorably wrote that 'Europe will be forged in crises, and will be the sum of the solutions adopted for those crises' (Monnet, 1976: 488).

Scholars are more circumspect on the causal relationship between crises and European integration. Lindberg and Scheingold (1970)—two pioneers of the neo-functionalist school of European integration—saw crises as drivers of integration, but only under certain conditions. Large crises may be more conducive to integration than small ones, they conjectured, because the latter are more likely to disrupt some rather than all of the Community's decision-making structures (Lindberg and Scheingold, 1970: 217). Crises can also be blunt opportunities for supranational institutions to show leadership, they suggest, because of the tendency of national leaders to close ranks during periods of economic and political turmoil. Supranationalism, which emerged in the 1990s as the intellectual successor to neo-functionalism (cf. Fligstein and McNichol, 1998), even views crises as symptoms of how integration has not gone far enough. Mattli and Stone Sweet (2012), for example, see the euro crisis as 'revealing the striking absence of what Europe needs most: strong political leadership capable of forging a more federal EU' (Mattli and Stone Sweet, 2012: 14).

The euro crisis, which emerged in late 2009, was arguably the worst economic calamity to befall the EU to date. Following two years of chaos on international financial markets after the collapse of the US subprime mortgage market, the member states that share the single currency found themselves facing deep recessions and burgeoning budget deficits. No euro area member was immune from these developments, but Greece, Ireland, Portugal, Spain, and Cyprus proved particularly vulnerable. That this crisis served as a trigger for institutional change in the EU in an attempt to save the euro is also self-evident. The heads of state and government have never met so frequently as during the crisis, with summits taking place on average every two months, and finance ministers meeting often more than once per month. In addition to a far-reaching reform of the **Stability and Growth Pact (SGP)** and other elements of euro area governance, EU leaders pledged up to €2 trillion to revive European banks and around €1 trillion to contain the **fiscal crisis** in Cyprus, Greece, Ireland, Portugal, Spain, and other euro area members. Financial support was not offered lightly to these member states which had little choice but to accept swingeing budgetary cuts and emergency revenue-raising measures, as well as unprecedented surveillance of their economic policies by the EU and **International Monetary Fund (IMF)**.

The euro crisis also triggered changes to the Lisbon Treaty, which now contains a legal basis for a permanent euro area assistance fund, the **European Stability Mechanism (ESM)**. The '**Fiscal Compact**', which provided for closer economic policy coordination and a binding commitment to fiscal discipline in national law, was concluded in the form of an **intergovernmental treaty** because of the refusal of the United Kingdom (UK) to agree to these measures in December 2011. The EU has also agreed to a **Banking Union**, which includes a single supervisory regime and a single resolution mechanism for struggling financial institutions. A euro area-wide deposit insurance scheme to protect savers is envisaged too but remains to be implemented as of early 2016. More generally, the euro crisis has driven debates about further EU reform. Even though the Union was hit hard by a refugee and migration crisis, no other event or policy challenge triggered more discussion about institutional matters, burden-sharing and solidarity, the allocation of competences and resources, as well as EU legitimacy more generally.

This chapter explores how the EU has responded to the euro crisis and how the crisis has shaped EMU and European integration. We argue that the crisis

has served as a spur for integration, but it has done so in ways that rest uneasily with existing theoretical approaches to the delegation of sovereignty in the EU. Whereas integration scholars have traditionally thought of integration in terms of the empowerment of the Community institutions, it is the heads of state or government and *de novo* institutions—that is, bespoke bodies that operate at one remove from the Commission and the Court of Justice—that are the real institutional winners from this crisis. This **new intergovernmentalism** (Bickerton et al., 2015a, 2015b; see Chapter 5) did not begin with the euro crisis but rather characterizes European integration since the Maastricht Treaty was signed in 1992. Yet, new intergovernmentalism's grip on the EU has been reinforced as a result of this crisis because of the determination of member states to press ahead with collective solutions to shared policy problems but without being seen to cede new powers to old Community institutions along traditional lines. The chapter begins by discussing why the euro crisis arose and how it unfolded, followed by a discussion of its impact on EU institutions. The penultimate section explores competing perspectives on what the crisis means for the EU's legitimacy and, finally, the chapter concludes by highlighting its main findings.

From global financial crisis to euro crisis

The global financial crisis, by some reckonings, struck the EU on 9 August 2007. The first sign of trouble was a press release from French financial institution BNP Paribas, which suspended trading on three investment funds as a result of difficulties in the US subprime mortgage market. Trouble had been brewing in this market for months, with the second biggest provider of subprime mortgages in the USA (that is, home loans offered to individuals with poor credit ratings) filing for bankruptcy in February 2007. Such difficulties were related, in turn, to a sharp slowdown in the US housing market in 2006, leaving many subprime mortgage holders unable to make their loan repayments. This turmoil soon spread to the country's financial sector at large, with the US investment bank Bear Stearns announcing large subprime-related losses in July 2007. Within weeks of BNP Paribas's press release, it was clear that several European banks were badly exposed to the subprime crisis. In Germany, in August 2007, Landesbank Sachsen was hastily bought by Landesbank Baden-Württemberg after an Irish-based subsidiary of the former had incurred large subprime-related losses. In the UK, Northern Rock fell victim to the first **run on a bank** in Britain for 150 years after struggling to meet its own borrowing needs in increasingly nervous financial markets.

In March 2008, the US Federal Reserve negotiated the sale of Bear Sterns to another US investment bank, JP Morgan, after the former had incurred in excess of US$3 billion in subprime-related losses. No such solution could be found for Lehman Brothers, another troubled US investment bank, forcing this financial institution into bankruptcy in September 2008. The result of this decision was pandemonium in international markets, as speculation mounted about which large financial institutions would be next to fail. EU member states' initial response to this escalation of the global financial crisis was ineffective and uncoordinated (see Box 26.1). A case in point was Ireland's unexpected decision in September 2008 to guarantee Irish banks. This move seriously destabilized the UK financial system, as British savers switched to Irish bank accounts on the understanding that their savings would be safer. Fearful of such 'beggar thy neighbour' policies, several EU member states moved quickly to guarantee bank deposits, ignoring calls for a more coordinated approach. The Irish guarantee had fateful consequences and brought the country from a position of budget balance and low government debt after two decades of impressive economic growth to the brink of sovereign default in a matter of months. A centralized system of EU bank deposit insurance and a common system for dealing with troubled financial institutions would have helped to manage the crisis better and the realization of this fact was a key driver behind later plans for and EU Banking Union.

The euro area entered a recession—a prolonged period of falling real **gross domestic product (GDP)**—in the first quarter of 2008 due to a dramatic downturn in global trade and a credit crunch at home, as euro area banks grew less willing and able to lend to consumers and businesses. In an attempt to counteract these developments, EU leaders agreed in December 2008 on a **fiscal stimulus package** under which national governments committed themselves to tax cuts and expenditure increases valued at 1.5% of GDP. This stimulus was relatively small compared to similar efforts in the USA and Japan, for example, with some

BOX 26.1 EXPLAINING THE GLOBAL FINANCIAL AND EURO CRISES

The euro crisis followed the global financial crisis, but the relationship between the two is complex. Economists are divided as to the precise causes of this global crisis, but most emphasize excessive risk-taking in financial markets in the early 2000s (see Financial Services Authority, 2009). Symptomatic of such risk-taking is the increasing importance of **securitization** since the mid-1980s. 'Securitization' refers to a financial practice that allows banks to sell on the risks associated with loans to other financial institutions. Initially, it was hoped that securitization would diversify risk should borrowers fail to meet repayments on these loans. In the event, it served only to amplify risk by imposing worldwide losses when US house prices started to fall in 2006. Globalization was the key driver of such financial innovation. In this regard, the EU's efforts to create a single financial market under the Financial Services Action Plan launched in 1999 arguably left member states more rather than less vulnerable to the events of 2007–08. The Capital Requirements Directives adopted in 2006, for example, failed to prevent some financial institutions in the EU from being woefully undercapitalized once the global financial crisis struck.

Supervisory failures were a general feature of the global financial crisis rather than one that was specific to the euro area, as the failure of authorities in the UK and the USA to prevent financial institutions from taking excessive risks showed. Neither of the latter two countries had ready-made instruments to help distressed financial institutions once the crisis struck. The UK lacked a permanent resolution mechanism for taking control of insolvent banks until 2009.

Many economists also see a link between the global financial crisis and the problem of **global imbalances** (Obstfeld and Rogoff, 2009). This problem refers to the accumulation of large **current account surpluses** in Asia and in oil-exporting countries since the mid-1990s, mirrored by the largest **current account deficit** in the history of the USA. The causes of these imbalances include high levels of savings in Asian countries, high oil prices, the reluctance of the USA to reduce domestic consumption, and the tendency of some surplus countries to peg their currencies to the dollar. The consequences of global imbalances are more straightforward; the savings glut in Asia and in the oil-exporting countries fuelled low **interest rates** in the USA and, by making it cheaper for homeowners to secure loans, contributed to the US **housing bubble**, which burst to such spectacular effect in 2006.

The euro area had a current account position of 'close to balance' or 'in surplus' during the first decade of the single currency and so was only indirectly exposed to the problem of global imbalances. However, it faced its own problem of internal balances, in part, because the falling interest rates experienced by some member states upon joining the single currency fuelled **credit booms** and housing bubbles. Portugal was an early victim of these imbalances, experiencing an inflationary boom between 1999 and 2002, followed by a prolonged period of slow growth. The Portuguese economy's failure to recover from this prior shock is one reason why it proved so vulnerable once the global financial crisis struck. Ireland, Spain, and Greece, on the other hand, saw credit booms and housing bubbles cut short by the crisis—facts that might explain why the **fiscal hangover** from the crisis was so strong in these countries.

Falling interest rates associated with joining a single currency is only one source of macroeconomic imbalances in the euro area; another is the failure of these countries to monitor excessive risk-taking by banks through a robust system of financial supervision. Such failures were acute in Ireland, where the Central Bank of Ireland and the Financial Regulator failed to sound the alarm over excessive risk-taking by borrowers and lenders alike. Problematic too was the failure of some peripheral euro area countries to prevent sustained losses of competitiveness during the first decade of EMU. This situation was acute, for example, in Portugal, which saw its unit labour costs relative to other euro area countries continue to rise even after economic conditions slowed in 2002. For some economists, this situation was simply the corollary of developments in Germany, which experienced a sustained fall in relative unit labour costs after 1999 in an effort to restore competitiveness and to shake off a decade of economic underperformance following the country's unification in 1990.

commentators suggesting that EMU paid a price for not having a common budget instrument (Henning and Kessler, 2012). The macroeconomic effects of fiscal federations are a matter of debate, however. On the one hand, such an instrument would have encouraged growth, especially in member states that had limited room for national stimulus packages. On the other hand, foreknowledge of such fiscal help may have created a problem of moral hazard (Persson and Tabellini, 1996) by encouraging even riskier policy choices from member states such as Greece in advance of the global financial crisis.

The coordinated fiscal stimulus package agreed by EU member states in 2008 provided a small but valuable lifeline to consumers and businesses, contributing towards a resumption of real GDP growth in the third quarter of 2009. Although the euro area had by then exited recession, concerns over the state

of public finances in the euro area intensified after all members experienced a sharp increase in government borrowing. Those countries that had witnessed an end to prolonged housing booms at the outset of the economic crisis were particularly hard hit, with Spain and Ireland posting budget deficits in excess of 10% of GDP in 2009, as the stamp duties associated with buoyant housing sales evaporated and the effects of a very steep recession hit. The rush to cut expenditure in these and other member states has been criticized in retrospect but national governments faced considerable pressure from financial markets at the time to get government borrowing under control. A common budget instrument would have helped to ease the burden of such austerity in the short run but it might have made matters worse in the long run for the reasons discussed above.

Whereas Ireland and Spain began the euro crisis with levels of government debt below 40% of GDP, government debt was in excess of 100% for Greece. This debt level alone provided grounds for pessimism about the state of Greek public finances once the recession hit. Matters were made considerably worse, however, when new Prime Minister George Papandreou announced in October 2009 that previous administrations had concealed the true scale of government borrowing. As a result of this announcement, Greece's budget deficit was revised from 3.7% of GDP to 12.5%, leading to a sudden loss of faith by financial markets in the country's ability to repay its national debt without outside assistance.

Had Greece not been a member of the euro area, then it would presumably have been offered assistance without delay; an EU–IMF financial support package was, after all, agreed with three non-euro area EU members, Hungary, Latvia, and Romania, in late 2008 and early 2009 with a minimum of fuss. That Greece was a member of the euro area complicated matters both legally and politically. Legally, the EU could not offer the same type of financial assistance to Greece as that to Hungary, Latvia, and Romania, since the latter was carried out under Article 143 TFEU, which applies only to non-euro area members. Politically, member states were divided on the decision to involve the IMF in the affairs of a euro area country. After several long months of procrastination—a period in which Greece's fiscal problems went from bad to worse—the heads of state or government finally agreed, in May 2010, on a €110 billion financial support package. The EU contribution to this package took place outside the Treaty, with individual member states putting up €80 billion in bilateral loans. In exchange for this financial support, Greece signed up to a detailed programme of economic policies designed to get its public finances under control. A **troika** of representatives from the Commission, ECB, and IMF assumed responsibility for negotiating this programme and monitoring its implementation, thus ensuring that key decisions over Greece's economy would, in principle, be jointly decided by the EU and IMF.

Why member states were so slow to provide financial support for Greece is a key question for understanding the politics of the euro crisis. For some economists, politicians simply failed to understand the magnitude of the crisis and the complexity of the policy responses required (De Grauwe, 2013) but this answer is not satisfactory from a political science perspective. The euro crisis was undoubtedly complex but dealing with complexities is part of what politicians do on a daily basis. A more plausible explanation is that the policy options for dealing with the crisis were costly, that such costs were unevenly distributed across the EU, and that those member states that were disproportionately exposed to such costs withheld support until they secured concessions. Take EU member states' foot-dragging over involving the IMF in financial support for Greece. Some heads of state or government, including Spanish Prime Minister José Luis Rodríguez Zapatero, were wary of involving the Fund in the affairs of a euro area member, but others, including German Chancellor Angela Merkel, were in favour. These differences had little to do with these individuals' grasp of economics but instead reflected national interests over involving the Fund (see Hodson, 2015). For Zapatero, any deal over Greece would set a precedent in the event of financial support for Spain, which had become a distinct possibility by early 2010. Since Spain has more influence in the EU than it has in the Fund, Zapatero had a strong interest in pushing for an EU solution to the sovereign debt crisis. Angela Merkel had a different set of interests because Germany stood to contribute the most to any financial support package and so had a strong interest in ensuring credible oversight of the conditions attached to any loans. Involving the IMF alongside the EU in support for Greece came to be seen as a more credible course of action because of the Fund's track record in crisis management and perceived independence from EU member states. Given the urgency of the crisis and the impossibility of finding a solution

without the EU's largest member states, Merkel eventually convinced other heads of state or government on a joint EU–IMF package for Greece.

By May 2010, financial market concern about the sustainability of public finances in other euro area members had intensified. In response, euro area leaders pledged €60 billion via a newly created European Financial Stabilization Mechanism (EFSM) and €440 billion via a new European Financial Stability Facility (EFSF) to provide financial support to any euro area member state that might need it. Ireland became the first member state to access these funds in November 2010. Portugal was next in line, securing €78 billion in loans from the EU and IMF in May 2011. By this point, the nightmare scenario was that the sovereign debt crisis would spread to Spain, Italy, and other large euro area members and so require financial support that went well beyond the resources available via the EFSM, EFSF, and the European Stability Mechanism (ESM), a €500 billion permanent crisis resolution mechanism that started operating in September 2012 (see below). Although the combined weight of these funds was €1 trillion, some economists estimated that at least twice this amount might be required if large euro area members got sucked into the crisis (Buiter and Rahbari, 2010). In the end, the euro area rode its luck during this phase of the crisis. Spain negotiated a loan from the EU of 'just' €100 billion to recapitalize its financial institutions after its housing bubble burst. Italy, meanwhile, managed to restore confidence by jettisoning Prime Minister Silvio Berlusconi, a politician who had lost the confidence of financial markets, and installing Mario Monti, a former European Commissioner, as head of a caretaker government. Monti's 17 months as Prime Minister were not an unqualified success but he took decisions that his predecessor did not and brought Italy back from the brink in the process.

Euro area members can claim credit for doing just enough before it was too late to survive this stage of the sovereign debt crisis, but it is doubtful that the policies pursued would have been sufficient without the intervention of the European Central Bank (ECB). The ECB was a reluctant hero, having responded with a combination of decisiveness and caution to the unfolding crisis. When it came to providing **liquidity** to European banks in the early stages of the global financial crisis, the ECB generally acted decisively. A case in point was the Bank's decision to allocate €94 billion in overnight loans on the day on which BNP Paribas sounded the alarm over problems in the US subprime market. The ECB was altogether hesitant about cutting interest rates, waiting until November 2008 to reduce the cost of borrowing in the euro area. The US Federal Reserve, in contrast, had embarked on a similar course of action in September 2008.

Between November 2008 and May 2009, the ECB's **base rate** fell from 3.75% to 1.0%. Fearful that these historically low interest rates would be insufficient to prevent the threat of deflation—sustained falls in the overall level of prices—the Bank launched a new '**covered bond scheme**' in June 2009. This scheme committed the Bank to spend €60 billion on bonds issued by private banks. With the launch of its **European Securities Markets Programme (SMP)** in May 2010, the ECB finally agreed to purchase bonds issued by euro area governments, albeit from investors who purchased government bonds rather than directly from the governments themselves. The scale of bond purchases under the programme was modest, and so it failed to convince financial markets. In July 2012, ECB President Mario Draghi finally bit the bullet by publicly announcing that he was prepared to do whatever it would take to save the euro. This move had an almost instantaneous impact on financial markets, which came to believe, rightly or wrongly, that the worst of the crisis was over now that unlimited bond purchases from the ECB was a possibility (see Box 26.2).

In 2013, Cyprus became the fifth and also the last euro area member to receive emergency financial support from the EU. Most importantly, Ireland exited from its EU–IMF programme in December 2013, with Spain and Portugal following suit soon after. Cyprus too was able to exit its support programme ahead of schedule in March 2016. If reliance on emergency financial support is considered to be a key feature of the euro crisis, these developments are certainly signs that the crisis is drawing to an end. It was around the same time that a series of crisis-driven institutional reforms were adopted and implemented. EMU's tightened framework for economic policy coordination became fully operational by mid-2013 and key elements of Banking Union were implemented by the end of 2014 (see section on 'EU institutions and the euro crisis' and Box 26.3). Moreover, progress was reported with regard to the overall stability of the financial system. An ECB stress test of the euro area's 130 largest banks in October 2014 suggested that just 13 financial institutions required further recapitalization. Finally, after recession and a period of only sluggish growth, the euro area rebounded in 2013. Employment levels

BOX 26.2 THE ECB AND THE CRISIS

'Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough' (Draghi, 2012). With these 23 carefully crafted words, delivered in a speech in London in July 2012, ECB President Mario Draghi finally gave financial markets what they had been looking for since the euro crisis began in 2009. Draghi's intervention meant, in effect, that the ECB was ready to play the role of **lender of last resort** vis-à-vis member states to save the single currency. This commitment gave rise to the so-called **Outright Monetary Transactions (OMT)**, under which the ECB agreed, in principle, to the unlimited purchase of government bonds on secondary markets for member states facing fiscal crises. Draghi's move was a major success in the short run, as evidenced by the falling risk premiums on government debt issued by Spain and Italy in the second half of 2012.

All of this raises the question of why the ECB did not act sooner. The answer is institutional. The ECB's reluctance to ride to the rescue reflected internal tensions within the Bank between those who were open to unconventional monetary policies and those who feared that such measures violated the Treaty's prohibition of monetary financing of member states' debt and the Bank's mandate to maintain price stability above all other goals. There was also a concern that bond purchases would take the pressure off member states to reform their economies and so get to the root causes of the euro crisis, such as a lack of competitiveness and weaknesses in financial supervision.

Draghi won out here thanks to his skilful chairing of the ECB Governing Council and his position was bolstered by the tacit support of German Chancellor Angela Merkel. Whereas the Bundesbank was critical of ECB bond purchases, the German Chancellor gave her country's central bank limited backing in such debates and so left German monetary authorities politically isolated. Although it took time to work through these internal tensions, the ECB's commitment to unlimited bond purchases was probably the single most important step in deescalating this stage of the crisis. This is a crucial point in the debate about whether the euro crisis was amplified because of a lack of centralized decision-making under EMU because it confirms that the EU had the policy instruments at its disposal to act earlier but chose not to because politics got in the way. EMU is hardly unique here. In the USA, for example, policy-makers faced deep divisions over how to handle the global financial crisis that they overcame only slowly and with varying degrees of success.

The OMT has not yet been deployed as of early 2018. Serious economic and legal doubts surrounded it initially. Regarding economic doubts, the ECB's decision to make access to the OMT conditional on compliance with a strict programme of economic and fiscal adjustment is problematic. This is so because member states most in need of OMT could well struggle to meet such conditions. Regarding legal doubts, the compatibility of the OMT with EU and German law was challenged before Germany's Federal Constitutional Court in June 2013. In its judgment on this case in February 2014, the Court raised concerns that the ECB had exceeded its mandate by launching the OMT and referred this matter to the Court of Justice of the European Union (CJEU) (see Gerner-Beuerle et al., 2014). The CJEU ruled in June 2015 that the ECB's announcement of the OMT programme was in line with EU law and within the Bank's mandate to take measures ensuring price stability in the euro area.

reached an all time low by mid-2013 but they too recovered strongly.

Yet, the negative effects of the euro crisis are still clearly detectable and the question remains as to whether they have the potential to reignite the euro crisis, in the sense of posing an existential threat to the integrity of the currency block as a whole and potentially of the EU as such. One of the key crisis response mechanisms is still operational. With its Expanded Asset Purchase Programme the ECB embarked on a policy of quantitative easing in January 2015. It initially allowed the Bank to purchase as much as €1 trillion in bonds from the government and private sector. This maximum amount was increased to over €2.2 trillion in December 2016. However, the ECB reduced the volume of its monthly purchases from around €80 billion to around €60 billion in April 2017 and to around €30 billion from January 2018 onwards (cf. European Central Bank, 2018). The ECB intervention substantially contributed to lower borrowing costs for those euro area members who had previously had to pay premiums on their government borrowing higher than those of German government bonds.

A worrying leftover from the euro crisis was the continuing dependency of Greece on financial assistance. Its status as a so-called programme country meant that its government was subject to strict conditions—or so-called conditionality—as stipulated by the Eurogroup and the IMF. In July 2015, only an eleventh-hour decision of the European Council avoided state bankruptcy. New ESM assistance was adopted by the Eurogroup amid sharp warnings by the IMF that

debt relief financed by the euro area was inevitable. A degree of debt relief was finally offered, although Greece's exit from financial assistance in August 2018 owed more to the harsh austerity measures implemented by the government, measures which reassured financial markets but imposed high costs on society. Another point of discussion concerns the fragile state of the banking sector in the euro area's third largest economy, Italy. In November 2017, ECB president Mario Draghi acknowledged the fragility of euro area banks, which had an estimated €1 trillion in non-performing loans (*Financial Times*, 20 November 2017). In 2017 alone, the Italian government spent €17 billion to aid the sale of the struggling banks, Banca Popolare di Vicenza and Veneto Banca to Intesa Sanpaolo (*The Telegraph*, 26 June 2017) and to rescue Banca Monte dei Paschi di Sienna with another €5.4 billion as part of a recapitalization package (*Financial Times*, 25 October 2017). Even if these amounts were much below what was spent in state aid for bank rescue during the euro crisis' most dramatic moments these episodes are worrying as they show that efforts to exit from state aid as the main instrument to finance bank rescues—a key promise of Banking Union—is not working in this large euro area member state. Moreover, as a country with traditionally high levels of accumulated government debt, Italy is in a particularly weak position to avoid sovereign debt difficulties in the event that large-scale interventions become necessary.

KEY POINTS

- Problems in the US subprime mortgage market triggered a banking crisis in the European Union which in turn paved the way for a steep recession, fiscal turmoil, and political instability.
- The EU's stop–start response to the economic crisis included a coordinated rescue of banks, a modest fiscal stimulus package, and, in cooperation with the International Monetary Fund, emergency loans for member states, which have proved politically contentious.
- The ECB's commitment in 2012 to engage in unlimited bond purchases to save the euro area marked a turning point in the crisis, but not the end.
- Some scholars blame the euro crisis on a lack of more centralized policy instruments, but this is open to debate given the downsides associated with some centralized solutions and the instruments already available to euro area authorities.

EU institutions and the euro crisis

For those who posit a link between crises and European integration, the euro crisis might have provided the perfect opportunity for a further transfer of powers to traditional supranational actors. In spite of claims to the contrary, the evidence thus far suggests that such transfers have been limited (for a contrasting argument, see Chapter 10). This section shows that there has indeed been no shortage of institutional reforms in response to the euro crisis, but that the changes implemented chime with the **new intergovernmentalism** (Bickerton et al., 2015a, 2015b) rather than ringing the bell for a new era of supranationalization. This section provides an overview of these reforms, discussing the changing role of the European Commission in euro area governance since 2009, before exploring the prominent part played by euro area finance ministers in the Eurogroup and by heads of state or government through the **European Council** and **the Euro summit**.

The role of the Commission

The euro crisis revealed the importance of the Commission as a supranational actor in EMU. The EU executive was present in all major debates over how to handle the crisis and it was given a more prominent role in economic and fiscal surveillance through the '**six pack**' and '**two pack**' reforms (see Box 26.3). However, in spite of these changes, there is little evidence to suggest that the Commission played the role of a supranational entrepreneur by pushing through proposals to empower itself at the expense of member states (Hodson, 2013). The muscular role played by the European Council and the Eurogroup in crisis management is part of the explanation here because it limited the room for Commission leadership. Yet, the Commission did not openly challenge this division of labour but worked, often behind the scenes, to support European Council and Eurogroup decision-making and implementation. The Commission's administrative resources were key in monitoring the implementation of the financial assistance packages—next to the ECB and the IMF, the Commission was a member of the so-called **troika missions**. It also provided administrative support to the Greek authorities. In the context of institutional reform, the Commission essentially worked towards implementing political agreements reached within the European Council. Though it formally

issued the legislative proposals which provided the basis for the six- and two-pack reforms as well as for the Banking Union (see Box 26.3), the Commission took its political cue from EU member states.

Some scholars see the Commission's role as having been significantly strengthened as a result of these changes (cf. for example, Majone, 2014; Chapter 10) but this assessment is open to question. A review of the major crisis-related institutional reforms (see Box 26.3) shows few instances in which the Commission gained significant new competences in the light of the crisis. Both the 'six pack' and the 'two pack' have essentially reinforced the role played by the Commission before the crisis: that of delegated monitoring with the power to sound the alarm when national governments fail to meet certain criteria, rather than an agent empowered to formulate and implement economic policies on behalf of member states (Hodson, 2009). Both reform packages give the Commission a wider range of criteria to monitor and increase the potential scope and intrusiveness of policy recommendations. Similarly, a new reverse majority rule strengthens the agenda setting powers of the Commission by ensuring that proposals for corrective action against member states that breach the excessive deficit and excessive imbalance procedures will be carried (in some cases) unless a qualified majority of member states disagree.

The real test of the Commission's role in the light of the crisis will occur if and when it finds itself on

BOX 26.3 MAJOR INSTITUTIONAL REFORMS: 'SIX PACK', 'TWO PACK', FISCAL COMPACT, AND BANKING UNION

Two major institutional reforms were adopted in the form of new secondary legislation introduced under Articles 121, 126, and 136 TFEU. The six pack, which entered into force in November 2011, reforms existing reprimand and surveillance mechanisms so far regulated by the Stability and Growth Pact (SGP) in the following way:

- greater emphasis on total government debt in excess of 60% of GDP in EU fiscal surveillance;
- more frequent use of pecuniary sanctions so as to allow for financial penalties sooner rather than later under the excessive deficit procedure;
- 'reverse voting' according to which Commission recommendations for corrective action in relation to the SGP will take effect unless they are opposed by a qualified majority of finance ministers;
- the creation of an excessive imbalance procedure; and
- changes to national budgetary rules so as to establish agreed minimum standards for, inter alia, public accounting and statistics, forecasts, and fiscal rules.

The two pack, which took effect in May 2013, tightens budgetary surveillance in a similar vein by requiring euro area member states to submit national draft budgets for the coming calendar year prior to their adoption for review by the Commission and the Eurogroup in October each year. Moreover, the new regulations stipulate specific conditions for the monitoring of countries receiving euro area financial assistance.

The Fiscal Compact, or in full, the Treaty on Stability, Coordination and Governance in the EMU, which entered into force in January 2013, contains both a statement of broader political commitment and novel definitions of the roles of individual institutional actors and the member states. Under this intergovernmental treaty, which was signed by all EU member states except the Czech Republic and the UK, though the Czechs signed later, governments have committed themselves to support the Commission, when it issues recommendations and proposes sanctions under the excessive deficit procedure, and pledged to introduce national-level legislation which implements the EU budget rules in domestic constitutions or budgetary legislation. The Court of Justice for the first time is given a potential role in the excessive deficit procedure as member states—not the Commission—can now call on the Court should governments fail to implement recommendations under the excessive deficit procedure. Finally, the lead role of the Euro Summit, which brings together euro area heads of state or government in an informal setting which was not foreseen by the Lisbon Treaty, is codified.

A Banking Union—or, at any rate, key elements of it—were agreed by the European Council in December 2012. The project is based on a comprehensive set of legal provisions which stipulate that the financial industry in the EU is regulated according to a single rulebook and is subject to a Single Supervisory Mechanism. In November 2014 the role of the single supervisor was taken over by the ECB. A Single Resolution Mechanism will apply in case of bank resolution and the build-up of a Single Resolution Fund was kicked-off in 2016 on the basis of private sector contributions. It is supposed to reach its full size by 2023. A European deposit insurance scheme, which is envisaged to protect individual savers up to €100,000, is yet to be implemented. It is modelled on existing national insurance schemes, while offering protection regardless of potential asymmetric shocks.

a collision course with member states over their economic policies. The EU executive can appeal under such circumstances to its independence and technocratic expertise but its perceived problems of legitimacy are also an easy target for national politicians seeking to deflect blame for their policy mistakes to Brussels. Moreover, in the past the Eurogroup did not find it difficult to unite when it came to fending off Commission recommendations which were not seen to be appropriate; a practice which suggests that the new reverse majority rule may be a much less powerful instrument for the Commission than it seems. Because of this tension, the Commission is likely to rely even more on the tacit support of the Eurogroup and, in cases of highly controversial decisions such as financial sanctions, the European Council. The political sensitivity of the euro area economic governance portfolio was also reflected in the allocation of portfolios under the Juncker Commission, which took office in November 2014. Juncker's team included the former French finance minister and Eurogroup member Pierre Moscovici as the Commissioner for Economic and Financial Affairs but also put the portfolio under the close oversight of the Commission President and a dedicated Vice President.

The 'six pack' and 'two pack' reforms show EU member states' willingness to reinforce the Commission's role as an economic watchdog by increasing its bark if not its bite. Other reforms show an even more marked reluctance by national governments to give new competences to the Commission. The most clear-cut case concerns the EU's role in crisis management. The European Council of December 2010 agreed on a limited revision to Article 136 TFEU to allow for the activation of a stability mechanism 'if indispensable to safeguard the stability of the euro area as a whole'. It was on this legal basis that the ESM was created in July 2011 with the signing of a special intergovernmental treaty setting out the statutes of the ESM and authorizing it to lend up to €500 billion to euro area members. Euro area member states act as shareholders of the fund and have contributed the base capital, which is in turn used to lend capital on international financial markets to finance ESM assistance packages. The ESM Board of Governors is composed of the euro area finance ministers and the Eurogroup president as its chair. The ESM is a *de novo* institutional structure, which is based on pooled member state resources rather than on the EU budget. The Commission is given a key role in negotiating and monitoring the conditions attached to ESM loans—alongside the ECB and IMF—but it attends meetings of the ESM Governing Council in an observer capacity only and has no say over ESM resources.

The ECB, rather than the Commission, is arguably the key winner from Banking Union. Under the single supervisory mechanism, the first pillar of Banking Union, which began operating in November 2014, the ECB has assumed overall responsibility for the supervision of over 3,000 banks in the 18 members of the euro area. To this end, a new Supervisory Board has been established within the ECB and given responsibility for, inter alia, assessing the stability of these financial institutions and licensing them. The second pillar of Banking Union is a Single Resolution Mechanism to deal with failing banks. Under proposals put forward by the Commission in July 2013, the Commission would have been formally responsible for deciding whether a failing bank should be resolved with the question of what form such resolution should take resting with a board comprising representatives of the Commission, ECB, and national authorities. Cautious though this proposal was in some respects it went too far for the Economic and Financial Affairs (ECOFIN) Council, which decided that decisions on whether to resolve a bank should rest with the ECB and national representatives but not the Commission (see Howarth and Quaglia, 2014).

The Eurogroup

Already prior to the euro crisis, the **Eurogroup** was the lead forum for economic policy coordination and decision-making under EMU. The informal forum comprising euro area finance ministers, the Commissioner for economic and financial affairs, and the ECB president, which was created by the European Council in December 1997, assumed an important role right from the start of the final phase of EMU, with ECOFIN devoting less and less time to EMU matters (Puetter, 2006). The Eurogroup has been busier than ever in response to the euro crisis. It was the Eurogroup which negotiated the allocation of capital and loan guarantees to the EFSF and which now effectively exercises the political oversight powers over the ESM. The Eurogroup has also been in charge of implementing and assessing compliance with the economic policy programmes accompanying all financial support packages adopted so far. Euro area finance ministers play the central political role in the newly

adopted surveillance, reprimand, and sanctioning mechanisms (see Box 26.3). The intensification of Eurogroup activity has been reflected in the fact that the group, since the beginning of the crisis, has been convened repeatedly more than once per month. Moreover, the Eurogroup's preparatory infrastructure has been expanded in the wake of the crisis. It is led by the Eurogroup Working Group (EWG), a high-level coordination committee of senior finance ministry officials from the member states, the Commission, the ECB, and a full-time president. The EWG itself is now supported by a committee of Brussels-based EWG alternates. Though already an important political body before the crisis, the Eurogroup has gained substantial new responsibilities and has become one of, if not the, most powerful and most frequently convened group of ministers in Brussels. The group and its preparatory infrastructure is at the heart of a dense web of day-to-day coordination activities involving the finance ministries of euro area member states and the Commission's Directorate-General for Economic and Financial Affairs.

European Council leadership

Another major indication of how the new intergovernmentalism has been intensified as a result of the euro crisis is the direct and frequent involvement of the European Council in aspects of day-to-day euro area decision-making. Whereas the heads of state and government have already played an increased role in overseeing EMU economic governance and various related coordination routines such as the **Lisbon Agenda** since the end of the 1990s, the crisis was a catalyst for closer top-level coordination. Never before in the history of EU decision-making have the heads of state or government met so often as during the euro crisis. While the European Council was convened on average three times a year before the launch of EMU, it now meets at least seven times. Economic governance issues constitute by far the most important agenda item of the forum (Puetter, 2014: 91–7). In 2011, the heads gathered for a total of 11 summit meetings—some of them held for all EU member states, some exclusively for the euro area. The practice of convening additional summit meetings only for euro area heads was first introduced in October 2008 when an emergency summit in Paris discussed the unfolding banking crisis. In October 2011, the euro area heads decided to further institutionalize this meeting format by referring to it as the Euro Summit and invited the Eurogroup to act as its preparatory forum.

These institutional developments were further helped by the entering into force of the Lisbon Treaty, which created the position of a full-time European Council president by the end of 2009. In this capacity the former Belgian Prime Minister Herman Van Rompuy quickly began to call additional meetings of the euro area members of the European Council and coordinated political agreement among the heads. The reason for the growing involvement of the heads was mainly that many crisis management decisions cut deep into domestic politics and would not have been possible without strong political backing. Often decision-making was tied to the political fate of individual member state governments. Moreover, crisis management involved a number of institutional decisions which had been unprecedented so far and for which the existing legal basis was partially contested, as the example of the first financial support package for Greece in 2010 illustrated. Except for the financial assistance package for Cyprus, the heads insisted on finalizing all financial aid decisions themselves and only left implementation to the Eurogroup.

In March 2010, together with the pledge to help Greece, the European Council agreed in principle to broader EMU institutional reforms. The European Council president chaired the preparatory work of EU finance ministers on institutional reform between May and October 2010—the so-called **Van Rompuy Task Force**. From then on, until December 2012, the European Council and its euro area formation met frequently to decide on all major institutional reforms (see Box 26.3). In each case, the European Council set the political agenda and provided detailed instructions for other institutional actors—notably the Commission, the ECOFIN Council, and the Eurogroup—to work towards the implementation of specific institutional reforms. Legislative proposals were issued and adopted at high pace and also found approval from the European Parliament (EP). How determined (most) heads of state or government were to press ahead with institutional reforms became clear in December 2011 when the British Prime Minister, David Cameron, refused to support plans for further changes to the Lisbon Treaty to facilitate closer cooperation between the euro area and other willing member states. In response to this impasse, the European Council moved quickly and negotiated the so-called Fiscal Compact (see Box 26.3) in the form of an intergovernmental treaty. The

fact that this treaty was negotiated outside EU law, but still impinges on the work of EU institutions and their relations with each other and the member states, showed how much the European Council was willing and able to bend existing constitutional principles.

In other words, the episode showed once again how much weight direct agreement between the heads of state and government within the European Council carried within the context of euro crisis management politics. Even though agreement often proved cumbersome, once adopted, European Council decisions had far reaching consequences for how the EU currently operates. It thus can be said that the European Council has become the 'new centre of political gravity' (Puetter, 2014) in euro area economic governance. This institutional development reflects both the deepening and the widening of economic policy coordination as collective EU-level decision-making has become far more important for domestic politics than it ever was. Moreover, both increased Eurogroup and European Council activity showed how much EMU economic governance relies on permanent consensus generation among the EU's most senior decision-makers. The further institutionalization of these bodies as forums for face-to-face policy deliberation which allow policy-makers to collectively react to unforeseen crisis situations and novel policy challenges can be understood as a new **deliberative intergovernmentalism** among euro area leaders (Puetter, 2012).

KEY POINTS

- The euro crisis triggered a number of major institutional reforms and EMU economic governance is now wider in scope and cuts deeper into domestic politics than it has done ever before.
- Integration has been deepened but without major new transfers of powers to the supranational level; instead intergovernmental policy coordination has been intensified substantially.
- The European Council and the Euro Summit assisted by the Eurogroup have played a lead role in the EU's response to the euro crisis and this role has been further institutionalized by the Fiscal Compact.
- The Commission has been given new responsibilities under reforms agreed in the light of the euro crisis, but the Eurogroup and the European Council remain in the driving seat.

The crisis and the EU's problems of legitimacy

The euro crisis followed a period of comparative economic calm—2008 was the first time since the single currency had been launched that the euro area experienced a recession—but it was just the latest in a series of political shocks to hit the EU over the last two decades. Others terms in this series include Denmark's rejection of the Maastricht Treaty in 1992, the resignation of the Santer Commission in 1999, Ireland's 'no' votes against the Nice Treaty in 2001 and the Lisbon Treaty in 2008, and the abandonment of the European Constitution after failed referendums in France and the Netherlands. Together, these and other events mark the end of what Lindberg and Scheingold (1970) called 'the **permissive consensus**' over European integration. One manifestation of this trend is rising public scepticism about the benefits of EU membership. In 1991, 71% of EU citizens agreed that membership was a good thing. By the time that the global financial crisis struck in 2007, this figure had fallen to 56%, and by the end of 2013, it had reached 50% (see Eurobarometer, at http://ec.europa.eu/public_opinion/cf/index_en.cfm).

The meaning of the euro crisis for the EU's legitimacy is the subject of an ongoing and lively debate in the academic literature. For Moravcsik (2012), national governments acted with 'remarkable flexibility' to stabilize the single currency even if doubts remain over its long-term viability. Challenging the idea that Germany did too little too late to prevent the crisis from escalating, he praises Angela Merkel's government for showing leadership over the euro crisis and bearing significant costs in dealing with it. In keeping with his liberal intergovernmentalist approach, he sees Germany and other member states as acting not for reasons of ideology or altruism but because the economic costs of seeing the euro dissolve would have been catastrophic. While acknowledging that EMU's problems are far from over, Moravcsik (2012) concludes that 'Europeans should trust in the essentially democratic nature of the EU, which will encourage them to distribute the costs of convergence more fairly within and among countries'.

Scharpf (2011) offers an altogether darker reading of the euro crisis, which he sees as fuelling a 'crisis of democratic legitimacy' in the EU. He reserves harsh criticism for the troika, which he describes as a form

of 'economic receivership' that has foisted painful economic policy adjustment on Greece and other member states rather than allowing national politicians and voters to reach a consensus on what had to be done. For Majone (2014), concerns over legitimacy go beyond the terms of emergency financial support to the reforms to euro area governance enacted in the light of the crisis. The crux of his argument is that the crisis has taken the EU yet further away from its roots as a regulatory regime. The new powers of economic surveillance entrusted to the European Commission under the 'six pack' and other reforms, he argues, go well beyond the kinds of functions that are and, more importantly, should be delegated to non-majoritarian institutions. Majone (2014) points the finger at both the European Commission and a subset of Germany and other member states, which he sees as being driven by a liberalizing zeal and which insist on reforms as a quid pro quo for providing financial support.

Implicit in the debate between these authors is the age-old question of whether the EU answers to its member states. It does for Moravcsik, who thus sees concerns over the EU's legitimacy as overblown, but does not for Scharpf (2011) and Majone (2014), who thus cry foul over how the euro crisis has been handled. Bickerton et al. (2015a, 2015b) offer a different take on this issue and argue that member states were in the driving seat of the European integration process while questioning the legitimacy of the choices they made. This new intergovernmentalist approach sees the EU's response to the euro crisis as symptomatic of national governments commitment to cooperative solutions but reluctance to delegate new powers to old supranational institutions along traditional lines. This explains the dominance of the Eurogroup and European Council in dealing with the crisis and member states' preference for empowering *de novo* institutions such as the ESM rather than the Commission. Yet national governments themselves cannot be sure of representing societal interests when acting at the EU level as their ability and willingness to accommodate and represent these interests has become increasingly contested. The result is a dangerous discord between elite and popular preferences which has taken hold in the EU since the early 1990s, but which has intensified as a result of the euro crisis.

The euro crisis has not only shaped the general direction of European integration (see Box 26.4). It can be also seen as a specific test case as to whether and to what extent closer euro area integration is compatible with the EU's original pledge to operate a broad socio-economic governance agenda for all its member states. The euro crisis was a test for the integration of economic governance with the EU's social and employment policy coordination portfolios in the sense that the latter dimension was almost absent from crisis management. Attempts by the European Council to reinstate this link through new initiatives in 2012 and 2013 speak to this point but came very late in the crisis management cycle. There is little doubt that the euro crisis has strained relations between the euro area and non-euro member states. This became plain as the European Council started to meet in the configuration of the Euro Summit, but it was also revealed by fundamental opposition from UK Prime Minister David Cameron, who not only rejected more comprehensive treaty change but also openly questioned whether the UK can remain part of a more closely integrated EU in which politics revolve around a closely integrated euro area. Moreover, member states which are eager to join the euro area in the future, or are in favour of closer EU-wide socio-economic policy coordination, have criticized crisis management procedures for excluding them from far-reaching decisions on institutional reform. The appointment of Donald Tusk, a former Prime Minister from a non-euro area country, as president of both the European Council and the Euro Summit, can be seen as an attempt to mitigate these tensions. Moreover, euro area member states have not used the Euro Summit meeting format as frequently as at the height of the sovereign debt crisis.

KEY POINTS

- EU scholars are engaged in a debate on what the euro crisis means for the EU's perceived problems of legitimacy.
- Opinion is divided over whether the EU's response to the euro crisis reflects the collective will of the member states and what this means for the Union's legitimacy.
- National governments cannot be sure of representing societal interests when acting at the EU-level. The crisis raises fundamental questions about the relationship between the euro area and other EU member states.

BOX 26.4 THE EURO CRISIS AND THE FUTURE OF THE EU

The euro crisis had a profound and lasting impact on European integration. This impact has reached well beyond questions of immediate crisis management such as emergency financial assistance and institutional adjustment. Most importantly, it showed how closely the fate of the Union has become intertwined with that of the single currency and how the fate of the euro rests on the ability of national governments to achieve consensus on difficult and unpopular choices under considerable time pressure. An indicator for this is how citizens think about EU integration. In 2007, before the global financial crisis was fully felt in the EU, the Eurobarometer recorded that 62% of the citizens of the newly enlarged Union felt very or fairly attached to the EU. During the crisis this support dropped markedly. By 2012 when several financial aid packages had been adopted and the conditionality of the adjustment programmes was felt in the euro area's most affected member states, the Eurobarometer recorded a post-enlargement record low of 45% of citizens who felt attached to the EU. By 2017 levels of positive attachment to the EU had again increased to 54%. While support in countries like France, Germany, and Spain had come back strongly and was partially even above the 2007 levels, it had stagnated at the 2012 low in Italy where it remained well under 50% and had even further deteriorated in Greece, compared with 2012.

Another issue intertwined with the euro crisis is Brexit. Even though it would be wrong to identify the euro crisis as the cause of long-standing and deep-rooted euro scepticism among large parts of the British political elite, the euro crisis undoubtedly provided ammunition to the anti-EU rhetoric of the Leave campaign. At the level of EU politics the euro crisis hindered efforts by British Prime Minister David Cameron to renegotiate the terms of the UK's EU membership ahead of a referendum which he had planned to win on the basis of a new settlement with Brussels. Cameron failed to win over other EU leaders. Rather, the latter had aligned over the question of euro area reforms, agreeing that this was their top priority. This led to the adoption by most member states of the Fiscal Compact (see Box 26.3) against the explicit desire of the UK. Cameron's attempted veto of this agreement lost him credit with other leaders. As the UK's former European Council Sherpa and Permanent Representative in Brussels Ivan Rogers recalled in a lecture at Oxford in November 2017, other EU leaders did not even notify Downing Street about their intention to press ahead with an intergovernmental treaty outside the EU treaty framework (see https://www.politico.eu/article/ivan-rogers-david-cameron-speech-transcript-brexit-referendum/ (accessed 14 December 2017)). Political differences of this magnitude would have been highly unlikely within the consensus-based European Council environment prior to the euro crisis. Whatever influence the euro crisis had on the outcome of the UK's EU referendum, it undoubtedly revealed British elites' frustrations with the way in which the EU's future had become fused with that of EMU.

The euro's status as a bellwether for the Union can also be seen in domestic developments in some of the euro area's most important member states. In France, Marine Le Pen saw her electoral prospects increase in advance of the 2017 presidential election as the euro crisis deepened and she campaigned for an 'orderly' exit from the single currency. In Germany, it is no coincidence that Alternative für Deutschland, with its new brand of German euroscepticism, was founded at the height of the euro crisis in 2012. Next to its anti-migration policy stance, opposition to the ESM has been a crucial element in its campaigns. In Italy, the 2018 general election saw two parties that had been highly critical of euro area membership win power. The Five Star Movement and the League softened their rhetoric on the euro but they insisted that Italy be given leeway under the EU's fiscal rules to increase government expenditure and cut taxes. The country's poor growth performance argued against further austerity but its high debt levels triggered financial market concerns about further borrowing. Negotiations with the EU continued at the time of writing, amid mounting fears that Italy might trigger a new phase of the euro crisis. Negotiations of this sort are not unknown in Italian politics, with former Prime Minister Matteo Renzi putting pressure on the Eurogroup in 2016 and 2017 to soften enforcement of the Stability and Growth Pact while the Italian government implemented economic reforms. Meanwhile, wealthier member states, led by Germany, refuse to move on to full implementation of Banking Union, and most notably the launch of a European deposit insurance scheme (see Box 26.3) and the enlargement of the ESM as long as problems in the banking sector persist in some countries. The stand-off reveals a fundamental legitimacy dilemma which has emerged in the aftermath of the euro crisis. Politicians in mainly northern European member states are eager to reassure their constituencies that additional financial resources for rescue mechanisms, which are designed to address future crises, are not transferred to financially weaker member states. Yet, politicians within the latter group of countries are at pains to explain that euro area fiscal policy rules are a constraint on domestic democracy.

The euro area's inability to put a definite end to the euro crisis experience was laid bare in 2017 when elections in the euro area's biggest economies—France and Germany—led to a period of prolonged disengagement with euro area reform.

(continued)

BOX 26.4 THE EURO CRISIS AND THE FUTURE OF THE EU *(continued)*

France became the scene of a dramatic electoral campaign in which Marine Le Pen campaigned for leaving the euro and holding a referendum on EU membership. She was defeated only in the second round of the presidential elections, as well as in the subsequent parliamentary elections to the National Assembly, by Emmanuel Macron and his new political movement, En Marche. Macron had campaigned on an explicitly EU-friendly ticket. He took office when Germany went into election mode and wasted no time in mapping out his ideas for EU reform while outlining a markedly euro area-centric vision of the EU's future. Yet, instead of setting the scene for a new German government, as Macron had hoped, Germany's leading politicians for the first time in the Federal Republic's history failed to form a coalition government in the immediate aftermath of elections, which saw Angela Merkel's CDU/CSU party and Martin Schulz's SPD haemorrhaging votes to Alternative für Deutschland.

Whereas Macron, on a European round-trip advocating his EU reform proposals, did not visit Hungary and Poland, which had witnessed a pronounced downward revision of core rule of law and democracy standards, he received a more positive response from the only euro area member among the so-called Visegrad countries, Slovakia. In reaction to Macron's proposals to make the euro area the core of a multi-speed EU, Slovak Prime Minister Robert Fico asserted his ambition to be part of this core and referred to his country as a 'pro-EU island in this region' (Euractiv, 24 October 2017). While the euro area still struggles to heal its divisions in the aftermath of the euro crisis, and engages in further institutional reforms, which are aimed at enhancing solidarity and burden-sharing, the EU's further institutional development is increasingly seen to be dependent on whether the EU might be able to leave some of its more reluctant members behind.

Conclusion

In 2008, the euro area celebrated the tenth anniversary of EU member states' decision to press ahead with the third and final stage of EMU. These celebrations were low key but infused with a sense of relief that EMU's first decade was not the disaster that some of its critics had predicted. Fireworks of a different sort were to come, however, when the global financial crisis that had begun the previous year led to a sovereign debt crisis that came close to tearing the single currency asunder. This scenario would have been a major catastrophe for the EU and, indeed, the world economy. The fact that it was avoided was due to good fortune and a set of policy responses that did just enough before it was too late to regain the confidence of financial markets. The euro area members at the epicentre of this crisis—Cyprus, Greece, Ireland, Portugal, and Spain—received emergency financial support from the EU and IMF, but paid a devastating price in view of the austerity measures that they had to endure. This combination of financial support and fiscal austerity allowed these member states to weather the storm—although some would argue that there were better places to take shelter—but in the end it was the ECB's commitment to do whatever it takes to preserve the single currency that prevented the sovereign debt crisis from spreading further in 2012. This commitment was a balm rather than a cure and serious concerns remained over the economic outlook for the euro area several years later.

Opinion is divided on whether a lack of European integration is to blame for the euro crisis and whether deeper integration is likely to be its legacy. The answer to these questions depends, of course, on how integration is defined. Scholars have traditionally equated integration with supranationalization, with some suggesting that a centralization of powers would have helped to mitigate the euro crisis and others seeing centralization to come. This chapter has challenged these views. A more centralized approach to fiscal policy and financial supervision would not have inoculated the euro area against the global financial crisis, it was argued, and may even have made matters worse. The ECB's belated decision to commit to unlimited bond purchases, moreover, relied on the belated use of an existing policy competence rather than the acquisition of a new one. Turning from cause to consequence, this chapter sees the EU as tending not towards a supranational system of policy-making following the euro crisis, but as reinforcing the new intergovernmentalism which prevails within the field of EMU economic governance. This trend can be seen most clearly in member states' reluctance to empower the Commission in the light of the crisis, in their preferences for deliberation through bodies

such as the Eurogroup and European Council and delegation to *de novo* bodies such as the ESM, and in the worrying disconnect between politicians and the people as European integration intensifies in unfamiliar ways. The political controversy surrounding the conditions of financial assistance to Greece in 2015 provided a dramatic illustration of this disconnect between elites and citizens. Difficulties on the part of Italian political elites in putting the country's financial sector on a safer path and stimulating the economy in the aftermath of the crisis' most dramatic moments still represent a major risk that the euro crisis may return. Moreover, the finalization of Banking Union has stalled as Germany and other wealthier euro area member states insist that they will only commit to new financial instruments and rescue mechanisms after ongoing local problems have been resolved domestically.

QUESTIONS

1. What are the key characteristics of the EU's response to the euro crisis?
2. Why and how are the heads of state and government seeking closer control over EU economic governance in view of the euro crisis?
3. Did the Commission acquire new powers as a result of the euro crisis?
4. Can closer integration be achieved through intergovernmental policy coordination within the euro area and, if so, how does it happen?
5. To what extent does the EU develop through crises?
6. Why did the euro crisis affect euro area member states differently?
7. How has the euro crisis affected the relationship between euro area members and other EU member states?
8. In what way does the Fiscal Compact change EU economic governance? Why was it concluded outside the EU Treaty?

GUIDE TO FURTHER READING

Bickerton, C. J., Hodson, D., and Puetter, U. (2015a) 'The new intergovernmentalism: European integration in the post-Maastricht era,' *Journal of Common Market Studies*, 53/4 : 703–22 This article identifies six broad hypotheses for understanding European integration in the post-Maastricht era. It is a helpful background reading to the explanation of what impact the euro crisis had on integration as outlined in this chapter.

Hodson, D. (2011a) *Governing the Euro Area in Good Times and Bad* (Oxford: Oxford University Press) This book discusses the evolution of euro area governance, from the launch of the single currency in 1999 to the beginning of the sovereign debt crisis in 2010.

Hooghe, L., Laffan, B., and Marks, G. (eds) (2018) 'Special Issue: Theory Meets Crisis', *Journal of European Public Policy* 25 (1) This special issue offers competing perspectives on the EU's crises from some of the leading theorists of European politics.

Matthijs, M. and Blyth, M. (eds) (2015) *The Future of the Euro* (Oxford: Oxford University Press). This edited collection contains essays on the euro crisis from leading scholars in the field of international political economy.

Puetter, U. (2012) 'Europe's deliberative intergovernmentalism: the role of the Council and European Council in EU economic governance', *Journal of European Public Policy*, 19/2: 161–78 This article explores intergovernmental responses to the euro crisis and the emerging role of euro area heads of state and government in the governance of EMU.

Schelkle, W. (2017) *The Political Economy of Monetary Solidarity: Understanding the Euro Experiment* (Oxford: Oxford University Press) This important book challenges the idea that economic differences between euro area members is necessarily a problem for the smooth functioning of EMU, viewing the single currency instead as a clever but contested form of risk sharing.

WEBLINKS

http://blogs.ft.com/brusselsblog/ The *Financial Times* Brussels Blog provides up-to-date news on the unfolding economic crisis and other EU issues.

http://ec.europa.eu/economy_finance/economic_governance/index_en.htm The European Commission's DG ECOFIN offers online access to key legal and political documents on the new economic governance framework.

https://www.ecb.europa.eu/home/html/index.en.html The website of the European Central Bank (ECB).

http://www.voxeu.org VOXEU provides a commentary on the economic crisis and other issues from leading economists.