



transform!
europe

ePaper

June 2017



Christakis Georgiou

Economic governance in the EU after the Eurozone crisis: a state of affairs

Report prepared for transform! europe

Christakis Georgiou

Economic governance in the EU after the Eurozone crisis: a state of affairs

REPORT PREPARED FOR TRANSFORM! EUROPE

TABLE OF CONTENTS

Introduction	3
Executive summary	5
1. The post-Maastricht evolution of the EU's economic governance institutions	7
A) The EU's economic governance architecture before the Eurozone crisis: the institutional imbalance of an incomplete EMU	8
B) The innovations introduced during the Eurozone crisis: tentative steps towards redressing the imbalance	14
2. The economic and political consequences of the EU's economic governance architecture	21
A) Economic consequences	21
I. The lead-up to the Eurozone crisis: bubblenomics and growing wage divergence lead to macroeconomic imbalances and lay the ground for the 2010-12 speculative crisis	21
II. The Eurozone's economic direction since the Eurozone crisis: asymmetric adjustment in a deflationary context and its recessionary consequences in 2011-13	25
B) Political consequences of the Eurozone crisis	29
I. The shift of further powers to the European level and the rise of asymmetric executive federalism on fiscal policy	30
II. The polarisation between Northern fiscal conservatives and Southern opponents of fiscal retrenchment and structural adjustment in the context of long-term structural shifts in mass politics	33

Christakis Georgiou holds a PhD in political science from the University of Montpellier and specialises in the political economy of European integration, in particular on the role of large corporations. As of the new academic year, he will be a post-doctoral fellow at the Centre de compétences Dusan Sidjanski en études européennes at the University of Geneva. His latest book is *"Les grandes firmes françaises et l'Union européenne"* (Le Croquant).

IMPRINT

2017 

transform! european network for alternative thinking and political dialogue
Square de Meeûs 25, 1000 Brussels, Belgium

transform! europe is partially financed through a subsidy from the European Parliament.

This work by transform! is licensed under a Creative Commons Attribution-NonCommercial-ShareAlike 4.0 International License. Permissions beyond the scope of this license may be available at office (at) transform-network.net.

Layout: sanja.at e.U.

Cover photo: "Gears from old mechanism", Depositphotos Inc./@Irochka

Introduction

PEDRO CHAVES, *Facilitator of the transform! Economic Governance Working Group*

This report is the first of a project that seeks to address in depth the issue of economic governance within the European Union, its impact in economic, social and political terms, and the various visions and proposals of the alternative Left in relation to this issue.

This task is undoubtedly an ambitious one, but it is also absolutely necessary. The transform! team working on this project, as well as the author of this report, Christakis Georgiou, share a central idea: that this element of what we might call EU public policy needs to be analyzed and understood well, including in terms of its implications and consequences. First, this is a matter of explaining with rigor that which appears obvious: an economic-institutional structure at the service of austerity policies. But this report has sought to – and succeeded in – departing from the beaten path of easy criticism. Instead, it uses and explores in depth the dynamics of economic governance, the reasons and logic behind the institutional mechanisms that have been put in place, and their consequences at various levels.

At the heart of the analysis lies one concern: to a large extent, the problems that arise in relation to economic governance require us, and the Left as a whole, to engage in deep reflection on the articulation of economic policy at the transnational level. The idea of solidarity and the internationalist project associated with the alternative Left is a very condition of our existence; an irreplaceable element of our political genetics. And yet we must recognize that we have rarely made the leap from general considerations to concrete proposals. And we have to admit something more, too: that some of the strategies of other global regions have proven to be impotent in the face of the economic challenges of globalization and its demands. Neither mechanisms of solidarity, nor structured cooperation, nor resource transfer, have been effective – I am referring here to experiences such as ALBA or UNASUR in Latin America.

For this reason, an in-depth reflection on economic governance must go beyond the typical litanies of our tradition against the logic of capitalism, and instead seriously address the reasons behind our criticisms. If we take this path, eventually, we will discover that there are things worth reflecting upon. We will learn how to build institutions and institutional relationships that are virtuous in

democratic terms, while being mutually-supportive and generous in economic terms.

The willingness to tackle this work with rigor and seriousness also has another purpose. We are aware that there are different perspectives and opinions on the issue of economic governance within our tradition. And, because of this, the political parties associated with our political space offer clearly differentiated, and sometimes antagonistic, alternatives. To a large extent, to talk about economic governance is to talk about the integration project itself and its future.

It is not the intention of this project to defend one position against others, and this is not for reasons of intellectual eclecticism. Rather, we think the debate is far better served by our attempting to do two things: provide quality input into the analysis, and promote spaces for dialogue between the various alternatives.

That is why we invited professionals, academics and activists who defend different and opposing positions to participate in drawing up this document – and we must say that the experience has proven to be highly enriching.

We are very confident that the continuation of this project will contribute to this dialogue between different perspectives. Of course, there are other ways and paths that have been opened, but this space can make an important contribution. This work owes a great deal to the generous and selfless efforts of several dozen people who have given us their ideas, proposals and time. We owe a debt of gratitude to each of them on behalf of the team of people working on this project, and on behalf of transform! europe.

This report is the culmination of several preparatory meetings, contact with many people, and a workshop held in Brussels on 13 and 14 October 2016. When preparing the report, we sent the first draft to all of participants in the initiative, as a result of which the text has undergone changes that have undoubtedly made it both richer and more nuanced.

The debate continues and looks set to continue in the coming years: the EU's activities in the field of economic and monetary union have not stopped, and nor will they. One of the most powerful conclusions of this work is that we should take great care when applying the word "crisis"

to European Union. In the face of the somewhat mechanistic idea that the EU would endure an inevitable collapse associated with the Euro or economic and monetary union, this report argues that Europe's economic and political elites have a vested interest in maintaining the EU, and that, by one means or another, the project will therefore be maintained and strengthened. The key to the vault was the European electoral cycle, and it seems that the outcome – elections in the UK included – could not have been more favorable to the mainstream.

And so the natural disintegration of the European project has been ruled out. However, it still remains to be seen what we should do, say and propose in a scenario where the EU is a cornerstone of the economic, social and political life of our countries. We are confident that this report will, in some way, provide rigorous analysis on a subject that is of the utmost importance for our capacity, as forces for political change, to design alternative scenarios.

Members of the transform! Economic Governance Working Group

Team Coordinator: **Pedro Chaves**

Members of the Team: **Elisabetta Cangelosi, Sigfrido Ramírez, Christakis Georgiou, Dimitri Zurstrassen, Pablo Sánchez, Judith Dellheim, Angelina Giannopoulou**

Participants in the Workshop: "Is it possible to reform EU economic governance?"

Held in Brussels on 13 and 14 October 2016

Máxime Benatouil, Maite Mola, Pedro Chaves, Sigfrido Ramírez, Kenneth Haar, Agustín José Menéndez, Daniel Albarracín, Dimitri Zurstrassen, Katherine Sifakis, Ramón Boixadera, Judith Dellheim, Vladimir Cvijanovic, Bruno Estrada, Christakis Georgiou, Elisabetta Cangelosi, Corinne Gobin, Gabriel Moreno, Pablo Sánchez, Paloma López, Paul Jorion

Executive summary

1. The institutional framework for economic policy that emerged in the EU following the Maastricht treaty was incomplete and imbalanced. The key institutional deficiency was that while monetary policy became centralised, fiscal, wage and banking policies remained highly decentralised. Crucially, the policy framework did not provide for a lender of last resort for member states and lacked clarity on the Eurosystem's role in preserving financial stability. The Eurozone lacked sufficient state capacity to guarantee the credit risk-free status of public debt and to deal with potential adverse shocks, in particular with so-called asymmetric shocks that require inter-regional transfers to be smoothly dealt with.
2. The Eurozone crisis exposed the deficiencies of the EU's economic governance architecture and has already resulted in a number of more or less substantial institutional innovations in an attempt to bridge the most glaring gaps. The lack of a lender of last resort for member states was dealt with and the Eurosystem's role in preserving financial stability was made clear while the banking union reforms have substantially centralised banking policy. However, fiscal and wage policies remain decentralised despite tentative steps towards a greater degree of coordination among member state policies. Thus, some of the key levers of economic policy in the Eurozone, namely German fiscal and wage policies, are wielded solely in view of how Germany is to conform to the SGP's criteria and irrespective of the collective needs of the Eurozone as a whole.
3. The economic consequences of the deficiencies of the EU's economic governance architecture were clearly visible in the shape of the Eurozone crisis. The single monetary policy gave a huge expansionary push to deficit member state economies and stoked various bubbles, notably in the property market. The decentralised structure of banking policy further fuelled these bubbles because of each member state regulator's attempt to protect and promote the banks under its watch. Finally, the decentralised structure of fiscal and wage policies allowed Germany to pursue a policy of competitive disinflation which contributed in the accumulation of macroeconomic imbalances within the Eurozone.
4. The EU's economic policy framework – despite the innovations introduced under duress during the crisis – reinforced the recessionary impact of the 2010-12 speculative crisis and imposed an asymmetric adjustment process on deficit member states. The introduction of a lender of last resort for member states and the Eurosystem's unconventional monetary policies slowed down the pace of the unwinding of macroeconomic imbalances but the persistence of a decentralised and uncooperative fiscal policy framework meant that the Eurozone's overall fiscal stance was pro-cyclical and contractionary until 2014. Moreover, the decentralised banking policy framework slowed down the cleaning up of bank balance sheets and prolonged the financial crisis conditions – in particular the credit crunch in the interbank market – which furthered weighed down on economic activity in the Eurozone. The overall direction of the Eurozone since 2010 has therefore been strongly disinflationary.
5. The institutional innovations introduced as a response to the Eurozone crisis have also had significant constitutional consequences. Substantial powers have been shifted from the national to the European level of government in an unconventional and improvised manner. This shift has been at the detriment of democratic legitimacy and accountability in that its net result has been to empower the executive branch of government to the detriment of the legislative branch. This 'executive federalism' is, moreover, asymmetric in character because its intergovernmental nature in the fields of fiscal, economic and labour market policies means that it functions according to the logic of relative bargaining power, thus empowering surplus member states to the detriment of deficit member states. Its intergovernmental nature also sets it apart from the established constitutional settlement based on the Commission's legislative initiative and the co-decision procedure involving the Council and the Parliament. As such, it has fuelled a crisis of the constitutional consensus.
6. The impact of the Eurozone crisis on mass politics is more difficult to discern. Broad developments in labour movement strength and labour struggles, the electoral

rise of the populist right and Euroscepticism in public opinion largely follow pre-Eurozone crisis trends and do not seem to have been much impacted by the crisis. Rather, the crisis has polarised the European body politic between fiscal conservatives in surplus member states and left-wing opponents of adjustment efforts in the deficit member states.

The aim of this report is to provide a general overview of the evolution of the EU's economic governance architecture, and in particular of the impact that the Eurozone crisis has had on that evolution, as well as to present a broad outline of its economic and political consequences.

The Eurozone crisis and its consequences have been the most important political development in Europe over recent decades. By general admission, the crisis shook the EU's institutional foundations to their very core and has highlighted the fundamentally incomplete nature of its overall economic policy framework. Almost every single commentator agrees that the Eurozone needs to further integrate if it is to prevent the recurrence of similar crises and the prospect of disintegration.

As the report will outline, the crisis has already yielded quite significant institutional innovations. However, there is much more to come, especially since the major political players involved in the process – the Commission, the European Central Bank, the French and German govern-

ments – have already explicitly signalled their willingness to contemplate steps towards the setting up of a Eurozone finance ministry and Treasury that would operate its own budget. The December 2015 meeting of the European Council discussed the Five Presidents' Report on the completion of the EU's economic and monetary union and decided to return to the discussion about the setting up of a Eurozone 'fiscal capacity' in its December 2017 meeting¹, once, that is, the major electoral events of that year – the French presidential and the German general elections – will have taken place.

The report is structured in two parts. The first part looks at the evolution of the EU's economic governance institutions before and after the Eurozone crisis. The second part looks first at the economic consequences of the institutional framework, again both before and after the crisis. It then goes on to outline the political consequences of the Eurozone crisis, both in terms of the EU's constitutional settlement and in terms of mass politics in the Eurozone.

I. The post-Maastricht evolution of the EU's economic governance institutions

At the time that this report was drafted, the Eurozone crisis had already produced a number of more or less important changes in the institutional architecture of EU economic policy. All of these changes constitute attempts – some more radical than others – to redress what can be referred to as the institutional imbalance at the heart of the incomplete economic and monetary union architecture that emerged during the 1990s, first through the Maastricht treaty and then through the agreement on the Stability and Growth Pact.

The first sub-section provides an outline of the EU's economic governance architecture before the innovations introduced during and in the wake of the Eurozone crisis and highlights the institutional imbalance of a monetary union without a corresponding centralisation of banking policy and a substantial degree of fiscal federalism. Crucially, this imbalance involved the absence of a lender of last resort for Eurozone member states as well as a lack of clarity on the Eurosystem's role in preserving financial stability within the Eurozone (understood as a mandate to prevent and/or to manage liquidity crises that could threaten important – 'systemic' – financial institutions).

The second sub-section provides an outline of the institutional innovations ushered in during and in the wake of the 2010-12 speculative crisis and shows how they were designed as steps towards redressing the institutional imbalance by taking another leap forward into a greater degree of integration in the Eurozone. The institutional innovations that stand out are the federalisation of banking policy, the Eurosystem's assumption of financial stability functions and the multi-dimensional solution to the issue of the lender of last resort for sovereigns.

A) THE EU'S ECONOMIC GOVERNANCE ARCHITECTURE BEFORE THE EUROZONE CRISIS: THE INSTITUTIONAL IMBALANCE OF AN INCOMPLETE EMU

■ *Free movement of capital on an erga omnes basis*

It is often forgotten that the free movement of capital within the EU only dates back to 1990, not the Treaty of Rome (1957) or the Single European Act (1986). It is therefore useful here to remind readers that agreement on the free movement of capital was reached through a directive in June 1988² that set June 1990 as the date by which member states had to eliminate all restrictions on capital movements. The decision to move towards the free movement of capital was part and parcel of the broader decision to move towards monetary union, as the free movement of capital was to mark the entry into stage one of the three-stage process that would lead to the introduction of the single currency a decade later. Crucially, the 1988 directive also provided that member states would have to 'endeavour to attain the same degree of liberalization'³ for capital movements with third countries. The Maastricht treaty reinforced the *erga omnes* principle by prohibiting all restrictions on capital movements. The freedom of capital movements is therefore unique in that it equally applies within the EU and in relation to third countries, which is not the case for goods, services or labour.

The decision to universally apply the freedom of capital movements was the result of the German government's and the Bundesbank's insistence in the face of French and Italian reticence⁴, as well as more broadly the reticence of member states with weak currencies in the Mediterranean arc of the EU (the same set of member states that came under pressure in bond markets during the Eurozone crisis). Just like in the case of the prohibition of monetising public debt and the no-bail out clause (see below), the rationale put forward by the measure's advocates was that exposing member state economies to the full scrutiny of international financial investors would reinforce the market discipline constraining member state policies, therefore increasing the pressure on governments to pursue investor-friendly policies that would allow for the convergence of macroeconomic outcomes across member states. Member states with high inflation and current account deficits would thus be more exposed to the pressure of capital markets and would therefore need to implement additional adjustment

and disinflationary policies that would allow their economies to converge to the German benchmark.

The free movement of capital, in other words, was an additional constraint on the economic policies pursued by EU member states, in particular those with weak currencies that did not enjoy the confidence of financial investors. It was an additional component of the process of asymmetrical macroeconomic convergence towards a low inflation environment that was seen as a prerequisite by the German government for the introduction of the single currency.

■ *The single monetary policy*

The introduction of the single currency was the major institutional innovation in the evolution of the EU's economic governance architecture and the key move towards a centralised policy framework. The euro eliminated two key economic policy tools at the national level: the exchange rate and the interest rate. Exchange rates were permanently fixed between the member state currencies on 31 December 1998 and in due course these currencies disappeared from circulation and were replaced by the single currency. Article 128(1) TFEU even disposes that the euro is the sole legal tender within the Union, thus theoretically prohibiting the issuance of parallel currencies that could enjoy legal tender status in any of the jurisdictions composing the Eurozone. This article was inserted as a way of emphatically excluding the possibility of parallel currencies, a scenario which had been put forward by the British government under John Major in the eve of the Maastricht summit as a way of preventing the future Eurozone member states from moving forward with the project of monetary union (hence the UK received a legal opt-out from the single currency).

In terms of the exchange rate, the relevant rate now became that of the euro as a whole. Article 219 TFEU grants responsibility for exchange rate policy to the Council of ministers⁵ but on condition of unanimity and without prejudice to the 'primary objective' of monetary policy, namely price stability (see below). This clause essentially reproduces the institutional structure of exchange rate policy-making that prevailed in Germany prior to monetary union (where exchange rate policy was the prerogative of the

finance ministry, not the Bundesbank) and enjoyed even the support of the Bundesbank during the Maastricht negotiations. However, the unanimity clause has ensured that the institutional margin for an active exchange rate policy is relatively narrow as all member states (but not the European Parliament which plays no role in exchange rate policy-making) have to agree on the policy course to be pursued. In practice, this helps ensure that monetary policy is primarily geared towards internal price stability irrespective of the impact this has on prices relative to the rest of the world. As such, it also stands in continuity with German practice prior to the euro and the Bundesbank's legendary obsession with domestic price stability to the detriment of international monetary stability.

The introduction of the euro also replaced national central bank interest rates (and discretion over open market operations) by the single monetary policy. The governing council of the European System of Central Banks (Eurosystème) – made up of the six executive directors of the European Central Bank (ECB) and the governors of the national central banks that have adopted the euro – sets a single interest rate that applies across the Eurozone and decides by majority on all aspects of monetary policy. When voting on monetary policy, each member of the governing council has a single vote. The only decisions where this does not apply are those that affect the subscribed capital of the ECB, where only central bank governors have a weighted vote according to the share of the ECB's capital held by their respective institutions. The ECB's capital is held by the national central banks according to their respective member states' share of Eurozone GDP and population. And although the Eurosystème has a consolidated balance sheet, profits (and, theoretically, losses) are distributed to each national central bank according to the share of the ECB's capital that it holds.

Article 127(1) TFEU sets a mandate for the conduct of the single monetary policy, the primary objective of which is to maintain price stability. This was a concession on the part of the French and Italian governments to their German counterpart designed to ensure that the single monetary policy would stand in continuity with the Bundesbank's policy of prioritising domestic price stability over any other objective. This dimension of the EU's economic governance architecture has always been disputed in France, where mainstream political opinion has always considered that the Eurosystème's statute should be reformed to make economic growth an objective on a par with that of price sta-

bility. However, the Treaty also provides that without prejudice to this aim, the Eurosystem's mandate is to support the general economic policies of the EU. The vagueness of the wording has been sufficient both to avoid putting on a par with price stability the objective of economic growth and to allow for space during the Eurozone crisis to interpret the Eurosystem's role as being to safeguard the Eurozone's financial stability. Clearly, however, none of these two objectives (growth and financial stability) was an explicit part of the single monetary policy's responsibility. In particular, the Eurosystem was not tasked with macro-prudential (system-wide) or micro-prudential (at the level of individual banks) supervisory responsibilities and therefore did not have to monitor, let alone act to prevent, the accumulation of financial risks in the private sector.

■ *The fiscal dimension: a rules-based but highly decentralised policy framework*

The acknowledgement that a single monetary policy entails at least some coordination of fiscal policy led to a loose rules-based framework that was first defined during the Maastricht negotiations (the famous five convergence criteria) and then mutated into the Stability and Growth Pact (SGP). The introduction of the latter was accompanied by the setting up of the informal meeting of the finance ministers of the Eurozone member states, which later became known as the Eurogroup, where member states would try to coordinate their fiscal policies in a non-binding way.

The convergence criteria (article 140 TFEU) are probably one of the best-known aspects of the EU's economic governance architecture and have been the focus of strong criticism, especially from the Left, because they are perceived as entrenching an agenda of fiscal retrenchment. Initially, there were five criteria (a budget deficit below 3% of GDP, a public debt below 60%, low inflation, exchange rate stability and convergence of long-term interest rates) but with the introduction of the euro only the first two remained relevant, namely the criteria pertaining to the conduct of fiscal policy⁶. These were introduced with the aim of ensuring that fiscal policy would not generate inflationary pressures throughout the Eurozone by being too expansionary. In practice, the criteria supplied a benchmark and a tool for raising the pressure on member states with high inflation and weak currencies (in the early 1990s, this mostly applied to Italy) to pursue more restrictive fiscal policies.

After the December 1995 meeting of the European Council in Madrid, when a firm commitment was made to the prospect of the single currency, a debate opened up about the framework for fiscal policy once the euro would be introduced. The German government insisted on perpetuating the fiscal convergence criteria and turning them into the main tool for coordinating fiscal policy across the Eurozone. This gave rise to the SGP, which tasked the Commission with monitoring compliance with the fiscal criteria and proposing sanctions for member states that failed to take action to correct any breaches. The rules provided that a qualified majority of Eurozone finance ministers would have to approve the Commission's proposal for sanctions. The Commission was to judge compliance with the criteria not in absolute terms but in terms of the trend followed by member state policies. Member states would thus have to strive towards a so-called Medium-Term budgetary Objective (MTO). This was a concession that the German government had made at Maastricht to its French counterpart which introduced a significant amount of discretion when assessing member state fiscal policies and in effect voided the criteria from much of their substance. Italy, for example, was allowed to qualify in 1997 for euro membership despite its public debt to GDP ratio being slightly above 110%. Since joining in 1999, Italy has breached the deficit criterion nine times and Greece has never respected it. According to one recent calculation, by 2012 there had been at least 77 breaches of the SGP⁷.

In practice, therefore, the criteria provided a very loose framework for fiscal policy. Their stringency and legitimacy was further eroded when in 2003 a qualified majority in the Council could not be found to adopt the Commission's recommendation of sanctioning France and Germany. In 2008-9, the Commission made use of the discretion afforded it by the SGP in order to support a Eurozone-wide policy of counter-cyclical deficit spending by suspending the criteria. As a general rule, the Commission was not in a position to use the criteria to intervene in the conduct of member state fiscal policies.

This was not simply a matter of not wanting to intervene in the domestic affairs of member states but was the direct result of the lack of a more elaborate framework. Crucially, the fiscal criteria were assessed on a case by case basis and did not include any provision for coordinating fiscal policy across the Eurozone with a view to arriving at an optimal policy orientation for the monetary union as a whole. There was, in other words, no provision for assessing the

Eurozone's aggregate fiscal policy, nor any guideline about the objectives of such an aggregate fiscal policy. Such a provision would have amounted to the constant demand of the French government for an 'economic government' and would task the Commission with making sure that the Eurozone's aggregate fiscal policy fulfilled the following two objectives. Firstly, Keynesian counter-cyclical management of the macro-economy would not simply be the responsibility of member state fiscal policies with respect to member state economies taken separately from each other. If the Eurozone as a whole was judged to be pursuing too contractionary an aggregate fiscal policy, the Commission would be tasked with recommending a rise in aggregate public spending and apportioning that rise to each member state according to how much fiscal space it had. Secondly, member state fiscal policies would be determined in relation to each other so as to achieve a balance between them and cushion asymmetric shocks within the monetary union. If a member state suffered a specific adverse macroeconomic shock that pushed it into recession and was not in a position to raise public spending to counter that shock, other member states would be asked to do so (or to boost domestic demand in other ways) in order to help pull that member state out of recession. In both cases, the Commission would be tasked with judging how individual member state fiscal policies could be combined in a way that would fulfil so-called stabilisation functions (countercyclical macroeconomic management and interregional stability) for the Eurozone as a whole.

The Eurogroup had, in fact, been envisaged by its advocates as the first step towards such an economic government and was the concession that the German government made to its French counterpart in 1997 in exchange for the introduction of the SGP. For France, the Eurogroup was the extension of the Franco-German economic council⁸ set up in 1987 in an attempt to create an institutional framework that would allow the French finance ministry to influence the conduct of German economic policy and steer it towards a more cooperative and therefore more expansionary path. But just like its predecessor, the Eurogroup did not have any substantial power and was only a forum for debate. One of the reasons why this was the case was the Franco-German disagreement on whether such an economic government should be set up for the EU as a whole (the German position) or for the Eurozone alone (the French position). The German government did not want to advance any further without the participation of the UK

and the latter was opposed to any form of fiscal policy integration whatsoever⁹.

In practice, therefore, fiscal policy remained highly decentralised and uncoordinated with only a very loose rules-based framework for Eurozone member states that essentially was an institutional legacy of the pre-Eurozone process of asymmetric macroeconomic convergence.

■ *The absence of a lender of last resort*

One crucial implication of the move to the single currency was that the new economic governance architecture did not provide for a lender of last resort for Eurozone member states. Two clauses were introduced at the behest of the German government which explicitly excluded such a prospect. The first was article 125 TFEU, better known as the ‘no-bail out clause’, which stipulates that neither the Union nor any member state ‘shall ... be liable for or assume the commitments’ of any other member state. The second clause is article 123 which prohibits the monetisation of all public debt by the Eurosystem, either through credit facilities for public sector entities or the direct purchase of sovereign bonds.

At the time, both clauses were seen by their advocates as reinforcing the market discipline with which member states would have to contend in managing their fiscal positions once the single currency came into being. The ‘no-bail out clause’, in particular, was designed to send a signal to financial investors that the more creditworthy member states would not be liable for the debts of less creditworthy member states in the Mediterranean arc of the Eurozone. Such a signal was expected to prevent financial investors from pricing sovereign risk on the assumption that all public debt in the Eurozone would be collectively underwritten. At the time, risk premia on sovereign debt¹⁰ were particularly high and the clause was expected to prevent these premia from quickly disappearing once the euro came into being as they were seen as the main transmission mechanism of market discipline.

Similarly, the prohibition to monetise public debt was expected to force member state governments to manage their fiscal positions on the assumption that should they lose market access (i.e., should financial investors cease to be willing to finance budget deficits at a reasonable interest rate) they would not be able to count on central bank credit to cover their financing needs. In other words, unlike the national central banks before the introduction of the single currency, the Eurosystem would not act as a lender of last resort for member states. By rendering member

states exclusively reliant on financial investors, article 123 was thus supposed to strengthen market discipline on the conduct of fiscal policy.

It is worth noting that in this regard the thinking of the architects of the Eurozone was similar to that which informed the adoption of the free movement of capital on an *erga omnes* basis. The overall thrust was to empower financial investors in their relation with member state authorities and economies.

Whereas the ‘no-bail out clause’ only set in law the prevailing situation, the prohibition to monetise public debts introduced a radical break with the pre-single currency era by breaking the central bank-Treasury nexus that lies at the heart of any modern polity. This effectively meant that member states were issuing debt instruments in what was a quasi-foreign currency. In the case of an unexpected change of sentiment among financial investors, a self-reinforcing dynamic would unfold in which temporary difficulties might lead to a full-blown liquidity crisis that could precipitate sovereign defaults. It is precisely in such circumstances that a lender of last resort for member states could be needed, and articles 123 and 125 made sure that the EU’s pre-crisis economic governance architecture did not provide for one.

■ *The banking dimension: decentralisation and soft coordination*

As mentioned above, the Eurosystem was not given any micro-prudential supervisory responsibility. Banking policy – the responsibility to set rules, supervise and resolve banks and guarantee deposits – was almost entirely decentralised and only a very soft form of coordination was introduced once the single currency replaced member state currencies.

The second banking directive¹¹ in 1989 created the single banking licence system, whereby a banking licence granted a bank by any EU member state supervisory authority was enough for that bank to operate anywhere in the EU under the supervision of the issuing authority. Responsibility for resolving banking crises – including the fiscal liability for bank recapitalisations – also remained with the member states. This system was designed to ensure both the pan-European expansion of banks in member states – considered necessary for the development of a single pan-European financial system based on the single currency – and to preserve the strong links enjoyed by banks with their home member state

authorities (a web of relationships which some scholars refer to as ‘banking nationalism’¹²).

The result of this policy was to organise a decentralised system based on soft-coordination and driven by regulatory competition. In 2004 the Commission established the Committee of European Banking Supervisors (CEBS) as a solely advisory body made up of representatives from member state supervisory authorities. But because of the politics of banking nationalism, each member state banking supervisor had strong incentives to relax the standards according to which the banks under its supervision operated so as to lower regulatory compliance costs and assist them in their attempt to successfully expand across Europe. The decentralisation of banking policy thus organised a system of regulatory competition at a time when each member state’s major banks were trying to expand their balance sheets and Europeanise their operations.

■ *The lack of coordination of wage policies and monitoring of macroeconomic imbalances*

The last dimension of the EU’s economic governance architecture prior to the Eurozone crisis that needs to be flagged here is the lack of coordination of wage policies and the absence of any monitoring of macroeconomic imbalances. Wage policies have, largely, been the result of organised systems of collective bargaining as well as minimum wage policies at the member state level. Indirectly, they have also been influenced by industrial relations and labour legislation. All of these policies have remained member state prerogatives and were only subject to the Open Method of Coordination (OMC) where member states collectively agree on a set of policies and objectives and then rely on soft law instruments (such as guidelines and indicators) for implementation¹³.

However, it is quite instructive that the EU did not even have a mechanism for monitoring the potential consequences of wage and labour market policies, namely the accumulation of macroeconomic imbalances within the monetary union. Macroeconomic imbalances have always been an important economic reality impacting macroeconomic policy in the EU¹⁴, but they never featured as a policy objective and were therefore absent from the list of the convergence criteria. The Commission was not tasked with monitoring their evolution and in the early 2000s there was even a debate about whether such imbalances had

any meaning under monetary union and therefore whether collecting relevant statistical data was even necessary¹⁵.

■ *The imbalanced nature of the EU’s pre-Eurozone crisis economic governance architecture*

In a nutshell, then, prior to the Eurozone crisis the EU’s economic governance architecture combined a centralised monetary policy with decentralised fiscal, wage and banking policies as well as the lack of a lender of last resort for member states. The recurring debate about an ‘economic government’ bears witness to the fact that it was generally understood that such an institutional set-up was incomplete and imbalanced. In fact, ever since the initial debate about the prospect of economic and monetary union it has generally been acknowledged that a sustainable monetary union would entail some degree of fiscal policy centralisation. The 1970 Werner report¹⁶ on EMU proposed to that effect both a federal system of central banks and a sort of federal finance ministry (dubbed ‘centre of decision for economic policy’) and highlighted that economic and monetary union meant that to a large extent fiscal policy would have to be decided at the Community level. The 1977 MacDougall report¹⁷ on the role of public finance in the EU estimated that a monetary union could be supported with a federal budget of around 5-7% of EU GDP and envisaged a long-term evolution of the EU towards a fiscal federation where the central budget would account for 20-25% of GDP. Jacques Delors himself had expected, during the debates of the Committee for the Study of Economic and Monetary Union which he presided in 1988-89, that the EU’s central budget would triple to 3% of the Union’s GDP by the time the single currency would be introduced¹⁸. Even most of the sovereigntist opponents of the monetary union project, such as British Eurosceptic Conservatives and French Gaullists, understood that the functional logic of monetary union would sooner or later entail some degree of fiscal federalism as well, which was one of the main reasons for which they were opposed to the single currency project.

Among economists, there is a general agreement as well that monetary union needs to be supported by some degree of fiscal policy centralisation. The most widespread theoretical framework used to explain this necessity is the Optimal Currency Area (OCA) theory. The OCA theory postulates that a monetary union can function smoothly if factors of production (labour, capital and commodities) are

highly mobile within the union, if prices (including wages) are flexible and if the component regional economies of the union are sufficiently diversified. If these factors prevail, so-called asymmetric shocks (localised financial crises or economic recessions) can be easily absorbed without adjusting nominal exchange rates. Capital will be drawn into the regional economy under stress to take advantage of the lower costs of production that result from the downward adjustment of prices, surplus labour will move to other regions of the union where it can be employed and regionally produced goods will quickly become competitive (since their prices will have fallen) leading to an export-led recovery. Price flexibility will mean that the adjustment of the regional economy under stress will happen through the downward adjustment of prices and not through that of quantities (lower output and higher unemployment). In other words, the adjustment of total labour costs will happen by cutting the wages of all workers instead of by firing a number of them and making the rest work longer hours, a mechanism which avoids wasteful resource idleness.

If most of these conditions do not prevail, however, then a centralised fiscal policy is needed to provide counter-cyclical stabilisation and to cushion asymmetric shocks by transferring resources to the regional economy under stress to support investment, demand and local public finances that might be constrained by the effects of the crisis (especially if monetisation of public debt is prohibited).

In the EU, commodities and capital are indeed highly mobile but labour is not¹⁹. The geographic mobility rate²⁰ for the EU15 in 2006 was between 0.1% and 0.2% whereas in the United States and Japan it was between 2% and 2.5% and in France and the Netherlands between 1.5% and 2%²¹. To compound this problem, prices – just like in most other advanced capitalist economies – are inflexible ('sticky') and adjustment mostly takes place through higher unemployment. If one accepts the OCA theory, then the EU would need a centralised fiscal policy tasked with smoothing inter-regional divergences and fostering economic convergence²².

Another way of explaining the imbalanced nature of the Eurozone is that associated with the institutionalist theory of money as a social contract²³. In this view, the Eurozone is incomplete because the single currency has created a common monetary space without a corresponding public space or polity which would have been embodied in a supranational fiscal authority (Treasury) with the power

to tax, borrow and spend in order to provide public goods decided through a common democratic process where a Eurozone parliament would vote on a Eurozone budget. In this view, moreover, public debt is a special kind of financial asset that is distinct from private debt instruments precisely because of the state's status as provider of public goods. According to Michel Aglietta, for example, 'public debt must be kept at a distance from the vicissitudes of the markets by guaranteeing its liquidity. This is the essential mission of the central bank. It follows that there exists an organic link between the State and money'²⁴ and that public debt has to be a generally credit risk-free asset. The solvency of the state (or its capacity to fulfil its mission) must be institutionally guaranteed through the state's capacity to create its own money to finance itself in other words. In the Eurozone, however, the lack of a lender of last resort for the member states was not compensated for by a supranational sovereign borrower that could monetise its debt through the Eurosystem in the context of its pursuit of the key task of provision of public goods, whereas in the United States, for example, the Federal Reserve System regularly buys large amounts of federal Treasury bonds directly from the federal government (in the United States, there is also an unofficial no-bail out clause for insolvent States). In other words, the central bank-Treasury nexus that existed at the member state level prior to the introduction of the single currency has not been replaced by an equivalent nexus at the Eurozone level. The Eurozone thus lacks a fiscal authority that would partner the Eurosystem and determine policy on the basis of an optimum policy mix between monetary and fiscal policy, provide supranational public goods and tailor policy according to the collective needs of the Eurozone economy as a whole. In that case, aggregate fiscal policy in the Eurozone would be the product of a cooperative dynamic, not the result of competition between member states. There is, in other words, a lack of state capacity in the EU under the institutional architecture described in this section which essentially amounts to a lack of inter-member state solidarity. Hence the incomplete nature of the EU's economic governance architecture and the need for a centralised fiscal policy.

The Eurozone's institutional framework prior to the crisis the monetary union suffered in 2010-13 was both imbalanced and lacked sufficient state capacity to withstand potential adverse shocks. The reforms introduced along with the single currency radically altered the dynamics of economic policy-making in Europe. This was not so much the

product of having a single currency and thus forfeiting the capacity to devalue member state currencies in order to adjust downwards nominal exchange rates. Most member states had already decided since the early 1980s that devaluations were too costly and had to be avoided because they led to a vicious cycle of imported inflation resulting in a new round of devaluation, thus hurting domestic savers and foreign investors, while also not being sufficiently efficient policy tools in restoring competitiveness.

Rather, the problem stemmed from the institutions that were lacking around the single currency. The free movement of capital, the 'no bail-out clause' and the prohibition to monetise debt (i.e. the lack of a lender of last resort for member states) exposed member states to the whims of financial investors in an unprecedented way, especially if one factors in the huge expansion of financial integration that took place between Maastricht and the Eurozone crisis. This could have been dealt with if a Eurozone Treasury had been created and allowed to borrow from the Eurosys-

tem. Such an innovation would have also entailed Europeanising several economic policy instruments (e.g., unemployment insurance). Moreover, the decentralisation of banking policy aggravated the imbalance in that it created a policy framework which encouraged excessive risk taking (financial bubbles), thus generating the potential for sudden reversals in investor sentiment leading to financial crises. The lack of clarity on a lender of last resort for the financial system added to the vulnerability of the Eurozone to such crises. Last but not least, the decentralisation of fiscal and wage policies meant that member states were exposing themselves to destructive competition among themselves through national competitive disinflation policies and thus to the potential accumulation of macroeconomic imbalances. This was also a potential source of fragility as in the case of a crisis, the unravelling of such imbalances would generate asymmetric shocks that the Eurozone was ill-equipped to deal with given that it had no centrally organised fiscal redistribution mechanism.

B) THE INNOVATIONS INTRODUCED DURING THE EUROZONE CRISIS: TENTATIVE STEPS TOWARDS REDRESSING THE IMBALANCE

■ *The partial resolution of the lender of last resort problem for member states*

The institutional problem most clearly highlighted by the Eurozone crisis in 2010-12 was the absence of a lender of last resort for member states.

The specificity of the Eurozone crisis was that it was a balance of payments crisis triggered by capital flight from the member states in the Mediterranean arc of the EU (and Ireland) towards the member states in Northern Europe. But whereas under the previous set of macroeconomic arrangements – the European Monetary System – the recurring cycle of balance of payments crises and capital flight gave rise to currency crises, the single currency framework meant that the crisis took the shape of a sovereign debt crisis²⁵. The impact of automatic stabilisers, and to a lesser extent of bank rescues, on public finances significantly widened budget deficits and public debt to GDP ratios.

The first flashpoint of the crisis was Greece, where the rise in public indebtedness made clear that the Greek state was insolvent. Precisely because Greece's solvency could not be guaranteed by central bank lending due to the prohibition of monetising public debt, investors

started fire-selling Greek sovereign bonds in their portfolios and demanding exorbitant interest rates to buy new bonds issued by the Greek treasury. The Greek crisis led to a contagion that spread speculation to the bonds of other Mediterranean member states after the French president, Nicolas Sarkozy, agreed in November 2010 in the Norman town of Deauville to a demand of the German chancellor, Angela Merkel, that in any future bail-out losses would be imposed on private creditors. In other words, the German government imposed a policy of only partially underwriting the bonds issued by Eurozone member states, an attempt to lend some credibility to the 'no bail-out' clause. It was following this decision that the speculative crisis snowballed. It would only be contained two years later after the Franco-German agreement had been reversed and a guarantee was provided that all bonds issued by Eurozone member states were credit risk-free.

This guarantee amounted to an implicit introduction of a lender of last resort in the Eurozone and was introduced in two ways. The first was the setting up of various schemes to provide loans to member states that had lost market access. These schemes were the Greek Loan Facility, the European Financial Stability Facility (EFSF) set up in 2011 as a

temporary fund²⁶ and the European Stability Mechanism²⁷ (ESM) that subsumed the EFSF in October 2012 as a permanent organisation²⁸. To some extent, these schemes can be said to function as fiscal liability pooling mechanisms because the member states that enjoy high creditworthiness essentially underwrite some of the borrowing done by member states under attack on the bond markets. These schemes have largely discarded the no bail-out clause and proven that financial investors were correct to expect that, in the last instance, the bonds issued by individual Eurozone member states would be underwritten by the rest of the member states. In this respect, the Eurozone crisis has been a major setback for the original German conception of monetary union that had largely shaped the EU's economic-policy framework since the Maastricht treaty.

The second way in which the lender of last resort issue was dealt with has been through the Eurosystem's policies. The latter has implemented a series of so-called unconventional monetary policies largely aimed at supporting the bonds issued by member states under stress, despite the opposition of the Bundesbank. The first such policy was the Securities Markets Programme (SMP) decided in May 2010²⁹ under which the Eurosystem bought such bonds on the secondary markets. This programme was replaced in September 2012 by the Outright Monetary Transactions³⁰ (OMT) programme under which the Eurosystem pledged to buy on the secondary markets the bonds of any member state that decided to ask for financial assistance from the ESM. This decision followed the famous statement by ECB president Mario Draghi in July 2012 to 'do whatever it takes to preserve the euro'³¹ which was widely perceived by financial investors as meaning that the Eurosystem would act as a lender of last resort and underwrite member state bonds. The remark had such an impact on bond markets that speculation soon died down and the OMT has never been activated. These decisions have, for practical purposes, overridden the prohibition to monetise member state deficits contained in article 123 TFEU, although the ECJ has upheld the legality of the OMT by arguing that the treaty allows purchases of sovereign bonds on the secondary markets³².

The objective of these policy innovations has been to eliminate sovereign credit risk and restore member state bonds to the status of risk-free assets and it is in this sense that they have contributed to resolving the lender of last resort issue and bridging one of the gaping holes in the EU's economic governance architecture.

■ *Tentative steps towards a greater centralisation of member state fiscal policies*

The second response following the crisis has been a series of tentative steps to further centralise fiscal policy in the Eurozone through reinforcing the monitoring of member state policies by the Commission and the formalisation of the whole process through the setting up of the European Semester procedure (see figure 1).

Of course, the most substantial change in terms of policy-making to have taken place during the crisis was the *ad hoc* centralisation of the fiscal policies of those member states that received financial assistance (Greece, Ireland, Portugal, Cyprus³³) through the role played by the Eurogroup in vetting the disbursement of financial assistance according to whether member states had fulfilled the conditions attached³⁴. In those cases, the Eurogroup acted as a Eurozone finance minister with full powers over member state policies. But like the fiscal liability pooling entailed by the financial assistance, this was only a temporary and *ad hoc* measure (despite its quite profound implications in terms of overall economic policy in these member states).

Figure 1: The European Semester procedure



In terms of the general economic governance architecture, the changes have been included in the so-called six-pack and two-pack set of regulations that revised the functioning of the SGP as well as in the Fiscal Compact³⁵. The overall thrust here is to reinforce monitoring by the

Commission through various reporting requirements, a common timeline, standardisation and public availability of statistical data. The most substantial innovation in the new rules is the so-called 'reverse qualified majority' in the Council for blocking sanctions recommended by the Commission, thus reinforcing the theoretical likelihood that recommended sanctions will be approved and thus strengthening the Commission's hand. Under the new system, the 2003 sanctions against France and Germany would not, for example, have been blocked. Finally, the Fiscal Compact pledges member states to adopt in their domestic legal systems balanced budget clauses requiring them to converge by 2018 towards the objective of a structural deficit of 0.5% of GDP and to reduce their public debt to GDP ratio by 1/20 every year if that ratio is above the 60% threshold³⁶. Again, the Commission is granted the power to propose sanctions for member states that breach these commitments which can only be blocked by a 'reverse qualified majority' of member states.

Box 1: The six- and two-pack reforms

The first set of legislative measures to have been adopted was the so-called six-pack of five regulations and one directive which reformed the SGP in December 2011³⁷. The reform introduced the European Semester and earlier sanction mechanisms in the shape of interest-bearing deposits of 0.2% of the GDP of a member state that fails to follow the recommendations of the Commission once it has been included in the so-called 'Excessive Deficit Procedure'. If the member state persists in not complying with Commission recommendations, the deposit is transformed into a fine. The reform also operationalises the public debt criterion in that it allows the Commission to include member states with more than 60% public debt to GDP in the EDP (even if their budget deficit respects the 3% criterion). The major reform is that now Commission recommendations only require a qualified minority to be adopted in the Council (or a 'reverse qualified majority' to be rejected). The reform also requires national statistical agencies to be made independent and conform to the technical standards set by Eurostat, in an attempt to avoid the statistical cooking of the books that allowed Greece to hide the extent of its budget deficit until 2009. Finally, the last two regulations of the six-pack introduce a simi-

lar system of monitoring and sanctions in relation to macroeconomic imbalances through the so-called 'Excessive Imbalance Procedure' (see also below).

The second set of legislative measures – the two-pack made up of two regulations – was adopted in May 2013³⁸. The reform requires member states to publish their medium-term fiscal plans ('Stability Programmes') and their yearly economic policy agenda ('National Reform Programmes') by the 30 April of each year as part of the European Semester process of multilateral surveillance by the Commission and the Council. The reform gives the Commission a right of inspection of the draft budgets of member states. Each member state now has to submit its draft budget before the 15 October. The Commission issues an opinion by the 30 November and can ask the member state to submit a revised plan if it considers that the initial draft does not comply with the SGP. The reform also requires member states to set up independent national bodies to monitor their compliance with the fiscal rules and provide independent macroeconomic forecasts on which to base their policy agenda. Finally, the two-pack provides for enhanced monitoring for member states that have exited a financial assistance programme until they have repaid 75% of the loans they received.

These reforms only amount to a slightly harder version of coordination of fiscal policy and do not change the substance of the SGP. The Fiscal Compact does create an additional legal constraint in favour of fiscal consolidation. But fiscal policy remains essentially decentralised and not determined on a cooperative basis from the point of view of the optimum stance for the Eurozone as a whole.

The latest round of the European Semester highlights this very neatly. The Commission made a first attempt in November 2016 (in its recommendations that kick-off the European Semester cycle) to set out recommendations for each member state on the basis of a declared policy objective for the Eurozone as a whole. After observing that fiscal policy for the area as a whole had to become more expansionary, it recommended an additional fiscal stimulus of 0.5% of Eurozone GDP (around €50 billion) and noted that this should come from member states (such as Germany and the Netherlands) that have achieved their fiscal

goals and therefore have more fiscal space to act. Pierre Moscovici, the economic and financial affairs commissioner, explained that the Commission wanted to move away from 'statistical aggregation' and toward acting as 'the Eurozone's finance minister'³⁹. However, the Commission also admitted in its relevant communication to the Council that 'for those Member States which have achieved their fiscal goals and/or have more fiscal space to act, the tools of the European Semester can only recommend, not enforce, more expansionary fiscal policies. This reflects what is sometimes described as an asymmetry of the EU fiscal framework: the rules can proscribe high deficits ... but they can only prescribe the reduction of budgetary surpluses, without imposing it.'⁴⁰ Predictably, the German finance minister, Wolfgang Schäuble, rejected the Commission's call by arguing that it had no mandate to recommend a fiscal stance for the Eurozone as a whole and that the SGP applied to member states individually⁴¹. The Eurozone finance ministers rejected the recommendations in early December.

■ *Monitoring of macroeconomic imbalances and private sector developments*

One of the innovations introduced as part of the six-pack is the extension of the European Semester cycle of monitoring and recommendations by the Commission beyond fiscal policy to developments in the private sector of the member states in the shape of the Macroeconomic Imbalance Procedure⁴² (MIP). This reflects the acknowledgement that coordination of economic policy cannot be limited to the fiscal dimension but has to incorporate wage developments, external competitiveness and sources of financial fragility such as housing market bubbles as well as the recognition that macroeconomic imbalances within the monetary union continue to matter and are not necessarily the result of fiscal policies. Indeed, member states such as Ireland, Spain and Cyprus received financial assistance largely to sort out problems generated by housing market bubbles and excessive private sector debt despite having consistently respected the fiscal criteria. In fact, no less than fourteen indicators are monitored by the Commission under the MIP, including current account balances, net international investment positions, unit labour costs, housing markets but also private sector debt. The Commission has also made a point of taking into account the cross-border consequences of member state policies and integrating in

its overall assessment the Eurozone dimension, just as its latest assessment of fiscal policy does. Accordingly, since 2014 the Commission has recommended that Germany take action to reduce its current account surplus by boosting private and public investment and reducing its savings rate⁴³. Finally, the MIP follows the SGP in that the Commission can recommend that the Council impose sanctions on a member state that has not taken action to correct imbalances highlighted by the Commission.

In theory, then, the MIP could evolve into a powerful tool in the hands of the Commission for steering not just fiscal but more broadly economic policies across the union. The possibility to sanction member states also strengthens the Commission's hand in trying to enforce the targets and policies agreed as part of the Europe 2020 strategy and which had up to recently only been subject to the OMC. A lot has been made, for example, of how the Commission allowed France to continue breaching the 3% budget deficit criterion in 2015 in exchange for the labour market reform that was introduced in 2016 and sparked a wave of protests by the trade union movement. The French case was indeed exemplary of how the Juncker Commission decided in 2015 to relax the drive to consolidate public finances in exchange for a greater effort on structural reforms⁴⁴, thus making use of the discretion that the policy framework affords it in judging the economic policies of member states and making recommendations.

However, up to 2016 – the fifth year of implementation of the MIP – no member state has ever been placed in the Excessive Imbalance Procedure (EIP), the so-called corrective arm of the MIP which requires action by the relevant member state under threat of sanctions. If the SGP is a guide to how the MIP will operate, then it has to be concluded that the new procedure is no more than a small step towards a slightly harder form of coordination than the OMC which does not substantially shift the locus of decision-making power. And just like the asymmetry of the SGP highlighted by the Commission above, it can be argued that the MIP rules 'only function in a restrictive sense. No automatic rule will force the German government to pursue a policy of higher wages and public spending increases to compensate for wage deflation in a set of other countries'⁴⁵.

■ *The Eurosystem takes up the task of safeguarding financial stability*

A much more substantial innovation has taken the shape of an evolution of the Eurosystem's actual practice rather than of a particular institutional innovation, namely the unconventional monetary policy measures aimed at safeguarding financial stability and preventing liquidity crises in the financial markets in 2010-12. However, this evolution has *de facto* enlarged the mandate of the Eurosystem from price stability to the safeguarding of financial stability by turning the Eurosystem into the lender of last resort for Eurozone banks and as such it is crucially important.

As argued above, the speculative crisis of 2010-12 was driven by the perception of financial investors that Eurozone sovereign bonds were not risk-free because there was no lender of last resort for the member states. This perception was killed off by the combined impact of the setting up of the EFSF/ESM and the OMT programme. But the speculative crisis also led to a crunch in the interbank markets, in particular for banks domiciled in the member states under attack in the bond markets. The Eurosystem thus once again sidelined the Bundesbank's objections and stepped in to essentially underwrite the financial markets by injecting a massive amount of liquidity into the system (see the huge expansion of the Eurosystem's balance sheet between 2010 and 2012 in figure 2) under unprecedentedly lenient terms.

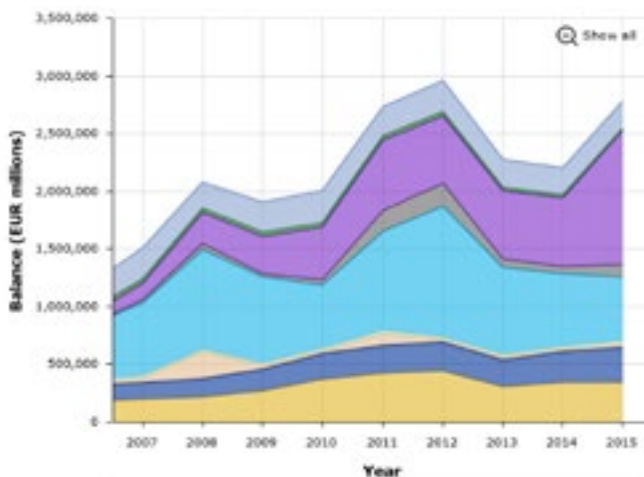
This happened in two ways. First, through two so-called Long-Term Refinancing Operations (LTROs) in December 2011 and February 2012, through which commercial banks were offered unlimited amounts of liquidity for a three-year period and at fixed rates. These operations injected around one trillion euros into Eurozone banks. Second, through a gradual and extensive relaxing of the rating requirements for the collateral that banks use for refinancing operations⁴⁶.

The banks to have most extensively benefitted from these measures were precisely those in member states under stress, namely Italian and Spanish (and to a lesser extent, French) banks⁴⁷. In this way, the Eurosystem acted as lender of last resort for those sections of the Eurozone's banking system that could not refinance themselves on the markets and thus prevented a disastrous wave of banking failures from further destabilising the Eurozone.

Overall, the Eurosystem's policies have evolved during the crisis towards those pursued by the Federal Reserve

System and the Bank of England (including by launching quantitative easing more recently, hence the renewed expansion of the Eurosystem's balance sheet from 2014 onwards) and away from the Bundesbank blue-print that is exclusively focused on price stability to the detriment of all other policy objectives. Thus, although the treaty has not been amended to specifically extend the Eurosystem's mandate to financial stability, in actual practice this amounts to a substantial departure from the pre-crisis model.

Figure 2: The evolution of the Eurosystem's balance sheet during the Eurozone crisis⁴⁸



■ The radical restructuring of banking policy in the Eurozone

The last innovation in the EU's economic governance architecture that has already been ushered in is the radical restructuring of banking policy known as 'banking union'. Together with the resolution of the issue of the lender of last resort for member states and the assumption by the Eurosystem of the responsibility for financial stability, this is the most substantial innovation to have already been implemented. Its political importance extends beyond its actual significance in terms of banking policy in that it was also crucial in enabling Draghi's 'whatever it takes' intervention in July 2012 that signalled the Eurosystem's readiness to underwrite the bonds of Eurozone member states. The central bankers only decided to take that step after the crucial June 2012 European Council where heads of state and government decided to launch banking union. Draghi called the decision 'the game-changer he needed' and wrote that it 'has been the greatest step towards deep-

er economic integration since the creation' of the single currency⁴⁹. In that respect, the decision to launch banking union was the major political turning point in the Eurozone crisis.

Banking union⁵⁰ is made up of three pillars: the Single Supervisory Mechanism⁵¹, the Single Resolution Mechanism⁵² and the proposed European Deposit Insurance Scheme⁵³. As part of the agreement, the ESM has also been given the capacity to directly recapitalise Eurozone banks through a so-called direct bank recapitalisation instrument⁵⁴.

The SSM centralises micro-prudential supervisory authority for all banks in the Eurozone within the ECB⁵⁵, although only the 127 largest (accounting for around 82% of banking assets in the Eurozone) are directly under its supervision. The SSM can decide, however, to directly supervise any other bank in the Eurozone if it judges that the national supervisor is not following its instructions properly. The SSM is now responsible for granting and withdrawing banking licences as well as ordering the restructuring or winding-down (i.e. the resolution) of a failing bank. To that effect, it also conducts stress tests and asset quality reviews (in conjunction with the EBA) to determine the state of bank balance sheets, for which it uses data that it directly collects from the banks it supervises.

The SRM is responsible for resolution and pools the financial resources (made up of levies on banks) set aside in member states to that effect. Finally, the EDIS plans to pool by 2024 the resources set aside in each member state for guaranteeing the first 100 000 euros in bank deposits⁵⁶.

The significance of these reforms is manifold. The first point to be made is that the banking union was conceived with the aim of breaking the so-called 'doom-loop' between banks and their home member states. The Eurozone crisis was in fact driven by speculation about both member state and banking sector solvency and the two reinforced each other in a vicious cycle. Financial investors worrying about the health of the banks started to speculate about the home member state's capacity to shoulder the fiscal liability entailed in backstopping the banks. That member state's bonds consequently lost value in the secondary markets and this in turn affected the balance sheets of the – mostly domestic – banks holding them, leading to fresh speculation about the banks' health. In other words, the concentration of domestic banking systems that preceded the Eurozone crisis as a result of the attempt to build pan-European banks and which went hand in hand with the push for financial integration meant that localised banking crises

were too severe for some member states to deal with on their own. Such banking crises – like those in Ireland, Spain and Cyprus – can be seen as severe asymmetric shocks that can only be mitigated by collective action at the level of the monetary union. Moreover, the potential cross-border and systemic consequences of the failure of any of the banking sectors of the member states under stress would also endanger the financial stability of the Eurozone as a whole. Again, a highly integrated financial system based on a single currency calls for a centralised banking policy.

The final point about the significance of the centralisation of banking policy is the end to regulatory competition that it entails. As mentioned above, the decentralisation of micro-prudential supervision and the politics of banking nationalism fuelled a process of regulatory competition among member state supervisors keen to support their local banks by lowering regulatory costs and standards. This was one of the reasons for which banks in the Mediterranean arc of the Eurozone (and in Ireland) generated housing market bubbles based on cheap credit that in turn aggravated the macroeconomic imbalances that built up before the Eurozone crisis (see next section). Moreover, banking nationalism was one of the reasons for which member state supervisors downplayed the problems in the banks under their watch and as a result resisted the necessary measures to clean them up and thus eliminate the vast amount of bad assets that have crippled their balance sheets and their lending capacity since the outbreak of the crisis. The SSM has accordingly made a point of taking a hard stance towards banks in trouble and preventing member state supervisors from shielding domestic banks with weak balance sheets⁵⁷.

■ *An overall assessment of the innovations*

The EU's economic governance architecture has thus evolved quite substantially under the weight of the Eurozone crisis. The most glaring gaps (absence of a lender of last resort for member states effectively rendering sovereign bonds risk-free and lack of clarity on how to preserve financial stability in case of severe liquidity crises) were quickly bridged through significant innovations (ESM and the Eurosystem's OMT programme for member states and the Eurosystem's unconventional policies to safeguard financial stability). This is quite a significant fact in its own right, as it has signalled that member states are politically committed to preserving the Eurozone as a functional set

of economic governance institutions and are therefore willing to take the necessary steps to make it viable – including by permitting a greater degree of policy centralisation. The strongest signal in that direction and the one which broke the stalemate in 2012 was the decision to launch banking union. The centralisation of banking policy has adapted the policy framework to the realities of an integrated pan-European financial system with very significant cross-border linkages and has provided one extra tool for dealing with severe asymmetric shocks. However, the fiscal and economic policy framework remains highly decentralised and therefore asymmetric as the powers of the supranational level are restricted to correcting excessive deficits and imbalances in individual member states, not steering the Eurozone economy as a whole. In practice, this means that the key levers of economic policy in the Eurozone, namely German fiscal and wage policies, are wielded solely in light of how Germany is to conform to the SGP's fiscal criteria and irrespective of the collective needs of the monetary union as a whole – despite the fact that Germany is the Eurozone's locomotive and single most important component member state economy. This has had important consequences for the Eurozone's economic direction as it has entrenched a process of asymmetric adjustment in a broadly deflationary context and had recessionary consequences in 2011-12 while it has also depressed wages and public investment across the Eurozone (see next section).

II. The economic and political consequences of the EU's economic governance architecture

A) ECONOMIC CONSEQUENCES

I) THE LEAD-UP TO THE EUROZONE CRISIS: BUBBLENOMICS AND GROWING WAGE DIVERGENCE LEAD TO MACROECONOMIC IMBALANCES AND LAY THE GROUND FOR THE 2010-12 SPECULATIVE CRISIS

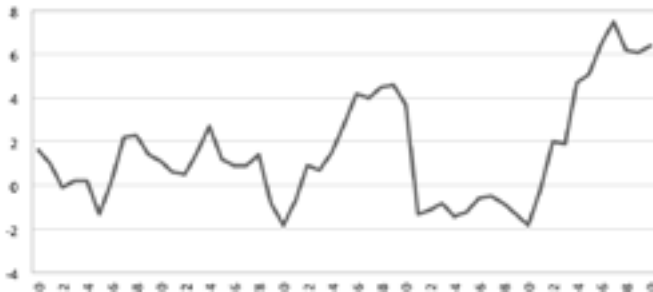
The broad shape of the Eurozone crisis is generally well known by now. The first decade of the monetary union saw a growing accumulation of macroeconomic imbalances driven by credit bubbles (mostly centred on housing markets) in deficit member states and divergent wage developments due to disinflationary policies in Germany. When the bubbles began to burst in 2008-9, the macroeconomic imbalances started to unravel through capital flight from the deficit to the surplus member states which quickly became concentrated on sovereign bond markets.

There is some debate among economists as to which of the two developments (bubblenomics and German wage deflation) was the main driver of the imbalances. The standard interpretation is that the wage freeze in Germany increased the competitiveness of German producers thus generating growing trade surpluses which were then recycled back into the deficit member states where they generated credit bubbles that sucked in further imports in a vicious cycle. In this interpretation, trade dynamics drove financial flows. A 2014 paper published by staff of the Commission's Directorate General for Economic and Financial affairs, however, provides evidence in favour of the alternative interpretation, namely that financial flows led trade flows⁵⁸. Cheap capital from across the world flew into the deficit member states through the activities of transnationally oriented large European banks and fuelled credit bubbles. The bubble-driven expansion sucked in imports from member states that suppressed such bubbles (e.g. Germany) and resulted in growing imbalances. This interpretation is consonant with the fact that the cross-border expansion of big European banks was a much more important development in the 2000s than deepening trade integration. It also identifies a common mechanism to the great financial crisis of 2007-08 and the Eurozone crisis in the role of speculative finance in blowing up unsustainable credit bubbles.

Whatever the precise mechanism at play, the structure of the resulting imbalances was the traditional one of surpluses in Northern Europe (with Germany as its epicentre)

mirrored in deficits in the Mediterranean arc of the EU (and Ireland)⁵⁹, a divide that reflects the broad distribution of industrial capacity within Europe. In fact, the transition to the single currency was facilitated by the historically unique circumstance of German reunification and its inflationary consequences which pushed the German current account into negative territory for an unprecedented ten-year period (1991-2001, see figure 3). But if one sets aside this interlude, the evolution of Germany's current account balance shows a clear long-term trend towards growing surpluses in step with the deepening integration of the European economy. Thus, in the 1960s and 1970s, those surpluses oscillated at between 2-3% of (West) German GDP. The late 1970s saw a short-lived reversal of that trend, as chancellor Helmut Schmidt succumbed to pressure from the American President Jimmy Carter to pursue an expansionary fiscal policy to help the United States balance its external accounts and prevent the further depreciation of the dollar. But as early as 1982, the German current account was back in surplus and peaked in 1989 at 4.6% before taking a vertiginous dip in 1991 soon after the replacement of the Ostmark by the Deutschmark at parity (the Bundesbank had recommended a 3:1 or 4:1 conversion rate but the federal chancellor decided otherwise). By 2002, Germany was back in surplus and reached a peak of 7.5% in 2007. The ensuing financial and economic crisis led to the collapse of a number of credit bubbles in the deficit member states that set the stage for capital flight towards Northern Europe that also affected the sovereign bond markets and thus led to the 2010-12 speculative crisis.

Figure 3: Germany current account as a percentage of GDP 1960 – 2010, Source: Ameco



This section focuses specifically on how the institutional structure of economic governance in the EU fuelled and/or abated these pre-crisis developments.

■ *The impact of the single monetary policy on real interest rates and sovereign bond yields in the deficit member states*

The introduction of the single monetary policy had a direct impact on the development of macroeconomic imbalances as it abruptly lowered real interest rates in deficit member states through the introduction of the single nominal interest rate. In Spain, real interest rates dropped from 7.88% in 1993 to 3.61% in 1997 and 1.25% in 1999 (date at which the single monetary policy came into effect) and even 0.18% in 2002 (date at which euro-denominated cash entered circulation). In Ireland, the figures were 5.3% in 1996, -0.75% in 1999 and -1.37% in 2002. In Greece (which only joined in 2001), 10.55% in 2000, 4.94% in 2001 and 3.22% in 2003 and in Portugal 9.13% in 1996 and 1.74% in 1999. In Italy, the drop was from 7.71% in 1997 to 2.57% in 2003⁶⁰.

A second channel through which the single monetary policy led to a substantial reduction in the cost of capital was through the mispricing of sovereign credit risk to which it induced financial investors. Before the prospect of monetary union became tangible in the mid-1990s, investors priced differently sovereign credit risk in EU member states and demanded a premium over the benchmark rate for German sovereign bonds (*bunds*) according to the inflation they anticipated in each member state and the credibility of the local currency in terms of preserving its value. Member states with high inflation and weak currencies which tended to suffer regular devaluations like the Greek drachma or the Italian lira had to pay high premia in order to sell their bonds. The prospect of the single currency rad-

ically changed investor behaviour as the risk of devaluation was now eliminated and the prospect of a member state defaulting on its debts was considered beyond the scope of the possible despite the no bail-out clause and the prohibition for the Eurosystem to monetise sovereign debt. Indeed, EU regulation confirmed and encouraged this interpretation when in 2003 the Commission authorised banks to use interchangeably as collateral in secured interbank transactions any Eurozone sovereign bond, all of which would be priced in the same way⁶¹. As a result, risk premia disappeared and the cost of capital literally collapsed for some member states (see figure 4).

Figure 4: Interest rates on 10-year government bonds of euro countries⁶²



This abrupt drop in real interest rates and sovereign bond yields amounted to a huge expansionary push from monetary policy for deficit member states and a policy of ultra-cheap money that would go on to fuel various credit-bubbles (in the housing market in Ireland, Spain and Cyprus and in private consumption in Portugal, Greece and Cyprus). The drop had actually been anticipated by the Commission but was expected to be a factor of convergence between the member states. Lower rates were expected to lead to an inflow of capital that would fund productive investments in the tradeable goods sectors of the economy, thus raising productivity and real wages towards the levels prevailing in the more industrially advanced member states of Northern Europe. Instead, financial investors massively misallocated capital towards the non-tradeable sectors of the economy, primarily the property market. The bubbles that resulted from this misallocation artificially raised prices and wages and boosted domestic demand, sucking in imports and swelling current

account deficits. They also loaded domestic banks with bad assets that would weigh down on their balance sheets after the bubbles were punctured.

One statistical manifestation of this vast misallocation of capital is the asset composition of the foreign capital inflows in the deficit member states. Cross-border financial flows were largely made up of investments in fixed-income assets (corporate and sovereign bonds and short-term interbank lending) instead of equity⁶³. Indeed, had capital imports funded productive investment, one way to do so would have been through equity investment in start-up companies or in established firms seeking strategic investors to help them fund productive investments through purchases of newly-issued equity. Instead, capital inflows were mostly through domestic banks borrowing abroad to fund speculative investments at home and foreign banks investing in sovereign bonds in search of a slightly higher yield than in, say, US Treasury bonds or German *bunds*. The consequence of this asset composition of capital inflows was that it exacerbated the vulnerability of recipient member states to macroeconomic shocks as well as capital flight and intensified their asymmetric impact. In a recession, paying back debt becomes a huge burden as the income out of which to reimburse one's creditors shrinks while the total volume of liabilities remains constant. Moreover, given the crucial importance of short-term interbank lending within the total amount of fixed-income asset capital flows, the banking sectors of deficit member states became highly vulnerable to a sudden stop in the capital flows. Indeed, when the crisis hit, cross-border interbank lending was much more affected than capital flows to equity markets⁶⁴.

A higher equity composition of the capital inflows would, instead, have spread private sector risk across the Eurozone⁶⁵ and would have mitigated the asymmetric nature of the shock instead of pushing the deficit member states' economies into debt deflation and pitting creditor against debtor member states.

■ *The lack of a central Eurozone budget and finance ministry and the misallocation of capital*

The speculative nature of these cross-border capital flows can also to some extent be attributed to the lack of a central fiscal policy based on a Eurozone budget and administered by a Eurozone finance ministry. Such a federal fiscal policy could have functioned at a much larger scale as the structural and investment funds of the EU budget already

do, namely by redistributing capital towards the poorer regions of the union in order to fund productive investments in infrastructural and other projects. A Eurozone budget could have also provided capital in preferential terms for the upgrading of industrial plant or through favourable investment amortisation regimes. In short, such a budget could have pursued an active policy of convergence through productive investments and targeted allocation of capital. Instead, as argued above, the EU's economic governance architecture prior to the Eurozone crisis entrusted the task of funding productive investments in the less industrially advanced member states to private financial firms. In other words, private financial investors were tasked with leading the convergence of the Eurozone's member state economies. This was the logical consequence of the various institutional choices that reinforced market discipline by empowering financial investors. But the financial investors completely bungled it, misallocating capital to non-productive investments and fuelling credit bubbles that drove the accumulation of macroeconomic imbalances instead of leading to a convergence of the member state economies.

■ *The link between decentralised banking supervision and the bubbles in deficit member states*

One final feature of the EU's economic governance architecture prior to the Eurozone crisis contributed in the development of credit bubbles in the deficit member states. This is the decentralisation of banking supervision and the regulatory competition that it gave rise to. Member state supervisors closed their eyes on the speculative excesses of the banks under their watch for two main reasons. One was that in looking to promote their domestic banks in the context of the integration of financial markets that the introduction of the single currency accelerated, they lowered regulatory standards in order to reduce regulatory compliance costs and facilitate the expansion of bank balance sheets.

The second was that in times of financial boom, however irrational it might be to supervisors who know a bubble when they see one, it is always politically difficult for a public authority to step in and put a stop to the party. Member state supervisors were too close to their domestic executives and came under pressure not to put a stop at the speculative activities that were sustaining rising incomes and jobs. A Eurozone supervisor, encompassing jurisdic-

tions that were not experiencing such credit bubbles and being at a much greater political distance from the local politicians and the banks that were momentarily benefiting from them, would have found it much easier to step in. This is borne out by the way in which the SSM has taken a much tougher stance in scrutinising the balance sheets of Eurozone banks during the stress tests and asset quality reviews that it has conducted in 2014 and 2016⁶⁶ and in its reluctance to treat leniently banks in need of extra capital.

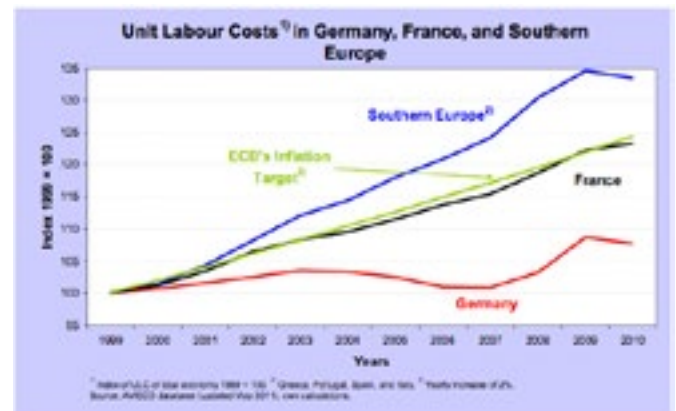
■ *The lack of coordinated economic policies, German competitive disinflation and the divergent patterns of wage developments*

The last way in which the EU's economic governance architecture prior to the Eurozone crisis affected economic developments and contributed to the accumulation of macroeconomic imbalances relates to the growing competitiveness and trade imbalances. The complete decentralisation of economic, and in particular wage and labour market, policies and the complete lack of coordination of those policies allowed Germany to pursue from the mid-1990s onwards a policy of competitive disinflation that fuelled divergent patterns of wage developments, thus contributing to the accumulation of macroeconomic imbalances.

Ironically, one of the key enabling factors of this policy was, once again, German reunification. The reunification shock did not solely generate inflationary pressures and fiscal expansion. It also operated at the labour market level and exercised a powerful downward pull on wage shares. The threat of wholesale off-shoring of plants to Eastern Germany and the other states of Eastern Europe pushed German trade unions to accept a policy of real wage stagnation in exchange for preserving employment levels. Klaus Zwickel, the then president of the powerful metalworkers' union IG Metall, proposed in 1995 a *Bündnis für Arbeit* (pact for work) in which he explicitly accepted a stagnation of real wages in exchange for the preservation of jobs in Germany. The Red-Green coalition government implemented this policy when it established the *Bündnis für Arbeit, Ausbildung und Wettbewerbsfähigkeit* (pact for work, education and competitiveness) in 1998. The key instruments of this wage freeze were the decentralisation of wage bargaining and the governance of labour markets primarily through contracts and mutual agreements instead of legislation⁶⁷. Individual firms were allowed to conduct wage bargaining

and to adjust wages to their own needs, instead of simply complying with national or sector-wide bargaining outcomes. This generated a race to the bottom that essentially froze industrial wages in Germany for more than a decade⁶⁸.

Figure 5: German disinflation and divergent wage dynamics in the Eurozone⁶⁹

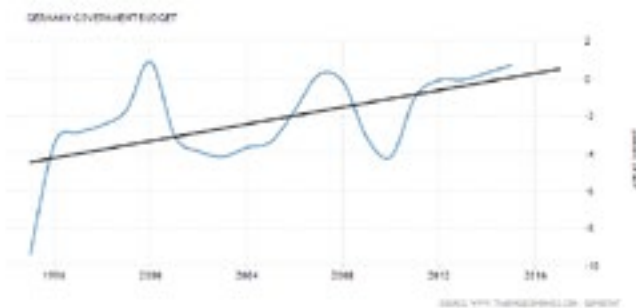


German wage moderation meant that German unit labour costs grew at a persistently lower rate than corresponding costs in the rest of the Eurozone as well as below the Eurosystem's inflation rate target (see figure 5). That led to another vicious feedback effect, since the average growth of unit labour costs and prices for the Eurozone as a whole was broadly in line with the Eurosystem's target. As the latter is supposed to pursue a single monetary policy based on average Eurozone performance, this development prevented the Eurosystem from moving to counteract the expansionary push of the introduction of the single currency by tightening monetary conditions in member states with above average wage and price developments, thus allowing the credit-driven bubbles and rising current account imbalances to continue growing unchecked.

There is, once again, a debate among economists about the specific impact of German wage moderation on macroeconomic imbalances. The standard interpretation is that wage moderation increased the competitiveness of German exports and allowed them to displace exports from other Eurozone member states, thus leading to higher trade surpluses in Germany. This interpretation has been challenged from various quarters, especially by arguing that competitiveness is not simply driven by price factors but also by non-price factors (quality of products, design, after sale-services etc.), that German exports excel in such

'non-price competitiveness' and that this accounts for most of the additional German competitiveness during the 2000s. In support of this interpretation one can also cite the fact that the Netherlands did not implement a wage freeze during the same period but still had very high and growing current account surpluses from 2002 onwards⁷⁰.

Figure 6: Trend of German fiscal policy since mid-2000s
Budgetary balance as a percentage of GDP, Source: Eurostat



Another argument against the standard interpretation is that labour costs are not the only determinant of price competitiveness. The cost of capital and industrial inputs (in particular energy) is also important. The two types of competitiveness (price and non-price) are in any case linked, as wage moderation boosts profit margins and facilitates productivity-enhancing investment and product upgrading. It is therefore difficult to entirely disentangle the various factors at play.

One point of universal agreement, however, is the impact of wage moderation in depressing domestic demand and therefore imports from the rest of the Eurozone. In this respect, German wage policy has pushed in the same direction as German fiscal policy (i.e. depressing domestic demand, see figure 6) for the past two decades.

II) THE EUROZONE'S ECONOMIC DIRECTION SINCE THE EUROZONE CRISIS: ASYMMETRIC ADJUSTMENT IN A DEFLATIONARY CONTEXT AND ITS RECESSIONARY CONSEQUENCES IN 2011-13

The outbreak and more importantly the persistence of the speculative crisis in 2010-12 demonstrated the extent to which the EU's economic governance institutions were not only at least partly responsible for the build-up in macroeconomic imbalances whose unwinding after 2009 gave rise to the crisis but also inadequate for dealing swiftly and effectively with it. Indeed, the precise shape of the Eurozone's institutional architecture reinforced the recessionary impact of the adjustment effort by imposing an asymmetric adjustment process despite the fact that the introduction of lender of last resort facilities for banks and member states actually mitigated the immediate impact of the speculative crisis.

■ *The role of the lender of last resort innovations in slowing down the pace of the unwinding of current account imbalances*

The process that would trigger the Eurozone speculative crisis in 2010-12 duly began in 2007 as part of the global financial crisis which saw a general flight to safety and, as a result, a substantial retreat of global cross-border flows⁷¹. The same thing happened within the Eurozone but in a

proportionally much greater scale (just like the expansion in cross-border flows in the years prior to the crisis had been on a greater scale within the Eurozone than globally)⁷². The unwinding of macroeconomic imbalances and the associated retreat of intra-Eurozone cross-border capital flows thus began a couple of years before the outbreak of the speculative crisis of 2010-12 and its first manifestation was through the collapse of the interbank lending market which particularly affected banks in the deficit member states.

It is from this early point in time that the Eurosystem began indirectly expanding its mandate to the safeguarding of financial stability by providing through unconventional monetary policies lender of last resort liquidity to the banks of the deficit member states in order to offset the capital outflows. As can be seen in figure 2, the Eurosystem's balance sheet began rapidly expanding in 2007. Almost at the same time, in order to facilitate this expansion and the associated liquidity provision through its main refinancing operations (MROs), the Eurosystem also started relaxing the rating requirements for eligible collateral in order to enable banks from deficit member states to use domestic assets (in particular sovereign bonds) that gener-

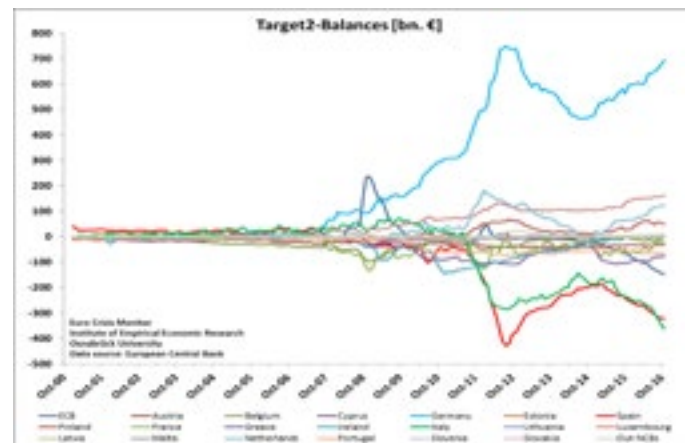
ally had a lower credit rating to access liquidity. As argued above, the culmination of this policy came in December 2011 and February 2012 through the two LTROs.

From the very beginning in 2008, the main beneficiaries of this new lender of last resort function were the banks of the deficit member states. The Spanish and Irish banks began tapping the Eurosystem for lender of last resort liquidity from early 2008 onwards, the Greek banks from late 2008 onwards, the Portuguese from mid-2010 onwards and the Italian banks from mid-2011 onwards. Even French banks began doing so from 2011 onwards⁷³. In fact, these three periods (2008, mid-2010 and mid-2011) correspond to the three main episodes of sudden reversals in capital flows within the Eurozone⁷⁴. Each time private capital flows went into reverse, Eurosystem liquidity and thus public capital flows stepped in to plug the gap.

In brief, what was happening was that capital fled the deficit member states mostly via the drying-up of international interbank financing for their banking sectors and found refuge in the banking sectors of the surplus member states. As a result, banks in the surplus member states scaled back the liquidity which they were tapping from the Eurosystem (until 2010, German banks were the main beneficiaries of Eurosystem MROs). The additional liquidity there was then lent back to banks in the deficit member states through the Eurosystem. Central banks in the surplus member states lent the additional incoming liquidity to central banks in the deficit member states which used it to refinance their domestic banks through the lender of last resort liquidity provisions⁷⁵, whereas until about 2008 the liquidity available in each member state was enough to conduct conventional refinancing operations. The accumulating claims of surplus member state central banks on deficit member state central banks (recorded through the so-called Target2 balances) amount to the cross-border *public* capital flows organised through the central banking system in order to offset the *private* capital outflows from deficit to surplus member states. The extent of these flows is shown in figure 7. This figure tells more or less the same story as the data on which national banking sectors mostly tapped the Eurosystem's lender of last resort liquidity facilities, namely the Spanish and Italian ones. But it also shows that the liquidity they tapped was essentially drawn from the German banking system which had been the main destination of the capital outflows in 2007-12. In a word, the Eurosystem's balance sheet replaced the private interbank market in an attempt to offset the unwinding of the current

account imbalances that had built up since the introduction of the single currency. This had the salutary effect of preventing the total collapse of the banking sectors of the deficit member states and the outbreak of a full-blown financial crisis in the Eurozone.

Figure 7: Target2 balances⁷⁶



The second way in which public capital flows through lender of last resort facilities offset the capital flight from deficit to surplus member states was through the EFSF/ESM loans. These were mostly used to offset capital flight from the sovereign bond markets of the deficit member states – the second major channel through which prior to the financial crisis intra-Eurozone cross-border capital flows were channelled to the deficit member states – and were triggered precisely when such capital flight started taking place, i.e. following the 2010 Greek crisis.

This large-scale replacement of private capital flows by public capital flows had two main economic consequences. The first was that it protected private investors from the consequences of the puncturing of the bubbles they had financed in the deficit member states and the subsequent unwinding of the intra-Eurozone current account imbalances. As Lane puts it: 'Large official gross flows also allowed private-sector foreign investors in creditor countries to exit from positions in the high-deficit countries by declining to rollover expiring claims. In the absence of large-scale official flows, foreign investors would plausibly have incurred larger valuation losses through sharper declines in asset values and more extensive debt write-downs⁷⁷. In other words, the public capital flows did not aim to correct the misallocation of capital carried out by private investors

in the previous years by funding productive investments but instead shielded those investors from the worst consequences of their own excesses.

The second economic consequence was that it slowed down the adjustment process entailed by the unwinding of the macroeconomic imbalances. This can be seen through a comparison of the adjustment in non-Eurozone member states that had also built up current account deficits (such as the Baltic countries and Bulgaria) and the adjustment in Greece, Spain and Portugal⁷⁸. The non-Eurozone member states unwound current account imbalances of between 15-25% of GDP in two to three years. The Latvian adjustment was particularly brutal, as it transformed a deficit of around 21% in 2007 to a surplus of around 8% in 2009. By contrast, the Greek current account deficit declined from around 15% of GDP in 2008 to 10% in 2011. The adjustment programmes implemented after 2010 sped up the process, as the Greek deficit fell to 2.2% in 2013 and has since stayed more or less constant. But the Greek adjustment pales in comparison to its Latvian counterpart. Whereas it took Greece around five years to effect a 12.8% reduction in its current account balance as a percentage of GDP, Latvia reduced its balance by 29% in a single year.

In brief, the public capital flows generated by the lender of last resort facilities introduced during the crisis simply slowed down and extended over time the recessionary adjustment process for deficit member states instead of transforming its nature through productivity-enhancing publicly-funded investments. Such investments could have (more or less quickly depending on their scale) rebalanced deficit member state economies away from the unproductive non-tradeable sectors towards the productive tradeable ones and would, as a result, have immediately spurred export growth by raising labour productivity instead of by lowering prices and wages and generating a double-dip recession. Indeed, the conditionality attached to the ESM public capital flows was used to force through a policy of structural adjustment through structural reforms and the compression of wage costs in deficit member states.

■ *The asymmetric unwinding of macroeconomic imbalances and the recessionary consequences of the decentralised fiscal and economic policy-making framework*

Although the lender of last resort facilities softened the impact of capital flight and slowed down the unwinding of

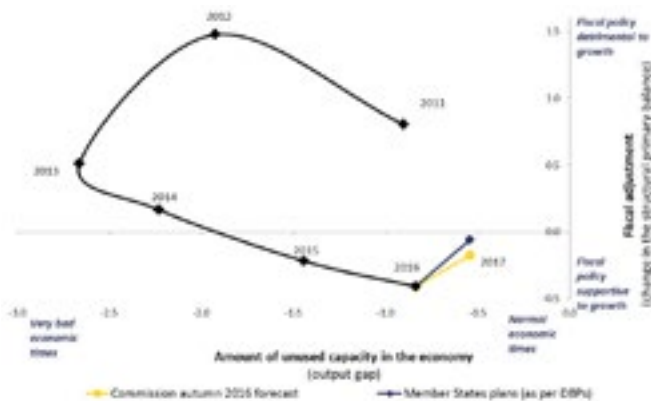
current account imbalances, the lack of a centralised fiscal policy or hard form of coordination resulted in an asymmetric adjustment process in a broad disinflationary context.

As argued above, one reason for this was that the absence of a central Eurozone budget, tasked with allocating productive investments across the monetary union on the basis of a conscious policy of convergence between the various regional component economies, meant that the only way for the imbalances to be unwound was through a downward adjustment of prices and wages in deficit member states – a policy known as internal devaluation. However, this could have been to some extent avoided if a hard form of coordination of fiscal and economic policies – instead of the SGP and MIP asymmetric framework – had helped deficit member states through a process analogous to the pan-European macroeconomic consequences of German reunification twenty years earlier. If the Commission's mandate had been to act as the Eurozone's finance minister and if the TFEU had granted it the power to constrain much more forcefully all member states to follow its prescriptions, the Commission could, theoretically, have recommended higher public spending (in particular investment) and substantial wage increases in surplus member states so as to significantly boost domestic demand there and suck in exports from deficit member states. In such a scenario, the distribution of the adjustment effort in deficit member states between export growth and import compression would have been more growth-friendly as exports would have risen much more quickly and imports would have fallen much less than they actually did. The overall adjustment process would have been more symmetrical, its consequences much less recessionary and the overall economic direction of the Eurozone less disinflationary (see the last point in this section).

Instead, the surplus member states not only imposed a disinflationary adjustment with recessionary effects on deficit member states through public spending and wage cuts, but they also pursued a contractionary fiscal and economic policy themselves, taking advantage of their lower borrowing costs generated by the capital outflows from the deficit member states in order to speed up their return to fiscal balance as mandated by the SGP. In other words, they chose to pass onto their wealthier taxpayers their lower borrowing costs instead of funding rising volumes of public investment that would have benefitted their constituencies as a whole as well as boosting domestic

demand and raising productivity. Germany, in particular, went from a budget deficit of 4.2% in 2010 to just 0.1% in 2012 and even registered a surplus of 0.7% in 2015. German labour costs also decreased between 2009 and 2012 before following a consistently upward trend thereafter⁷⁹.

Figure 8: Eurozone fiscal stance and its pro-cyclical character, 2011-17



These policies had a clearly recessionary effect as they supplemented the ongoing process of private sector deleveraging with public sector deleveraging and thus tipped the Eurozone back into recession from late 2011 to early 2013. Private investment in the Eurozone declined from a peak of about 20% in 2007 to around 17% in 2014. Public investment also declined from its peak of 3.6% of GDP in 2009 through to 2014 when it remained below its pre-crisis level of around 3%⁸⁰, whereas the logic of counter-cyclical fiscal policy would have demanded that it rise to at least partly compensate for the decline in private investment. In Germany, public investment not only kept falling but was also below the Eurozone level by about 0.7% of GDP⁸¹ despite the fact that the German federal government had the fiscal space to boost public investment as the Commission finally pointed out in November 2016. As the Commission also pointed out in its associated communication, the overall fiscal stance in the Eurozone was contractionary in 2011-14 and only slightly expansionary in 2015-16 (see figure 8). These data also point to the pro-cyclical character of overall Eurozone fiscal policy, in particular in 2011-13 when economic activity was retrenching and therefore called for fiscal stimulus. The trend line in the graph moves from the bottom right end of the graph (fiscal expansion and normal economic times) to the upper left end (fiscal contraction and economic recession) when a counter-cy-

clical policy would be precisely the opposite (from bottom left to upper right).

■ How the decentralised banking policy framework aggravated the speculative crisis and reinforced its recessionary consequences

Finally, the decentralised banking policy framework also had detrimental economic consequences during the Eurozone crisis. It aggravated the speculative crisis and prolonged the interbank market credit crunch in a way which significantly tightened credit conditions in deficit member states and therefore reinforced the recessionary consequences of fiscal and economic policy there.

The lack of a single Eurozone supervisor and the decentralisation of the contingent fiscal liability for bank bailouts reinforced doubts about the solidity of the banks in deficit member states. Three mechanisms were at play here. To begin with, the decentralisation of banking supervision and the associated regulatory politics of banking nationalism meant that financial investors continued believing that bank balance sheets had not been repaired after the 2007-08 financial crisis and that the banking system remained fragile. This contributed to the credit crunch in the interbank market. The perception of supervisory cover-up also proved to be correct. The EBA coordinated EU-wide stress tests conducted by member state supervisors in 2009, 2010 and 2011 and these tests showed that banks like the Franco-Belgian Dexia or the Spanish Bankia were perfectly sound. When these collapsed in due course, the proof that member state supervisors were protecting 'their' banks was out in the open. The Bankia collapse in particular was the one that triggered the decisive move to banking union in the June 2012 European Council. The Spanish government had said in February 2012 that the bank was sound, only to decide on a €19 billion recapitalisation plan two months later. During the same period, some €100 billion left the country⁸².

The second mechanism at play was the uncooperative interaction between member state supervisors. Each national authority asked the banks it supervised to repatriate liquidity and privilege its lending operations within its home member state. Each supervisor looked, in fact, to protect national liabilities first and even to support the sovereign bonds of its associated member state by asking the banks it supervised to increase their holdings of such bonds. This was a powerful driver of the process of financial

fragmentation of the Eurozone which reinforced the pattern of private capital flight and therefore prolonged and intensified the speculative crisis.

The last mechanism was the 'doom loop' described above. The fact that each member state was fiscally liable on its own for the solvency of its domestic banking system raised doubts about the solvency of the deficit member states and in return the declining valuations of sovereign bonds on secondary markets weighed down on bank balance sheets.

These mechanisms prolonged the financial crisis conditions – in particular the credit crunch in the interbank market – for two or three additional years from 2010 onwards and meant that banks in deficit member states tightened credit provision to local small and medium sized companies that depend on domestic bank lending. In Italy, the outstanding volume of loans to the private sector has been on a steady downward trend since late 2011⁸³ whereas in Spain the trend has been steeply downwards from 2009 onwards⁸⁴. The interbank market credit crunch was thus transmitted to the real economy and has far outlived the collapse of the various property bubbles in deficit member states.

■ *The disinflationary direction of the Eurozone since the outbreak of the speculative crisis*

The overall economic consequences of the Eurozone crisis have been what could be called the Germanisation of the

Eurozone. The Eurozone's current account with the rest of the world has swung heavily into surplus from a small deficit in 2009⁸⁵. The surplus was above 3% of Eurozone GDP in 2016, making the monetary union the main surplus region in the world economy ahead of both Japan and China. This development has been especially pronounced from 2011 onwards, after the turn to the policy of structural adjustment for deficit member states, the general contractionary turn of the Eurozone's overall fiscal stance and the double dip into recession. And just like for the deficit member states in relation to the rest of the Eurozone, this has mostly been achieved through a persistent depression of domestic demand instead of through a particularly rapid growth in exports. Not only did wage levels in the deficit member states decline but investment levels also plunged as reported above. Eurozone unemployment rose from trough (2008) to peak (2013) from around 7% to above 12% with half of the rise concentrated in 2011-13⁸⁶ and youth unemployment has been about double that⁸⁷. Inflation declined in the Eurozone from late 2011 to 2015 – briefly turning negative that year – before picking up in 2016 after the Eurosystem finally embarked on a programme of quantitative easing. Economic indicators have picked up since 2013, but the recessionary shock of 2011-13 has had a lasting impact. The investment gap and the lost output and lower productivity growth that this entails are, in particular, quite substantial⁸⁸.

B) POLITICAL CONSEQUENCES OF THE EUROZONE CRISIS

The final aspect to be examined in this report are the political consequences of the evolution of the EU's economic governance architecture since the Eurozone crisis. One can distinguish two dimensions here: first, the constitutional changes that have resulted from this evolution, the

new political dynamics unleashed by these changes and the overall evolution of the EU's federal pact; second, the impact that the Eurozone crisis and its management have had on mass politics in terms of electoral dynamics, labour struggles and public opinion shifts.

I) THE SHIFT OF FURTHER POWERS TO THE EUROPEAN LEVEL AND THE RISE OF ASYMMETRIC EXECUTIVE FEDERALISM ON FISCAL POLICY

■ *The unconventional and improvised shift of further powers to the European level*

Probably the single most salient constitutional aspect of the evolution of the EU's economic governance architecture since the outbreak of the Eurozone crisis has been the shift of further powers from the member states to the European Union level. As Agustín Menéndez highlights with respect to the overall constitutional innovations, these "have not been adopted through "standard" supranational Treaty amendment process but taken off the beaten constitutional track through ordinary law-making procedures, through peculiar intergovernmental negotiations and last but not least, through the toleration of new institutional practices. Most relevant constitutional decisions, have, moreover been taken on the (constitutional) hoof"⁸⁹. In other words, substantial powers have been shifted from the member states to the European Union level in an unconventional and largely improvised manner as a response to the Eurozone crisis. Just like in the past, this crisis has acted as an integrationist catalyst and major constitutional decisions have been taken under duress.

One consequence of this is the relative erosion of the rule of law entailed by the legal gymnastics that have been necessary to effect the shift of powers to the European level of government and that often contradict the spirit and even the letter of the treaties. The French finance minister and future managing director of the IMF, Christine Lagarde, reportedly admitted this in December 2010, declaring in relation to the Greek and Irish assistance programmes that 'We violated all the rules because we wanted to close ranks and really rescue the euro zone ... The Treaty of Lisbon was very straight-forward: No bailout.⁹⁰ Similarly, the Eurosystem's OMT programme has been legally challenged for breaching the clause prohibiting the monetisation of public debt (article 123 TFEU) and although the ECJ has ruled that the programme does not violate the treaty, it seems pretty obvious that the Eurosystem's indirect assumption of the function of lender of last resort for member states contradicts the spirit of the treaty (at least such as it was intended by those who inspired the relevant treaty article).

Some powers have been shifted in wholesale fashion to the European level. This is in particular the case for financial and banking policies. The lender of last resort function

– both for banks and member states – has been granted to the Eurosystem and the ESM. Although the settlement agreed in Maastricht did not include such a function at the European level, this did exist prior to the Maastricht agreement but remained entirely decentralised at the member state level. The institutional gap created in Maastricht has therefore been bridged through a substantial and decisive empowerment of the European level of government.

But this empowerment has not happened through conventional constitutional reform procedures. The Eurosystem essentially extended on its own its mandate through its unconventional monetary policies and this *de facto* extension was then legitimised by the ECJ through the Gauweiler judgment (C-62/14). As for the ESM, it was set up as an international organisation through an intergovernmental treaty that came into force in September 2012 *before* an amendment of article 136 TFEU authorising the setting up of such a fund⁹¹ had entered into force. The ESM is therefore not properly integrated into the body of EU law and plans for its introduction into TFEU do not foresee such a development at the earliest before July 2017.

The second power to have been transferred to the European level of government in wholesale fashion is banking policy (except, for the moment, deposit guarantee schemes). Both supervision and resolution are now centralised and even the task of recapitalising systemic banks has been acknowledged as falling under the remit of the ESM. Resolution funding is also being progressively centralised through the gradual merger of national resolution funds into the Single Resolution Fund. The SRF will be funded by a bank levy and its setting up therefore entails a modicum of fiscal federalism since what essentially are fiscal resources will be Europeanised.

In the case of banking union, the legal framework is also confusing. TFEU article 127(6) had envisaged the possibility of transferring micro-prudential prerogatives to the ECB and was therefore used as the legal basis for the setting up of the SSM⁹². The SRM was also set up through a regulation⁹³ but the SRF was set up following another intergovernmental agreement in May 2014⁹⁴ and is, again, outside the body of EU law.

Finally, the macro-prudential supervision of the EU's financial system has been Europeanised through the ESRB,

although this is a development unrelated to the Eurozone crisis as it was the result of the 2009 de Larosière report and subsequent conventional reform procedures.

The empowerment of the European level of government in the case of fiscal and economic policies is of a much lesser scope but nonetheless real in that the OMC has been effectively abandoned for economic policy. The reform of the SGP, in particular the lower majority threshold for sanctions, and the institution of the MIP empower the Commission by both extending the range of member state policies that it monitors and on which it makes recommendations and by slightly strengthening its capacity to constrain member states to comply with its prescriptions. The Council in its composition of Eurozone member state finance ministers has also been empowered by these innovations in that it has to adopt the Commission's prescriptions. The institution of the European Semester, despite only being a procedural change, also empowers both of these institutions as the policy-making cycle in individual member states now has to conform to the supranational cycle and member state legislation first has to be examined by the Commission and the Council before reaching the floor of member state legislatures.

There is, moreover, the exceptional case of member states receiving financial assistance from the ESM which, beyond the four crisis cases (Greece, Ireland, Portugal and Cyprus), is now a permanent feature of the EU's economic governance architecture. In such cases, a kind of temporary and exceptional constitutional transformation is foreseen, in which fiscal liability for borrowing needs is centralised and, in exchange, so is fiscal and economic policy. Again, as these programmes fall within the scope of the ESM, the legal framework falls without the body of EU law.

■ *The rise of executive federalism and the lengthening of the chain of democratic legitimacy*

The above enumeration of the specific institutions to have been empowered through the shift of powers to the European level includes one key absentee: the European Parliament, i.e. the federal legislative branch of government elected by universal suffrage in a system of proportional representation and as such the one to enjoy the greatest degree (or the shortest chain) of democratic legitimacy and which, as a result, is the guarantor of democratic accountability in the EU system of government. The Parliament's role in the emerging institutional set-up is strictly limited to

formulating opinions and auditioning the representatives of other supranational institutions that hold actual power (the Commission and the ECB); in no way does it share in the formulation, let alone the conduct, of policy. In the case of the financial assistance programmes, the European Parliament was even entirely left out of the loop as opposed to the Commission and the Eurosystem (through the ECB) which, together with the IMF, were tasked with negotiating adjustment programmes with assisted member state governments, monitoring their evolution, assessing member state compliance with the agreed programmes and recommending to the Eurogroup whether or not to disburse the funds provided for by the agreements. The European Parliament can thus be said to only have consultative and accountability through transparency functions under normal circumstances and to be entirely excluded from the policy-making process under exceptional circumstances (precisely the ones where the centralisation of powers is the greatest).

By contrast, the supranational institutions to have been substantially empowered (the Commission, the Eurogroup and the Eurosystem) are all parts of the executive branch of government and therefore have a longer chain of democratic legitimacy as they are not directly designated by universal suffrage. The Eurosystem, moreover, is not accountable to any legislature, as opposed to the Commission (European Parliament) and the finance ministers making up the Eurogroup (member state parliaments), as its members cannot be revoked or impeached and do not need to win a vote of confidence in parliament.

The net result of the Europeanisation of further powers has therefore been to strengthen the executive branch of government to the detriment of the legislative branch and thus to lengthen the chain of democratic legitimacy enjoyed by the governing institutions of the European Union and to reduce the overall extent of democratic accountability of the decision making process. This development, therefore, aggravates what is usually referred to as the democratic deficit of the EU.

Ben Crum refers to this development as 'executive federalism'⁹⁵ and further notes, in relation to fiscal and economic policy, that because ultimate decision-making power rests with the member states through the role played by the Eurogroup, the intergovernmental dynamics that preside over that body's deliberations further erode the influence that member state legislatures can have on policy-making, thus further weakening the democratic legitimacy of the

overall structure⁹⁶. The same effect can be attributed to the functioning of the European Semester after the adoption of the two-pack regulations since proposed legislation is first shown to the Commission and the Eurogroup before coming to the floor of member state legislatures. Although these retain the ultimate decision-making power, this is constrained by the inter-executive bargaining over reform agendas that takes place in Brussels through the interaction of the Commission and the Eurogroup.

In Crum and Snell's analysis, executive federalism is the result of the operation of Dani Rodrik's 'political trilemma of globalisation', in which there cannot simultaneously be substantive democratic government (in the sense of decision-making under the effective control of directly elected legislatures), national determination and international economic integration. The preservation of the Eurozone thus entails either a lengthening of the chain of democratic legitimacy as analysed here in order to preserve formal control over fiscal and economic policy at the member state level (executive federalism, a combination of national determination and international integration) or the democratisation of the new institutional architecture through the substantial empowerment of the European Parliament, in which case a Eurozone finance ministry (the Commissioner for economic and financial affairs) would formulate fiscal and economic policy for the Eurozone as a whole under the political control of the European Parliament (democratic federalism, a combination of democratic government and international integration). This would ultimately come down to a vote on a Eurozone budget. In this analysis, democratic federalism is closely associated with the state capacity identified by Aglietta as necessary for bringing stability and completing the Eurozone.

■ *The asymmetric character of executive federalism in fiscal and economic policy and the crisis of the constitutional consensus*

The rise of executive federalism in fiscal and economic policy has one other crucial implication. Crum spells this out as follows: 'The second implication of the key role of executives is that this mode of decision-making basically evolves according to the logic of international power rather than that it is subject to procedural principles that ensure transparency, the equality of Member States and their right to

self-government. In other words, under executive federalism it is the creditor states that call the shots.⁹⁷

In other words, because this executive federalism essentially hinges on the Eurogroup and its intergovernmental dynamics, the bargaining power asymmetries that preside over the operation of this body entail an empowerment of surplus member states in relation to the standard constitutional settlement that generally presides over the EU's functioning. (This settlement is based on the legislative initiative of the Commission and the co-decision procedure where the Council and the Parliament act as co-legislators). This, in turn, has fuelled a crisis of the established constitutional consensus underpinning the EU's federal pact through the enfeeblement of deficit member states (and thus the break with the principle of substantive equality between member states), the marginalisation of the Commission (and thus the weakening of the community method of government) and the sidelining of the Parliament (and thus the lengthening of the chain of democratic legitimacy as detailed above). This is probably the most widely held assumption about the nature of the EU's economic governance architecture such as it has evolved since the Eurozone crisis, in particular its popular version which sees in the German chancellor the ultimate arbiter in the EU.

Menéndez points out⁹⁸ in support of this interpretation that within the ESM emergency decisions can be taken when an 85% majority is reached (under normal circumstances, unanimity is required⁹⁹). Since votes are weighted according to the share of the ESM's capital subscribed by each member state, this threshold effectively grants a veto to Germany, France and Italy – the three biggest member states within the Eurozone and the three most important ESM shareholders. Given that Germany is much more likely – as a surplus member state – to voice hawkish views on matters pertaining to financial assistance to member states, this rule effectively enshrines its capacity to dictate terms in such (exceptional) cases. The asymmetric adjustment process undergone by the deficit member states since the onset of the crisis confirms this interpretation.

II) THE POLARISATION BETWEEN NORTHERN FISCAL CONSERVATIVES AND SOUTHERN OPPOSITIONS OF FISCAL RETRENCHMENT AND STRUCTURAL ADJUSTMENT IN THE CONTEXT OF LONG-TERM STRUCTURAL SHIFTS IN MASS POLITICS

■ *Disentangling the Eurozone crisis's political consequences from long-term structural political developments*

The constitutional consequences of the Eurozone crisis are plainly obvious and can easily be attributed to the crisis itself. The same, however, cannot be said about the crisis's impact on mass politics in any of its various manifestations, be they the ebb and flow of labour struggles, electoral dynamics or trends in public opinion. These are as much, if not to a greater extent, determined by long-term structural shifts in the way capitalist democracies operate as they are by conjunctural factors relating to the short-term economic and political cycle. It is therefore important to try to disentangle the political consequences of long-term structural shifts in advanced capitalist democracies from those specifically related to the Eurozone crisis.

In particular, the most salient recent development in mass politics in both sides of the Atlantic has been the electoral success of populist radical right-wing forces. This development is by no means a specific feature of the Eurozone, as evidenced by the election of Donald Trump in the White House and the broader electoral victory of a radicalised Republican Party in the 2016 Congressional and gubernatorial elections in the United States as well as the success of the Brexit campaign in the June 2016 referendum in the United Kingdom. Both events have overshadowed all comparable developments in the Eurozone, from the surge of right-wing populists in the 2014 European elections to the narrow defeat of the far-right candidate, Norbert Hofer, in the 2016 Austrian presidential election and the Front National's performances in various electoral contests since 2014 in France, including Marine Le Pen's presence in the second round of the 2017 presidential election. Similarly, the more limited breakthrough of various radical left forces such as Podemos and Syriza in the Eurozone is paralleled by the sweeping victory of Jeremy Corbyn in the leadership contest in the British Labour Party and Bernie Sanders's energetic and widely popular though ultimately unsuccessful bid at the Democratic Party's presidential primaries in the United States.

The point here is not to deny the importance of the Eurozone crisis in shaping mass politics since the outbreak

of the Greek crisis in 2010. In some cases, like Greece for example, that impact is far too easily recognisable. Rather, it is to situate the consequences of the crisis in the context of long-term trends in order to examine whether it has resulted in breaks from those trends or whether continuity has prevailed.

The first point to consider is the long-term evolution of working class and trade union strength. On this front, once more, developments are common to both Europe and America. The long-term decline in trade union and working class strength has continued since the crisis and no substantial reversal can be observed. All three indicators of trade union strength – membership, density and collective bargaining coverage – show continued, albeit modest, decline since 2010¹⁰⁰. Union density remains higher in Europe than in America although the decline is similar in direction and timing, the bulk of it being concentrated in the 1980s.

But whilst membership and density have only slightly decreased since the onset of the crisis in the European Union, collective bargaining coverage has declined more markedly in step with the trend towards bargaining decentralisation, in particular in the Eurozone's deficit member states. The decline was most dramatic in Greece, from around 85% coverage in 2008 to 40% in 2012. In Spain, the corresponding drop was from 80% to around 57% and in Portugal from 83% to 67%¹⁰¹, a development clearly attributed to the financial assistance programmes by the Commission's own admission, which also notes that 'decentralisation and the decline in bargaining coverage were clearly visible trends even before the crisis ... What has changed since the crisis is the speed and degree of the changes that have occurred'.

The changes are largely attributed to government intervention in labour market institutions due to the commitments that deficit member states made in the context of financial assistance programmes. The Commission also notes that the long-term decline in centralised (nation or sector-wide) collective bargaining and coverage is due to the declining value that employers attach to such bargaining in limiting competition on labour costs. The growing impact of the internationalisation of competition renders irrelevant such centralised bargaining as production units in a

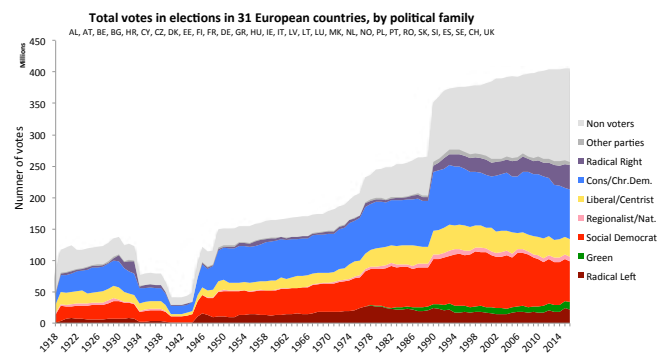
single member state economy are not simply in competition with each other but also have to compete with units abroad where national collective bargaining norms do not apply¹⁰². Decentralisation of collective bargaining thus affords employers the flexibility to adapt to international competitive pressures by more easily adjusting downwards wages and working conditions. In this respect, the industrial relations and other related labour market reforms (reductions in the minimum wage and relaxation of employment protection legislation) undertaken in the context of the adjustment programmes have aligned deficit member states with trends that had already prevailed in the rest of the European Union¹⁰³. The long-term trend in labour market institutions seems to be a social race to the bottom driven by competition between member state norms which, short of returning to closed autarchic national economies, could potentially only be challenged by the Europeanisation of collective bargaining¹⁰⁴. This is similar to the political trilemma outlined above: in an era of international economic integration, effective centralised bargaining is incompatible with nominally national bargaining structures. However, no trend in favour of pan-European centralised bargaining is discernible since the Eurozone crisis.

Finally, the confirmation of trade union and working class weakness throughout the crisis can also be seen in indicators of industrial conflict. In the United States, the number of strikes has declined to a trickle since the financial crisis and is lower than in the 2000s and much lower than in the 1990s and 1980s¹⁰⁵. The European Trade Union Institute reports similar declines in Europe, with the number of days lost due to strike action per 1000 workers being lower in 2010-15 (38) than in 2000-09 (53) and even lower than in 1990-99 (≈ 95)¹⁰⁶. In short, there is no discernible upturn in labour struggles due to the Eurozone crisis and the structural adjustment programmes implemented in deficit member states; the long-term trend of trade union and working class weakness that began in the early 1980s has continued in the same path as before the crisis. There is, in other words, no challenge from a labour movement that continues to suffer from the impact of the long-term rise in unemployment, the shift from manufacturing to services and the renewed reluctance of employers to accept the presence of unions in workplaces¹⁰⁷. If the Eurozone crisis has had a specific impact, it has been to accelerate these trends in the deficit member states.

The second point to consider relates to the electoral rise of right-wing populism. The latter's rise largely precedes

the Eurozone crisis and there seems to be little evidence that the crisis had a decisive impact on the populist right's electoral fortunes. Most scholars date the resurgence of this political tendency back to the early 1980s¹⁰⁸. A recent study based on an exhaustive set of data covering 268 parties in 31 European countries concludes that a modest rise occurred during the 1970s followed by a surge in support in the 1980s and 1990s and a levelling off thereafter. The re-introduction of multi-party systems in former Eastern-bloc countries in the early 1990s was, in particular, a major push for the populist right¹⁰⁹. A similar conclusion can be arrived at on the basis of a similar calculation by Simon Hix and Giacomo Benedetto¹¹⁰ (see figure 9), which also shows a further rise in electoral support for the populist right since 2012.

Figure 9: 100 Years of European Electoral Politics



If one considers the case of the French Front National – probably the most consequential of the established European populist radical right parties – this seems a good description of the evolution of the party's electoral fortunes. After failing to get onto the ballot in the 1981 presidential elections, the party's real breakthrough came in the 1986 legislative (9.65%) and the 1988 presidential elections (14.39%). In the 1990s, the FN oscillated between 12% and 15% of the vote and in the 2002 presidential election, the total score of the two populist right-wing candidates rose above 19%¹¹¹. The FN's share of the vote in the 2012 presidential election (17.9%) was broadly in line with the party's electoral strength during the previous twenty-five years and Marine Le Pen's score in the first round of the 2017 presidential election (21.3%) did represent another modest rise in support¹¹².

Moreover, developments since the Eurozone crisis do not lend much support to the narrative of a big boost for the populist right coming from the fallout of the crisis. The

Dutch Partij voor de Vrijheid (PVV) thus saw its share of the vote drop from 15% in 2010 to 10% in 2012 at the height of the crisis. And although the party recovered to 13.1% in the 2017 general elections, this was an underwhelming achievement. In Belgium, the Vlaams Belang has kept losing votes since 2007 and in Austria, the combined far right share of the vote was 29% in 2008 and 27% in 2013. In Italy, the two avowedly populist right-wing parties – the Lega Nord and the Fratelli d'Italia (the closest heir of Alleanza Nazionale) – only got a combined 6% in 2013, a much lower share of the vote than at any general election since the mid-1990s¹¹³. The German Alternative für Deutschland failed to pass the 5% threshold in the 2013 Bundestag election and has really only seen its popularity soar after the outbreak of the refugee crisis in 2015.

The rise of the populist radical right has generated an avalanche of studies by political scientists to the point that since the early 2000s, academic studies of this party family outnumber the combined number of studies for all other party families put together¹¹⁴. Predictably enough, there is a lot of disagreement about the drivers of the populist right's electoral rise, with some focusing on the impact of economic restructuring and globalisation and others on socio-cultural determinants. The interpretation that seems best equipped to make sense of the electoral phenomena described briefly in the previous paragraph is that the populist right's rise reflects a rear-guard battle by formerly dominant groups of traditionalist voters (older, white, religious, less educated, men, mostly from the petty bourgeoisie) against the gradual advance of the progressive agenda on social issues associated with the New Left political wave and related autonomous single-issue movements (LGBT and women's rights, racial equality, multiculturalism and support for immigration, environmentalism, anti-authoritarianism). In other words, the populist right is an expression of a cultural and nativist backlash against social liberalism and progressive social change and is to a large extent unrelated to issues of economic distribution. The study by Inglehart and Norris cited above shows that this is the most consistent driver of support for far right populist parties, whereas evidence about the importance of economic issues is mixed¹¹⁵. Thus, whereas all the populist parties in their study are socially conservative and reactionary, they divide roughly equally on economic issues with some holding libertarian positions and others favouring protectionism, state intervention and social safety nets. Their rise is closely correlated with the declining salience of econom-

ic issues in party programmes and the rising salience of non-economic ones. The single most important socioeconomic group voting for them is the petty bourgeoisie and the support they enjoy among each successive generation of voters declines. These findings dovetail with the observation that sociocultural issues are much more important for populist right parties than socioeconomic ones and that the only policy issue on which they have succeeded in influencing government policy is immigration¹¹⁶.

Thus, a plausible interpretation is that during an economic crisis, when the salience of the issues with which they are most clearly identified declines, these parties find it harder to get their message across and thus fade into the background. They perform best during good economic times, an interpretation which can make sense of the persistently high showings of the Swiss Schweizerische Volkspartei (the single most successful populist right party in Europe) and the Austrian Freiheitliche Partei Österreichs or the surge of the Finnish Perussuomalaiset and the Swedish Sverigedemokraterna since 2010. This interpretation could also make sense of the case of the French FN which is torn between an economically liberal wing that believes that Eurosceptic rhetoric against the single currency should be toned down in favour of classically conservative positions against high taxes and red tape on small businesses and an economically statist, sovereignist and protectionist wing that insists instead on the issue's importance¹¹⁷. Both wings of the party, however, share the party's fundamentals on immigration, multiculturalism and authoritarianism and agree that these are the main ingredients of the party's success. Similarly, the German AfD's founder, Bernd Lucke, an academic macroeconomist who set up the party in 2013 in protest at Merkel's handling of the Eurozone crisis, left the party in July 2015 claiming that it was becoming 'islamophobic and xenophobic' after he lost the leadership contest to Frauke Petry¹¹⁸, an exponent of the party's far right wing who has accentuated the AfD's anti-immigrant profile. It is only following Petry's takeover that the AfD has soared in opinion polls¹¹⁹.

The last point to consider here is the long-term trend of Euroscepticism in public opinion and the confidence of EU citizens in EU institutions. Can the Eurozone crisis be said to have led to a substantial rise in Euroscepticism in public opinion that marks a departure from previous trends and has it weakened confidence in the EU?

The most frequently cited and long-running indicator of Euroscepticism comes from the regular Eurobarometer survey run by the Commission since 1973 and relates to

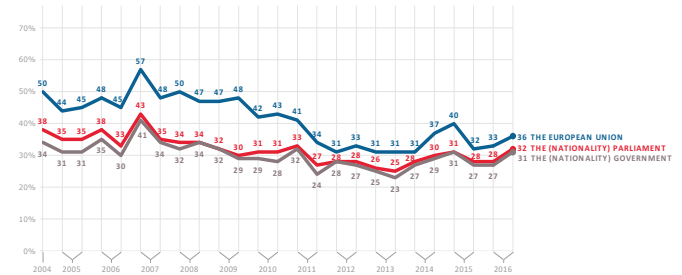
support for EU membership. Figure 9 shows the evolution of positive and negative views relating to EU membership. The sharpest decline in positive views took place in the early 1990s and since then the average level of positive views seems to have remained below the average for the years 1973-1991, although still substantially above the level for negative views. These rose in the early 1990s, declined until 2002 and then rose again, although since 2003 they seem to have stabilised at around 17%. Post-2010, both positive and negative views have been stable.

Figure 10: Opinion about EU membership¹²⁰



The latest Eurobarometer survey reports results about trust in the EU and member states (see figure 10). This fell across the board from 2007 until 2013 and has only slightly recovered since. The EU has consistently enjoyed a higher level of trust than member state governments but the gap narrowed from 2011 onwards from double to single digits, a development that could be attributed to the Eurozone crisis, especially since the same survey shows that in 2011-13 the gap between positive and negative images of the EU narrowed down to 1% from 35% in 2006 before widening again to 22% (2015) and 10% (2016). However, Eurozone-only data offer at best mixed evidence about the impact of the Eurozone crisis on public opinion. Net support (those in favour minus those against) for the single currency did slide in 2010-13 to around 33% before rising thereafter back up around 42%¹²¹. But to the question whether the euro was a good or bad thing for their country, positive responses rose from 51% in 2010 to 57% in 2013 and negative ones fell from 36% in 2011 to 33% in 2013¹²².

Figure 11: Eurobarometer % – EU – Tend to trust



On balance, then, it seems difficult to conclude that the Eurozone crisis has led to a surge in Eurosceptic attitudes in public opinion – either towards EU membership or the single currency. Rather, the evidence suggests that satisfaction with and confidence in EU institutions has fallen in line with satisfaction with member state governments (albeit in a greater proportion), a development which signals growing public dissatisfaction with the system as a whole rather than a surge in Euroscepticism.

There is, then, very little evidence to support the claim that the Eurozone crisis has had a substantial impact on long-term trends in mass politics in Europe. It has not reversed trends in working class and trade union strength, does not seem to have contributed in any significant and precise way in the electoral rise of the populist right and has not had any clear-cut overall impact on public opinion towards European Union membership and the single currency.

This is obviously not to say that it has not shaped European mass politics in any sort of way. But, quite clearly, it has done so in contrasting ways according to whether one is looking at surplus or deficit member states.

■ *The fiscal conservative revolt in surplus member states*

In surplus member states, the most salient political reaction against the measures introduced during the Eurozone crisis has been a revolt by wealthy middle-class fiscal conservatives against those elements of the institutional innovations that entail fiscal liability pooling as well as the extension of the Eurosystem’s mandate and the impact of its unconventional monetary policies. These voters tend to be net contributors to the public budget and therefore envisage any extension of the actual or contingent fiscal liability of their governments as a liability on them. They constitute, therefore, the main support base for tax and public spending cuts and their ideology is that of small govern-

ment. They also tend to have substantial savings and fear nothing more than the prospect of inflation which would devalue their wealth; they have therefore been adversely affected by the ultra-loose money policies of the Eurosystem. In this respect, they form the backbone of the creditor mentality in surplus member states and have envisaged the handling of the Eurozone crisis as a struggle to prevent the financial assistance packages from shifting losses onto their own pockets – either through the extension of their government's fiscal liabilities or through inflation (which would devalue the stock of public debt and thus help deficit member states).

This fiscal revolt has by no means been confined to the populist right parties such as the AfD, the PVV or the Finns party which hold openly Eurosceptic positions such as the dismantling of the single currency. Rather, the revolt encompassed the core support base of centre-right parties such as the CDU and the FDP in Germany or the VVD and the CDA in the Netherlands¹²³ and mostly found expression through the stance taken by conservative media outlets as well as in rifts and infighting within the parliamentary groups of conservative parties.

The revolt was most clearly on display in Germany where highly respected conservative economists such as Hans-Werner Sinn and news outlets ranging from the tabloid *Bild* to the respected broadsheet *Frankfurter Allgemeine Zeitung* became its mouthpieces. Various conservative politicians and university professors also brought cases against the ESM and the Eurosystem's OMT programme at the German Federal Constitutional Court in Karlsruhe in an attempt to block these innovations. The Bundesbank also gave expression to the revolt, especially through its persistent and open criticism of the Eurosystem's unconventional monetary policies. CDU members of parliament regularly defected from the government line during votes on financial assistance packages, egged on by such small business lobbies such as *Die Familienunternehmen* (the association of family businesses¹²⁴) and the CDU's own Economic Council¹²⁵. The revolt crystallised around the notion of "transfer union", just like "austerity" became the byword for the structural adjustment policies denounced by opponents in the deficit member states. Wolfgang Schäuble's ultra-hawkish line can largely be attributed to the attempt to placate these voters and prevent a full-scale revolt that could see them defect to populist right parties that do not enjoy the support of German big business.

■ *The resistance to structural adjustment in deficit member states*

In deficit member states, the reaction to the Eurozone crisis was the mirror opposite to that in the surplus member states. It revolved around opposition to the structural adjustment programme that was imposed there through the financial assistance programmes agreed with the rest of the Eurozone. The most salient expression of this opposition was a revolt by public sector workers against spending cuts and to a lesser extent by all workers against the curtailment of labour rights and the rise in the retirement age, measures that were either part of the adjustment programmes agreed upon with the creditors or, in the case of Spain, that were taken independently of the agreed upon programme. The ETUI noted in a note accompanying its first report on strikes in Europe in 2014 that the general downward trend was interspersed by various peaks which were accounted for by mass political strikes 'often occurring in the public sector ... with 'Germanic' and Nordic Europe as exceptions' independently of the industrial relations system prevalent in each member state. In particular, 'political mass strikes – either generalized public sector strikes or general strikes in certain regions or for the whole economy – are associated with the South of Europe but also Belgium and France and Cyprus, Estonia, Ireland'¹²⁶. The ETUI also noted that in some cases – like Spain – the number of days lost due to strike action was underestimated. This reaction was also concentrated during the height of the crisis and was determined by the pace of implementation of major labour market and other related reforms. Thus, in Greece there was a wave of general strikes in 2010-12 which has substantially waned since¹²⁷ and in Spain and Portugal there was a number of such strikes in 2010-13. The high point of this activism was on 14th November 2012, when a pan-European day of action was called by the European Trades Union Council which underscored the divergent reactions by the labour movement to the handling of the Eurozone crisis. Only unions in Spain, Italy, Portugal, Cyprus and Malta called for general strikes on that day, unions in other member states preferring to simply stage more or less symbolic street demonstrations.

It therefore appears that although the crisis did not lead to a reversal of workplace activism, rank and file initiative or confidence, it did generate substantial opposition to the economic direction entailed by the handling of the Eurozone crisis which did translate into action organised from

above, i.e. by the national leaderships of the various labour confederations, and which took on a political character since the protests were ostensibly against government policy. But there was a noticeable lack of any momentum from below in terms of labour struggles surrounding these initiatives from above. This is the main reason for which these mass strikes should be seen as one-off events.

Finally, it seems also pretty obvious that in some of the deficit member states, most clearly Greece and to a lesser extent Spain, the reaction to structural adjustment policies contributed to the reconfiguration of the party system and the electoral rise of radical left forces. Syriza, in particular, built on the massive disappointment within the trade union movement with PASOK's role in the agreements signed with the creditors. In Spain the picture is more mixed, since the Zapatero government's popularity in the polls began declining right after the 2008 general election and accelerated after it implemented various measures in September 2010. The PSOE had already lost substantial electoral support by the 2011 general election (from 43.9% in 2008 down to 28.8%), and was in opposition when the conservative government signed the financial assistance agreement with the ESM in the summer of 2012. The party only lost further support from May 2014 onwards, when Podemos burst onto the electoral scene – a development which also coincided with the decline in support for Izquierda Unida and the Unión Progreso y Democracia centrist party as well as the rise of the centrist Ciudadanos¹²⁸. Thus, the broader economic crisis might be a more potent force in determining developments in mass politics in Europe than the actual shape it was given in Europe in 2010-13 by the Eurozone's peculiar institutional framework.

Notes

1. European Council meeting conclusion, 17-18 December 2015, p5, <http://www.consilium.europa.eu/en/press/press-releases/2015/12/18-euco-conclusions/>
2. http://www.europarl.europa.eu/atyourservice/en/displayFtu.html?ftuld=FTU_3.1.6.html
3. <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31988L0361:EN:HTML>
4. See Rawi Abdelal *Capital Rules: The Construction of Global Finance*, Harvard University press, 2007, chapter 4.
5. <http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:12012E/TXT&from=EN>
6. All five criteria continue to apply for member states that are legally bound to adopt the euro but have not yet done so.
7. Gunnar Beck "The suspension of the rule of law in the euro zone and why Chancellor Merkel should not place her trust in rules", Eutopia law blog post, <https://eutopialaw.com/2012/07/02/the-suspension-of-the-rule-of-law-i>
8. <http://www.france-allemande.fr/Le-Conseil-economique-et-financier,0276.html>
9. Tony Blair therefore vetoed the extension of qualified majority voting to taxation in the Lisbon treaty, which would have allowed for some degree of fiscal policy centralisation at the EU level and could have put a stop to the process of fiscal competition among member states that has fuelled a fiscal race to the bottom.
10. In this case, a risk premium refers to the difference in interest rates on the bonds issued by the Eurozone member states, with Germany being the benchmark as it has consistently had the lowest interest rates on its sovereign bonds.
11. <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31989L0646:EN:HTML>
12. See Rachel Epstein and Martin Rhodes 'International in life, national in death? Banking nationalism on the road to Banking Union', KFG working paper no 61, 2014 (http://www.polsoz.fu-berlin.de/en/v/transformeurope/publications/working_paper/wp/wp61/index.html) and Nicolas Véron 'Europe's radical banking union' Bruegel essay and lecture series, 2015 (<http://bruegel.org/2015/05/europes-radical-banking-union/>).
13. Another, informal, name for the OMC is 'naming and shaming'. The Lisbon Agenda and the Europe 2020 strategy have both been based on the OMC.
14. The structure of macro-economic imbalances that triggered the Eurozone crisis in 2009 (German and Northern European current account surpluses mirrored in French and Southern European deficits) has more or less been in place since the 1950s, with the partial exception of the 1990s (see below, section II/a/i). After every new round of integration, the imbalances grew deeper. See Harold James *Making the European Monetary Union*, Harvard University Press, 2012, pp 1-28.
15. See David Marsh *The Euro: The Battle for the New Global Currency*, Yale University Press, 2011, pp. 240-241.
16. http://ec.europa.eu/economy_finance/publications/publication6142_en.pdf
17. http://ec.europa.eu/archives/emu_history/documentation/chapter8/19770401en73macdougallrepvol1.pdf
18. James Making of, op. cit. p 253.
19. Trésor-Economics 'Labour mobility in the EU: dynamics and policies', no 143, February 2015. <http://www.tresor.economie.gouv.fr/File/409589>
20. This is the proportion of inhabitants in an area who did not live there the previous year.
21. Internal mobility in Germany was lower than in France at 1% to 1.5% and lower still within the Mediterranean arc member states (Italy, Greece, Spain and Portugal) at 0% to 0.5%.
22. The EU budget's structural and regional funds are indeed conceived along these lines but are too limited in scope.
23. The theory was developed in France by scholars from various disciplines. Regulation school economists have been prominent in developing the theory. See Michel Aglietta *Europe: Sortir de la crise et inventer l'avenir*, Paris, 2014, pp 59-67, for such an explanation of the Eurozone's incomplete nature.
24. Ibid, p 65. My translation.
25. See James Making, pp 1-28.
26. https://en.wikipedia.org/wiki/European_Financial_Stability_Facility
27. <https://www.esm.europa.eu/about-us/history>
28. A fourth mechanism that has played a similar role is the Commission-administered European Financial Stabilisation Mechanism. But the EFSM's resources are more limited (it has a borrowing ceiling of €60 billion as opposed to €700 billion for the EFSF/ESM) and it implicitly draws on the fiscal liability of all 28 EU member states as the EU budget is the underlying guarantee for the EFSM's borrowing. http://ec.europa.eu/economy_finance/eu_borrower/efsm/index_en.htm.
29. <https://www.ecb.europa.eu/press/pr/date/2010/html/pr100510.en.html>
30. https://www.ecb.europa.eu/press/pr/date/2012/html/pr120906_1.en.html
31. <https://www.ecb.europa.eu/press/key/date/2012/html/sp120726.en.html>
32. In the 2014 Gauweiler judgment (C-62/14), <http://curia.europa.eu/juris/celex.jsf?celex=62014CJ0062&lang1=en&type=TEXT&ancre=>.

33. Spain received funds from the ESM but these were destined to recapitalise its banking sector and were therefore only attached to conditions relating to banking policy. http://ec.europa.eu/economy_finance/assistance_eu_ms/spain/index_en.htm
34. Note that while the work of assessing reforms was carried out by the so-called Troika (Commission, ECB, IMF), the crucial decision to approve those reforms and thereby to disburse funds was left to the Eurogroup. The IMF also provided assistance (about a third of the total) and decided according to its own procedures whether to disburse the funds.
35. Officially, the Treaty on Stability, Coordination and Governance (TSCG).
36. The structural deficit is calculated after adjusting for the impact of the business cycle (the short term fluctuations of economic activity).
37. http://europa.eu/rapid/press-release_MEMO-11-898_en.htm#footnote-1
38. http://europa.eu/rapid/press-release_MEMO-13-457_en.htm
39. Politico 'Brussels does the full Keynes', 16 November 2016, http://www.politico.eu/article/brussels-does-the-full-keynes/?utm_cont
40. Page 3 in https://ec.europa.eu/info/sites/info/files/2017-european-semester-communication-fiscal-stance_en_1.pdf
41. Reuters 'Germany says EU executive has no mandate to tell it to spend more', <http://uk.reuters.com/article/uk-germany-schaeuble-idUKKBN13D174>
42. http://ec.europa.eu/economy_finance/publications/eefp/pdf/ip039_en.pdf
43. http://ec.europa.eu/europe2020/europe-2020-in-your-country/deutschland/country-specific-recommendations/index_en.htm
44. See the Commission's communication 'Making the best use of the flexibility within the existing rules of the Stability and Growth Pact', 13 January 2015, http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/2015-01-13_communication_sgp_flexibility_guidelines_en.pdf
45. Aglietta Europe, p. 229.
46. For details and a favourable assessment, see Guntram Wolff 'Eurosysteem collateral policy and framework: Was it unduly changed?'; Bruegel policy contribution, 2014/14, http://bruegel.org/wp-content/uploads/imported/publications/pc_2014_14.pdf
47. Wolff estimates that in 2014 banks in Italy, Spain, Portugal, Ireland and Greece accounted for more than 80% of Eurosystem liquidity. Banks in Greece, Ireland and Cyprus also received Emergency Liquidity Assistance (ELA) credit. Unlike standard Eurosystem liquidity, ELA credit is not recorded as part of the Eurosystem's consolidated balance sheet but remains on the balance sheet of the member state central bank issuing it. Thus, if the recipient bank defaults, only that particular central bank will register losses, not the Eurosystem as a whole. The extension of ELA credit still has to be approved by a two thirds majority of the Eurosystem's governing council.
48. <https://www.ecb.europa.eu/pub/annual/balance/html/index.en.html>
49. See Véron 'Europe's radical banking union', op. cit. pp 14-19, Draghi citations in pp 18 and 19.
50. It is important to distinguish these reforms from the setting up of the European System of Financial Supervision in 2009-12. The ESFS covers the whole EU and is made up of four new agencies. The first is the European Systemic Risk Board chaired by the ECB and tasked with macro-prudential supervision. Then, there are three micro-prudential supervisory agencies: the European Banking Authority, tasked with coordinating the work of banking supervisors and developing technical regulatory standards, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority with similar mandates to the EBA. Note that the ECB's role in the ESRB validates the analysis that since the Eurozone crisis the Eurosystem's effective mandate has been extended to financial stability.
51. <https://www.bankingsupervision.europa.eu/about/thessm/html/index.en.html>
52. http://ec.europa.eu/finance/general-policy/banking-union/single-resolution-mechanism/index_en.htm
53. The Commission introduced legislation to set up the EDIS in November 2015 (http://europa.eu/rapid/press-release_IP-15-6152_en.htm?locale=en) and the Council decided in June 2016 to pursue preparatory work in that direction (<http://www.consilium.europa.eu/en/press/press-releases/2016/06/17-conclusions-on-banking-union/>).
54. <https://www.esm.europa.eu/press-releases/esm-direct-bank-recapitalisation-instrument-adopted>
55. Again, this is another recognition of the Eurosystem's new role in safeguarding financial stability.
56. A directive was adopted in 2009 which harmonised across the whole EU the requirement for national deposit guarantees of the first 100 000 euros in bank accounts. http://ec.europa.eu/internal_market/bank/docs/guarantee/200914_en.pdf
57. See for example the SSM's rejection of Monte dei Paschi di Siena's – Italy's third biggest bank – demand for additional time for finding a private-sector solution for a recapitalisation. Financial Times 'ECB rejects Italy's plea for more time to rescue Monte dei Paschi', 9 December 2016, <https://www.ft.com/content/bfb22cc0-be0e-11e6-8b45-b8b81dd5d080>
58. Alexandr Hobza and Stefan Zeugner 'The 'imbalanced balance' and its unravelling: current account and bilateral financial flows in the euro area', European Economy, economic papers 520, July 2014, http://ec.europa.eu/economy_finance/publications/economic_paper/2014/pdf/ecp520_en.pdf
59. In 2008, the surplus group of member states had a surplus of around 6% of their combined GDP; the collective deficit of Greece, Ireland, Italy, Portugal and Spain was almost 7%. Ibid, p5.

60. By contrast, in Germany rates were almost flat at 8.84% in 1997 and 8.24% in 2002. Source: World Bank.
61. Daniela Gabor and Cornel Ban 'Fiscal policy in (European) hard times: Financialization and varieties of capitalism', unpublished manuscript, <http://www.bresserpereira.org.br/terceiros/cursos/2013/Gabor-Ban.pdf>
62. Source : Hans-Werner Sinn 'Germany's capital exports under the euro' VoxEU 2011, <http://voxeu.org/article/germany-s-capital-exports-under-euro>
63. In 2004-06, more than three quarters of cross-border capital flows in the Eurozone were in fixed-income assets; in Spain this exceeded 95% of the total. Most of this was interbank lending and investment by financial firms in sovereign bonds. Hobza and Zeugner 'Imbalanced balance', op. cit. pp12-13.
64. Philip R. Lane 'Capital Flows in the Euro Area', European Economy, Economic Papers 497, April 2013, http://ec.europa.eu/economy_finance/publications/economic_paper/2013/pdf/ecp497_en.pdf
65. This would be because the income (dividends) earned through equity stakes as well as equity valuations depend on the underlying performance of the economy. In a recession, firms would pay less or no dividends to their foreign shareholders and equity valuations would fall. This would result in the foreign investors sharing in the adverse consequences of the recession.
66. In the first asset quality review that it conducted in 2014, the SSM identified 136 billion euros in additional non-performing loans to the ones identified by member state supervisors. Financial Times 'ECB says banks overvalued assets by €48bn', 26 October 2014, <https://www.ft.com/content/5bdcf20-5cfc-11e4-9753-00144feabdc0>
67. Christian Dustmann, Bernd Fitzenberger, Uta Schönberg and Alexandra Spitz-Oener 'From Sick Man of Europe to Economic Superstar: Germany's Resurgent Economy', Journal of Economic Perspectives 28/1, 2014, <http://fmwww.bc.edu/EC-C/U2014/388/jepDustman.pdf>. The authors show that the 2004 Hartz IV reforms were marginal to this policy of real wage stagnation.
68. Peter Bofinger 'German wage moderation and the EZ crisis', VoxEU, 2015, <http://voxeu.org/article/german-wage-moderation-and-ez-crisis>
69. Source: 'German mercantilism and the failure of the Eurozone, Guest Post by Heiner Flassbeck', <https://yanisvaroufakis.eu/2012/04/21/german-mercantilism-and-the-failure-of-the-eurozone-guest-post-by-heiner-flassbeck/>
70. <http://www.tradingeconomics.com/netherlands/current-account-to-gdp>
71. Gian-Maria Milesi-Ferretti and Cédric Tille 'The Great Retrenchment: International Capital Flows During the Global Financial Crisis', conference presentation 2010, http://econ.sciences-po.fr/sites/default/files/file/Draft_EP_Dec_15_final.pdf
72. Lane 'Capital flows in the Euro area', op. cit. One other reason for the vast financial retrenchment in the Eurozone was the heavy dependence of intra-Eurozone flows on interbank channels, which collapsed on a much greater scale than other kinds of capital flows.
73. Wolff 'Eurosysteem collateral policy', op. cit. p6.
74. Silvia Merler and Jean-Pisani-Ferry 'Sudden stops in the Euro area', Bruegel policy contribution, 2012, http://bruegel.org/wp-content/uploads/imported/publications/pc_2012_06.pdf
75. This was an automatic result of the way the Eurosysteem works, not a conscious policy choice, and one view is that it is a simple accounting device. The Bundesbank has resented having to accumulate claims on the other member state central banks but could do nothing to stop this from happening. Indeed, this has fuelled an impassioned debate in Germany about the potential implications of a default by a member state on the Bundesbank's balance sheet. Right-wing critics claim that the intra-Eurosysteem recycling of liquidity amounts to a fiscal policy and is, therefore, not within the Eurosysteem's mandate because in such a case the Bundesbank would register losses which would have to be absorbed by the German taxpayer (since the Bundesbank is owned by the German Federal Treasury). See Hans-Werner Sinn and Timo Wollmershäuser 'Target loans, current account balances and capital flows: the ECB's rescue facility', International Tax and Public Finance, Springer, vol. 19/4, 2012, <http://www.nber.org/papers/w17626>.
76. Source: Euro crisis monitor, Institute of Empirical Economic Research, Osnabrück university, <http://www.eurocrisismonitor.com/>
77. Lane 'Capital flows in the Euro area', op. cit. p12.
78. Merler and Pisani-Ferry 'Sudden stops', op. cit. p3.
79. <http://www.tradingeconomics.com/germany/labour-costs>
80. ECB 'Public investment in Europe', ECB Economic Bulletin, Issue 2/2016, https://www.ecb.europa.eu/pub/pdf/other/eb201602_article02.en.pdf
81. Paul de Grauwe 'Stop Structural Reforms and Start Public Investment in Europe', Social Europe, 17 September 2014, <https://www.socialeurope.eu/2014/09/public-investment/#>
82. Financial Times 'Spain reveals €100bn capital flight', 31 May 2012, <https://www.ft.com/content/25c39204-ab01-11e1-b875-00144feabdc0>
83. <http://www.tradingeconomics.com/italy/loans-to-private-sector>
84. <http://www.tradingeconomics.com/spain/loans-to-private-sector>
85. <http://www.tradingeconomics.com/euro-area/current-account-to-gdp>
86. <http://www.tradingeconomics.com/euro-area/unemployment-rate>

87. <http://www.tradingeconomics.com/euro-area/youth-unemployment-rate>
88. Productivity growth in the Eurozone plunged into negative territory during the double dip recession in 2011-13 and has remained consistently below the average for the advanced capitalist economies. Mario Draghi is the latest high-profile official to warn of the long-term consequences of the slowdown in productivity growth. http://www.ecb.europa.eu/press/key/date/2016/html/sp161130_1.en.html
89. 'Editorial: A European Union in Constitutional Mutation?', *European Law Journal* 20/2, 2014, https://www.researchgate.net/publication/260801524_Editorial_A_European_Union_in_Constitutional_Mutation
90. Reuters, 'France's Lagarde : EU rescues 'violated' rules : report', 18 December 2010, <http://www.reuters.com/article/us-france-lagarde-idUSTRE6BH0V020101218>
91. European Council decision of 25 March 2011 amending article 136 TFEU <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L:2011:091:FULL&from=EN>
92. Regulation No 1024/2013 <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R1024&from=en>
93. Regulation No 806/2014 <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0806&from=EN>
94. <http://register.consilium.europa.eu/doc/srv?l=EN&f=ST%208457%202014%20INIT>
95. 'Saving the Euro at the Cost of Democracy?', *Journal of Common Market Studies*, 51/4, 2013, <http://onlinelibrary.wiley.com/doi/10.1111/jcms.12019/abstract;jsessionid=38A8A8FD8C15411064B5C54A8362FCEF.f02t03>
96. See also Jukka Snell 'The Trilemma of European Economic and Monetary Integration, and Its Consequences', *European Law Journal*, 22/2, 2016, <http://onlinelibrary.wiley.com/doi/10.1111/eulj.12165/full>
97. Crum 'Saving the Euro', art. cit. p622.
98. 'The Crisis of Law and the European crises: From the Social and Democratic Rechtsstaat to the consolidating state of (pseudo) technocratic governance', presentation at the workshop 'Is it possible to reform the economic governance of the European Union?' organised by transform! Europe and GUE/NGL at the European Parliament in Brussels on 13-14 October 2016, http://www.transform-network.net/uploads/tx_news/Workshop_13-14_Oct_Program_folder_EN.pdf
99. The ESM's board of directors is made up of the Eurozone finance ministers, in effect the Eurogroup.
100. For the United States, see <http://unionstats.com/>. For the European Union, see Commission Industrial Relations in Europe 2014, chapter 1, <http://ec.europa.eu/social/main.jsp?catId=738&langId=en&pubId=7739>
101. Commission Industrial Relations in Europe 2014, op. cit. p29.
102. Ibid, p11.
103. The importance of collective bargaining decentralisation in German wage policy was noted above. One significant exception in this respect seems to be France, although the 2016 labour law partly moves French norms in the direction of decentralisation. The first major economic reform announced by the new French president, Emmanuel Macron, aims to substantially extend the scope of such decentralisation.
104. Indeed, all the participants in the panel on trade unions in Europe in the 21st century organised by transform! Europe at the 'Penser l'émancipation' international conference in Brussels on 30 January 2016 shared this position. <http://chsg.ulb.ac.be/ple/programme>
105. Bureau of Labor Statistics data, <https://data.bls.gov/cgi-bin/surveymost?ws>
106. <http://www.etui.org/Topics/Trade-union-renewal-and-mobilisation/Strikes-in-Europe-version-3-July-2016>
107. Jeremy Waddington 'Trade union membership in Europe: The extent of the problem and the range of trade union responses' ETUI-REHS Research Department, 2005, <http://library.fes.de/pdf-files/gurn/00287.pdf>
108. An oft-cited article is Cas Mudde 'Three Decades of Populist Radical Right Parties in Western Europe: So What?', *European Journal of Political Research* 52/1, 2013, https://www.researchgate.net/publication/263045135_Three_Decades_of_Populist_Radical_Right_Parties_in_Western_Europe_So_What
109. Ronald Inglehart and Pippa Norris 'Trump, Brexit and the rise of Populism: Economic Have-Nots and Cultural Backlash', HKS Faculty Research Working Paper Series 16-026, 2016, <https://research.hks.harvard.edu/publications/workingpapers/citation.aspx?PubId=11325&type=FN&PersonId=83>
110. 'Rise and Fall of Social Democracy, 1918-2017', slideshow presentation, 2 May 2017, <https://www.slideshare.net/SimonHix/hixbenedettoris-and-fall-of-social-democracy2may2017>
111. Apart from the FN's candidate (Jean-Marie Le Pen), a candidate who had split from the party a few years before (Bruno Mégret) also stood in the 2002 election.
112. Although the more substantial novelty was her progression in the second round to 33.9%, whereas her father had stagnated in the 2002 second round. This highlights a new electoral phenomenon, namely the closeness between mainstream conservative right-wing populist voters.
113. <http://www.nytimes.com/interactive/2016/05/22/world/europe/europe-right-wing-austria-hungary.html>. Italy saw of course the electoral breakthrough of the Cinque Stelle movement in 2013, but this case has to be set apart because the party combines

progressive ideas on issues such as generational renewal and gender equality with reactionary attitudes on others such as migration.

114. Cas Mudde 'The Study of Populist Radical Right Parties: Towards a Fourth Wave', C-REX Working Paper Series, no 1, 2016, p3, <http://www.sv.uio.no/c-rex/english/publications/c-rex-working-paper-series/Cas%20Mudde:%20The%20Study%20of%20Populist%20Radical%20Right%20Parties.pdf>
115. The most detailed exit polls also support a similar interpretation of the Trump election and the Brexit vote. See respectively CNN exit polls <http://edition.cnn.com/election/results/exit-polls/national/president> and Lord Ashcroft's poll <http://lordashcroftpolls.com/2016/06/how-the-united-kingdom-voted-and-why/>.
116. Mudde 'Three Decades of Populist Radical Right Parties', art. cit.
117. Le Figaro 'Le FN prêt à revoir son programme économiques', 19 January 2016, <http://www.lefigaro.fr/politique/2016/01/19/01002-20160119ARTFIG00280-le-fnpret-a-revoir-son-programme-economique.php>. The FN has indeed toned down its anti-euro rhetoric since the 2015 regional elections, in an attempt not to scare away middle-class conservatives and pensioners. An open struggle has broken out in the party after the perceived failure of Marine Le Pen in the presidential election, which the liberal wing has attributed to the party's position in favour of abandoning the single currency. See Libération 'Sur l'euro, la querelle monte au Front National', 12 May 2017, https://oeilsurlefront.liberation.fr/les-idees/2017/05/12/sur-l-euro-la-querelle-monte-au-front-national_1569082
118. Reuters 'German AfD founder leaves party decrying xenophobic shift', 8 July 2015, <http://www.reuters.com/article/us-germany-politics-euro-sceptics-idUSKCN0PI25720150708>
119. https://en.wikipedia.org/wiki/Opinion_polling_for_the_German_federal_election,_2017
120. http://ec.europa.eu/public_opinion/topics/eb40years_en.pdf
121. The data on trust are in page 14, on the EU's image in page 15 and on the single currency in page 26, <http://ec.europa.eu/COMMFrontOffice/publicopinion/index.cfm/Survey/getSurveyDetail/instruments/STANDARD/surveyKy/2137>
122. In fact, the sharpest drop in positive opinions was from 59% in 2006 to 45% in 2007 – before even the financial crisis had begun. This set of data is reported in the latest flash Eurobarometer survey on the Eurozone, <http://ec.europa.eu/COMMFrontOffice/publicopinion/index.cfm/Survey/getSurveyDetail/instruments/FLASH/surveyKy/2104>
123. ECFR 'Dutch drama over Greek crisis', 24 August 2015, http://www.ecfr.eu/article/dutch_drama_over_greek_crisis_4004
124. Philine Schuseil 'The German Industry and the euro', Bruegel blog post, <http://bruegel.org/2012/07/the-german-industry-and-the-euro/>
125. Financial Times 'German MPs urged to take tough line on Greece', 25 February 2015, <https://www.ft.com/content/fd51e310-bcd8-11e4-a917-00144feab7de?siteedition=intl>
126. <http://www.etui.org/News/Strikes-in-times-of-crisis-no-increase-or-no-data>
127. See pp9-10 in <http://www.inegsee.gr/wp-content/uploads/2016/11/SEPTEMBRIOS-OKTOBRIOS-2016.pdf>
128. https://en.wikipedia.org/wiki/Spanish_general_election,_2015#/media/File:OpinionPollingSpainGeneralElection2015.png