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EU Integration
During the Eurozone Crisis
Through the Lenses of Neo-functionalism

Bachelor's Thesis

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How can we explain integration of the EU in the wake of the eurozone crisis?

By

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Declaration of Consent and Statement of Originality

I hereby declare that no portion of the work referred to in this thesis has been submitted in support of an application for another degree, or qualification thereof, or for any other university or institute of learning.

I declare that this thesis is my independent work. All sources and literature are cited and included.

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Acknowledgment and Dedication

My gratitude goes to charming Prof. Daniela Chalániová along with all the professors and staff I had the pleasure and honour to meet at the Anglo-American University. My dedication goes to every reader of this thesis. Hope you will find it informative and enjoy the read.

Thank You.

Abbreviations

CJEU - Court of Justice of the European Union
CMU - Capital Markets Union
EAPP - Emergency Expanded Asset purchase Programme
EBA - European Banking Authority
ECB - European Central Bank
EDIS - European Deposit Insurance Scheme
EDP - Excessive Deficit Procedure
EERP - European Economic Recovery Plan
EFSF - European Financial Stability Facility
EFSI - European Fund for Strategic Investments
EFSM - European Financial Stabilisation Mechanism
EIOPA - European Insurance and Occupational Pensions Authority
EMU - Economic and Monetary Union of the European Union
ESFS - European System of Financial Supervisors
ESM - European Stability Mechanism
ESMA - European Securities and Markets Authority
ESRB - European Systemic Risk Board
EU - European Union
GDP - Gross domestic product
GIPSC - Greece, Ireland, Portugal, Spain, Cyprus
IMF - International Monetary Fund
LTRO - Long-Term Refinancing Operation
MS - Member State of the European Union
MIP - Macroeconomic Imbalance Procedure
MRO - Main Refinancing Operations
NF - Neo-functionalism theory
OMT - Outright Monetary Transactions
RNF - Revised Neo-functionalism theory
SGP - Stability and Growth Pact
SMP - Securities Markets Programme
SSM - Single Supervisory Mechanism
SRB - Single Resolution Board
SRM - Single Resolution Mechanism
TFEU - Treaty on the Functioning of the European Union
TSCG - Treaty on Stability, Coordination and Governance in the Economic and Monetary Union

Abstract

EU Integration

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The objective of this thesis is to explore the degree of change of the European Union (EU) integration in response to the eurozone crisis. Following the outbreak of the financial crisis in 2008 and the subsequent economic crisis, some Member States (MSs) of the EU got caught in a scenario in which they were running a risk of inability to fulfil their insolvency obligations (i.e. pay back their debt and bankroll government operations). This possibility of sovereign debt default ominously floating among the countries using the euro was termed the eurozone crisis and represents the main focus of this research, the aim of which is to answer the following research question: “How can we explain integration of the EU in the wake of the eurozone crisis?”; for during this “stress test” period a great deal of action has been taking place within the EU co-operative. To help unravel the substance of the outcomes of this time-framed qualitative case study, the variables of the revised neo-functionalist framework have been used to determine the extent of validity of the two-folded hypothesis: (i) whether there was more of the EU integration observed, and (ii) whether the key drivers behind this integration process were the forces external to the EU (i.e. exogenous spillover). The employed data gathering technique relied predominantly on the identification and analysis of the EU institutional innovations, though, the official and unofficial statements of the elites and some statistics (e.g. public opinion) were also very valuable to provide additional insight besides the examined (legal) documents. The main findings of the research can be summarised as follows. During the eight year period (2008-2015) there were detected no traces of significant disintegration of the EU, but on the contrary from 2009 a massive institutional build-up has been taking place with transfer of powers going from the national to the EU level, i.e. from the governments to the supranational institutions (The European

Commission, The European Central Bank). The only exception has been that of the public and the macro-economic variables; a rift in the economic performance and the decisions taken at the EU level contributed to the stalling of a European “demos” formation and rise in euro-scepticism. The process towards the “ever-closer” union moved substantially through the economic, fiscal, and financial reforms, of which the later (Banking Union) is still in the process of development, interconnecting MSs more tightly through the shared responsibility. It should be however noted, that this progress has been much greater among the eurozone MSs and conduced the advancement of the two-tire Europe (different speed of integration between eurozone and non-eurozone MSs). In such there can be no doubt that the EU made a huge progress in the past few years in reinforcing its architecture, yet, the explanation of the forces behind this integration process is more trickier. The evidence point out that the exogenous spillover (represented by the process of globalisation) played indeed an important role and is expected to play an even bigger in the future.

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“...to continue the process of creating an ever closer union among the peoples of Europe...”

– The Treaty on European Union, 1992

1 Chapter 1: Introduction

Before 2009 could arrive, the established fellowship of the European Union (EU) got drawn into a storm. This storm has been commonly referred to as "the crisis" and was spotted in many other parts of the world. But particularly in the EU, its reign has been long and left many scars, both on the body and the soul, for the union to cope with.

My quest in this thesis is concerned with this protracted period of "the crisis"[1] and the integration[2] aspect of the EU. The aim is to answer the following research question: "How can we explain integration of the EU in the wake of the eurozone crisis[3]?" To do this, however, a number of sub-questions need to be addressed. (i) How was the EU, particularly the economy, influenced by the crisis?; (ii) How did the member states (MSs) and the EU institutions react to solve the crisis?; and (iii) How did their actions affect integration process of the EU?

My hypothesis is that "exogenous spillover" factors such as – globalisation and the concealed potency of international market forces – have been the primary drivers behind the integration of the EU during the crisis. This hypothesis entails two assumptions which will be either confirmed or disproved. The first being that there has been indeed greater integration observed, and second, this integration was attributed to the external forces to the EU - "exogenous spillover".

The choice of theory for the purposes of this thesis has fallen on the neo-functionalist tradition of explaining regional integration process. The entire revised neo-functionalist theoretical framework (RNF), as developed by Arne Niemann in his book *"Explaining*

[1] By the term "crisis", unless otherwise specified, I mean collectively the financial, economic and sovereign debt crises which cover the period roughly from 15 September 2008 to 15 July 2015. The time when Lehman Brothers, the fourth largest bank in the US declared bankruptcy and initiated a widespread global financial crisis that transformed into an economic crisis and then a European sovereign debt crisis; and the date when the third bailout package (worth €86 billion) has been approved by the Greek government with potential to finally resolve the European sovereign debt crisis. Source: Catharina Moh, 'Greece Debt Crisis: Eurozone Deal Laws Backed by MPs',16 July 2015.

[2] Integration is understood as "the process whereby political actors in several distinct national settings are persuaded to shift their loyalties, expectations and political activities toward a new centre, whose institutions possess or demand jurisdiction over the preexisting national states"; which defined by Ernst B. Haas in his seminal work The Uniting of Europe: Political, Social, and Economic Forces 1950-57 (Stanford, CA: Stanford University Press, 1958), 16.

[3] The eurozone crisis is synonymous to the European sovereign debt crisis and refers to the state when several member states of the EU (namely Greece, Ireland, Portugal, Spain, and Cyprus) had to be bailed-out via the Economic Adjustment Programmes by the "Troika" (the European Commission, the European Central Bank and the International Monetary Fund) to avoid the risk of sovereign default.

Decisions in the European Union", 2006, has been identified to be of particular relevance to explain the key outcomes that took place during the crisis and reasons behind them. It "seeks to provide a model for explaining particular decision-making instances or processes"[4] and embraces a much wider scope of analysis, including external pressures to the EU. A complex theory, such as RNF, is required to make sense of the events unfolding in the EU.[5]

The method to gather data for this research uses the case study approach and focuses on three techniques. The identification of new institutional innovations

- The European Semester, The European Financial Stability Facility (EFSF), The European Financial Stabilisation Mechanism (EFSM), The European Stability Mechanism (ESM),
- The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG), The Six-pack, The Two-pack, The Euro-Plus-Pact, The Macroeconomic Imbalance Procedure (MIP),
- The European Systemic Risk Board (ESRB), The European Banking Authority (EBA), The European Securities and Markets Authority (ESMA), The European Insurance and Occupational Pensions Authority (EIOPA)
- The Single Supervisory Mechanism (SSM), The Single Resolution Mechanism(SRM), The Single Resolution Board (SRB), The Single Resolution Fund (SRF), The European Fund for Strategic Investments (EFSI)

official and unofficial statements of high EU and MSs officials as well as some statistics (e.g. public opinion). Using these tools the idea is to look in the retrospect and examine how the EU and MS actors responded to the crisis. The obtained findings are then consulted with the latest secondary academic literature on this theme.

The value of this research resides in the critical evaluation of the recently encountered EU challenges and opportunities uncovered by the crisis. Its aim is to provide an insight on the current standing of the EU integration processes and shed a better light on what the EU integration trajectory might be. The developments at the EU level tend to have far reaching implications worldwide and better awareness about them, which remains chronically under

[4] Arne Niemann, *Explaining Decisions in the European Union* (2006), 51.
[5] Ian Cooper, 'The Euro Crisis as the Revenge of Neo-Functionalism', September 2011.

communicated, may be beneficial to know for every citizen. How has the EU institutional design changed over the crisis period and what powers have been delegated to the supranational level? Is the integration process irreversibly on the road of differentiated integration, i.e. multi-speed EU, that has become “a permanent and normal feature of European integration” ? [6] Hopefully, by the end of the paper you will be able to find out an answer to these and alike questions, as well as discover some useful information that will improve your conceptualisation of the EU project.

The thesis is structured as follows. Second chapter, theory and methodology, makes a quick run over the key assumptions of the leading theories that strive to explain or understand the ongoing integration process of the EU: liberal intergovernmentalism, federalism, functionalism, social constructivism, multi-level governance and new institutionalism. Justifications are provided why they had been all brushed aside and neither the original neo-functionalism (NF) was found to be suitable. The specific details of the revised neo-functionalist framework (RNF) are then presented, demonstrating the significance and level of innovation that was achieved from the NF theory. Lastly, the adopted methodology to the case study of the eurozone crisis sketches how the RNF conceptual framework is put into operation. Third chapter briefly sketches the impact of the crisis on the EU (i.e. unemployment, GDP growth, deficit) and causes for the inception of the financial, economic and debt crises with specific reference to the Economic and Monetary Union (EMU). Fourth chapter explores the process of crisis management and through the dialectic process, between four integrative forces[7] and four countervailing forces[8], explains how by the virtue of fiscal, economic, and financial reforms (i.e. creation of new supranational institutions, new mechanism, procedures, etc.) the role of the European Commission and the European Central Bank (ECB) have been strengthened while the public morale deteriorated. Fifth chapter specifically assess the fifths integrative force: the exogenous spillover (i.e. globalisation) and its relation to the EU integration process during the crisis period. Finally, in the conclusion main findings are summarised and critically evaluated in terms of their limitations.

[6] Benjamin Leruth and Christopher Lord, ‘Differentiated Integration in the European Union: A Concept, a Process, a System or a Theory?’(July 2015): 761.

[7] Integrative forces: endogenous spillover, political spillover, social spillover, cultivated spillover

[8] Countervailing forces: sovereignty consciousness, domestic constraints, diversity, negative integrative climate

2 Chapter 2: Theory and Methodology

2.1 Literature review

In the foreground it is worth to note that so far there has not been formed a consensus among the scholars on what exactly propels the EU development. The discourse effectively levels off in the belief that there are various pluralistic forces, within and outside of the EU, that shape its progression, with scholars giving more weight to one or the other force. It is therefore, really up to every individual to make up his/her mind on this matter. My opinion for example would be that the EU may be best explained as a unique and ongoing historical project which does not have a finite form to which it strives, but rather it adjusts itself to the concurrent and anticipated phenomena, all the while being constrained by the past choices it had already subsumed and is moulded by the topical mood of the elites, and the populations they represent, prevailing at any given time. Whatever the case might be, it is essential to envision the present and future developments correctly as much as possible as without such knowledge one can hardly plan adequately and even more so for a project of the magnitude such as that of the EU. For this reason, it is valuable to provide a couple of remarks, just enough to delineate theoretical awareness, about each of the prominent theories.

2.1.1 Liberal intergovernmentalism

First, liberal intergovernmentalism, as developed by Andrew Moravcsik in 1993, would probably account to be the prime candidate for its wide and thorough explanation of notable EU integration stages in a fairly simple manner. By drawing both on the neo-realist and neo-liberal traditions, liberal intergovernmentalism reaffirms that states are the most important international actors, which rationally pursue self-interest “through intergovernmental negotiations and bargaining”[9] that is derived and formed by the national preferences. However, despite pointing out the global anarchical international context, liberal intergovernmentalism inflates the power of states as unitary actors. It underestimates the divergence of interests within the state on the domestic level. It claims that states are in

[9] Andrew Moravcsik and Frank Schimmelfennig, ‘Liberal Intergovernmentalism’, in *European Integration Theory*, by Antje Wiener and Thomas Diez, (2009), 68.

complete control of the integration process[10], but fails to take adequately into account the changing international environment and the role of non-state actors, especially those that are external to the state such as powerful (and to large extent independent) supranational institutions like the Court of Justice of European Union (CJEU), the European Commission (the Commission) or transnational actors such as multinational corporations (MNCs).

2.1.2 Federalism and Functionalism

Second and third theories of European integration, both federalism and functionalism, that rapidly rose to prominence during the post-war period, make several eminent claims that take into consideration external impulses about the nature and the trends of the integration process. Federalism[11] grounds its ambitious, normative speculation about the direction of the European Communities[12] on the historical analysis of the conditions[13] under which "previously separate, autonomous, or independent territorial units" decided to "constitute a new form of union"[14] establishing equal partnership based on shared rules and mutual reciprocity.[15] In terms of how sovereignty would be pooled together to achieve such goal, it, however, provides virtually no tools of explanation, suggesting only that states are increasingly falling short to meet citizens' demands. Its appeal is normative rather than explanatory therefore.

Functionalism[16], on the other side, formulates a much more rigorous approach that decently takes into account the global context; arguing that "a common need for technocratic management of economic and social policy leads to the formation of international agencies"[17] and gradual creation of international society in their quest to pursue prosperity. Nevertheless, its excessive focus on pragmatism, economic interdependence, and economic determinism neglects the political side of the matter. Besides, its cosmopolitan aspirations go far beyond

[10] Ibid., 71.
[11] Key thinkers: Altiero Spinelli and Ernesto Rossi (Ventotene Manifesto of 1941)
[12] European Communities were a set of three intergovernmental institutions (European Coal and Steel Community (ECSC) , European Atomic Energy Community, and European Economic Community) that existed between 1952-1993 and where the predecessors to the EU.
[13] Similarities and difference of territorial, economical, cultural, religion, etc.
[14] Michael Burgess, 'Federalism', in *European Integration Theory*, by Antje Wiener and Thomas Diez, (2009), 26. Burges provides examples of Switzerland, India, Germany or the US.
[15] They would refrain from taking decisions that would harm the general welfare.
[16] Key thinker: David Mitrany (A Working Peace System, 1943)
[17] Desmond Dinan, ed., *Encyclopedia of the European Union* (2000), 245.

explaining regional integration processes.

2.1.3 Social Constructivism

Fourth, the contribution of social constructivism (SC) aims to raise the importance of "deliberation, discourses, norms, persuasion, identity, socialisation, arguing"[18] to the debate on the EU integration. It asserts that through active social interactions and learning, societies (re-)build identities and contribute to the development of national and the EU norms that shape politics, which in turn exert influence on the culture. The construction of the European identity[19] is the principal thought behind social constructivism. Yet, it largely ignores to consider the material aspects, such as economy, which are central to the EU evolution.

2.1.4 Multilevel governance and new institutionalism

The fifth and sixth theoretical approach, multi-level governance[20] and new institutionalism, too expand the thinking about the EU, addressing the complexity and the degree of institutionalisation of the EU that has advanced over the years. As the name suggests, multi-level governance argues that the decision making authority has been increasingly embracing non-hierarchical character, moving from national governments to the supranational institutions, regional and many sub-national governance authorities.[21] This resulted in the greater need for interaction and deliberation between individual political arenas which became interconnected through the overlapping competences.

New institutionalism, which may be further divided into rational choice, sociological and historical institutionalism, emphasises the role of institutions and how their establishment creates a "path dependency"[22], as well as a host of formal and informal rules through which agents may act and pursue their goals. Unfortunately, neither of them seriously accounts for external pressures to the desired extent, having a heavy inward orientation.

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[18] Jeffrey T. Checkel, 'Constructivist Approaches to European Integration', 2006, 2.
[19] Thomas Risse, 'Social Constructivism and European Integration', in *European Integration Theory*, by Antje Wiener and Thomas Diez, (2009), 151.
[20] Key thinkers: Liesbet Hooghe and Gary Marks
[21] Simona Piattoni, 'Multi-Level Governance in the EU: Does It Work?' (2009), 6–7.
[22] Paul Pierson, 'The Path to European Integration: A Historical Institutionalist Perspective', April 1996, 13.

2.1.5 Neo-functionalism

Seventh, while it is true that neo-functionalism (NF) was profoundly inspired by the functionalist theory[23], its fathers E.B. Haas and L. N. Lindberg devised considerably different set of assumptions in their works[24] to better suit the case of the European Communities. In particular, they reduced the integration process from the global scale to the regional level. In very simple terms, they perceived integration to be driven by three key factors: governmental and non-governmental elites, (supranational) institutions, and the concept of the "spillover effect".[25] Both authors considered integration to be a continuous process, where for Lindberg integration process would remain in a "constant flux"[26] and Haas would (initially) augur that it would result in creation of "a new community"[27], since not merely expectations and activities would be shifted to the new centre but also the loyalties of political actors.[28] Without clearly set boundaries and the disposition to be modified, typified by an "inherent propensity for self-reflection"[29], NF attracted many prominent academics[30] who worked with the theory, expanded it in various directions and enriched it with their own novelties, making it rise to become the one of the leading theories of regional integration.

This however at the same time spurred much confusion of what actually falls within the NF domain. Too much ambiguity, too many interpretations of the classic assumptions, as well as the progress made since the inception of the theory demanded that the NF be updated and put into a new robust theoretical framework that could be successfully applied onto current EU integration issues. Arne Niemann did precisely this with his revised neo-

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[23] In particular the works of David Mitrany and Jean Monnet

[24] Hass :"The uniting of Europe; political, social, and economic forces, 1950-57", 1958
Lindber: "The Political Dynamics of European Economic Integration", 1963

[25] They rejected the notion that states are the only relevant actors.

> "Neo-functionalists assume that regional integration is characterized by multiple, diverse, and changing actors who are not restricted to the domestic political realm but also interact and build coalitions across national frontiers and bureaucracies."

Source: Arne Niemann and Philllipe Schmitter, 'Neofunctionalism', in *European Integration Theory*, by Antje Wiener and Thomas Diez, (2009), 47–48.

[26] Leon N. Lindberg, *The Political Dynamics of European Economic Integration* (1963), 6.

[27] Ernst B. Haas, *The Uniting of Europe: Political, Social, and Economic Forces 1950-57* (1958), 16.

[28] Niemann, *Explaining Decisions in the European Union*, 15.

[29] Ibid., 3.

[30] Examples: S. Scheingold (1971), P. C. Schmitter (1971), W. Sandholtz (1998, 2001), A. Stone Sweet (1998, 2001), or A. Niemman (2006)

functionalist theory.[31] He expanded the original NF theorising[32], by taking into consideration new realities, contributed with some of his own concepts, and rejected[33] certain precepts that clearly did not hold thus making the theory more coherent and robust.

2.2 Theory description

2.2.1 Revised neo-functionalism (RNF)

The three most important features to highlight about RNF that differ from neo-functionalism (NF) and which are going to be elaborated more in-depth later in this chapter are the following: Firstly, by loosening the conventional rational-choice premises[34] the RNF incorporated some elements from the constructivist thoughts - mixing material ("soft" rational-choice) and ideational ("soft" constructivist) ontological positions[35], thus bridging the two sides. Secondly, instead of adopting a NF's actor-centred approach, Niemann puts domestic, supranational and international agents on equal ground with domestic, supranational and international structures. And thirdly, rather than viewing integration as a self-reinforcing dynamic process, Niemann proposes to view integration as a dialectical process – a sort of a tug-of-war - between "pro-integration" integrative forces[36] and "anti-integration" countervailing forces[37]. He also downgraded the universal applicability of NF depriving it of the status of a grand theory since the pressure for further integration (i.e. spillover) did not necessarily have to be automatic and under certain circumstances could in fact result in the so-called "spillback"[38]. One such example is the proposition concept of the end of ideology[39] which is rejected on the basis that there is no evidence for it. All of the key differences between NL and RNF assumptions are summarised in Table 1.1. on page 52 and

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[31] This framework was initially developed to analyse the PHARE programme; Common Commercial Policy; and visa, asylum and immigration policy.
[32] E.g. introduced "soft constructivist ontology" or devised countervailing forces
[33] E.i. grand theory design, automatic spill over, continuation of unabated economic growth, end state of the EU. Source: Niemann, *Explaining Decisions in the European Union*, 5, 13, 17.
[34] Actors are rational, intentional and self-interested actors.
[35] Niemann, *Explaining Decisions in the European Union*, 26, 52.
[36] Ibid., 30–47.
[37] Ibid., 47–50.P. 47-50
Countervailing force: sovereignty-consciousness, domestic constrains, diversity + negative integrative climate
[38] Spillback comprises four countervailing force
[39] The assumption is that as societies become richer they would disregard nationalist, socialist or religious ideals and being more concerned with the pursuit of wealth.
Source: Niemann, *Explaining Decisions in the European Union*, 16.

in Table 1.2. on page 53 of *"Explaining Decisions in the European Union"*, 2006.

Table 1.1. *Principal changes in underlying assumptions from the original to the revised neofunctionalist framework*

Original neofunctionalist assumption	Revised neofunctionalist assumption
No systematic formulation of a basic ontology. A mainly 'soft' rational-choice ontology with some reflexive elements	No striving for ontological purity. Agents combine several action modes in their behaviour. A 'soft' rational-choice is complemented by a 'soft' constructivist ontology
(More) emphasis on agents	Structuration: equal ontological status of structure and agents
Integration/spillover an automatic process	Integration occurs under certain conditions (broadly when spillover pressures are stronger than countervailing forces). Conditions require further specification
Integration as a dynamic process	Integration as a dialectical process
Understands itself as a grand theory	A wide-ranging but partial theory
End-state: 'political community' of Europe. Later on the end-state was left open. Often misinterpreted as federal supra-state	No predicted end-state; further deepening in terms of breadth and depth of integration likely. End-state fallacy clarified
Community a creature of elites; permissive consensus	Primary role still attributed to elites, but wider publics assumed to have an impact
End of ideology (especially nationalism)	End of ideology assumption dropped
Growth in Europe continues unabated	Unabated growth assumption dropped

Table 1.2. *Main changes concerning the hypothesised pressures from early neofunctionalism to the revised neofunctionalist framework*

Change pressure	Specification	Extension
Functional spillover	• (Functional) 'pressures from within' brought out more explicitly and upgraded in importance. • Departure from deterministic ontology ('soft' functionalism)	• Scope broadened from economic linkages to include all endogenous – functional tensions and contradictions
Exogenous spillover		• Exogenous spillover itself a new (mainly structural) pressure
Political spillover	• Interest groups not only influenced by functional, but also by exogenous and domestic structures	• Advocacy coalitions are integrated into the concept
Social spillover	• Emphasis on the *quality* of interaction, *reflexive* learning and the role of *communication*. • Learning and socialisation not constant but subject to conditions	• Concept of communicative and norm-regulated action is incorporated
Cultivated spillover	• Was underestimated by neofunctionalists as a dynamic; now upgraded	• (1) Council Presidency, (2) ECJ, (3) EP and (4) Epistemic communities incorporated
Countervailing forces		• Countervailing forces themselves a new element

2.2.2 Agents

In what terms does the RNF bring an added value to neo-functionalism? Well, following the original NF though it is assumed that both government (e.g. MS representatives) and non-government (e.g. interest groups) elites are considered to be rational[40] and self-interested who wish to maximise the fulfilment of their interests. They are prone to seek common solutions to problems that transcend the scope of nation states and are much more likely to arrive at "positive sum games" – giving up something to achieve something else of greater value to them[41]. Building on this, Niemann elevated the importance of the wider public which does not merely facilitate a pro-EU "permissive consensus"[42], but is capable of exerting influence by voicing its euro-optimism/euro-scepticism. Besides these three key actors (i.e. government elites, non-government elites and the public, supranational institutions) are deemed over time to gradually "have a life of their own" and accumulate enough power and authority to become agents themselves, seeking to pursue even more power, and able to influence the perceptions and interest of those who had created them (i.e. the elites and the public)[43]. This however does not mean that institutions can "determine actors' behaviour in any mechanical or predictable fashion", since "actors have created structures in the first place and can potentially change them any time", but rather they set the boundaries within which agents may act - framing the scope of viable options agents may choose from.[44] It is crucial to point out that all of these key multiple diverse agents are considered to have the capacity to learn, reflect and revise their preferences, being highly responsive to the changing environment.

2.2.3 Structural pressure and the concept of the "spillover"

The power of structural forces undoubtedly plays a central role along with agents in both NF and RNF and may be best represented by the concept of the "spillover". In its broader sense spillover may be understood as a functional desire to attain and operate

[40] Ibid., 25.
[41] Ibid., 24.
[42] Leon Nord Lindberg and Stuart A Scheingold, *Europe's Would-Be Polity: Patterns of Change in the European Community* (1970), 41.
[43] Niemann, *Explaining Decisions in the European Union*, 16.
[44] Ibid., 31.

constantly at the most optimal level permissible by the currently available opportunities. Haas formulated this process as a spillover: an "′expansive logic of sector integration', whereby the integration of one sector leads to 'technical' pressures pushing states to integrate other sectors"[45].The spillover effect was most lucidly observed in relation to the economic interdependence of coal and steel community which provoked and fostered further integration of the transportation sector: "integration of one sector at the regional level is only practicable in combination with the integration of other sectors, as problems arising from the functional integration of one task can only be solved by integrating yet more tasks".[46]

2.2.4 Endogenous spillover

In the RNF this functional-economic interdependence was broadened beyond the "economic spillover" to "encompass all types of endogenous-functional interdependencies" which Niemann classified into two sub-categories.[47] First, the original functional spillover pressure would refer to sector-to-sector integration[48] and second, termed functional "pressure from within", would create pressure and foster deeper integration in the same sector or policy area. Either had the capacity to facilitate integration in breadth[49] and depth[50].[51]

2.2.5 Exogenous spillover

Next, neo-functionalism does not take into account the broader changing international context adequately, which was viewed to have predominately a disintegrative force on the EU: "every international system based on fragmentation tends to reproduce diversity through the dynamic of unevenness"[52]. The exhibited need to embrace not only the functional pressure arising within the EU but also external to it was labelled by Niemann as an "exogenous spill-over". It was perceived to have a strong propensity to cluster member states together, like a

[45] Niemann and Schmitter, 'Neofunctionalism', 49, referring to Haas, The Uniting of Europe, 1958, 383.
[46] Ibid., referring to Haas, The Uniting of Europe, 1958, 297.
[47] Niemann, *Explaining Decisions in the European Union*, 30.
[48] "dissatisfaction of collective goal attainment in one area induce integration in other sectors or policy area" Source: Ibid.
[49] Bredth: integration from sector to sector, from issue area to issue area.
[50] Deepening: integration within that same issue area
[51] Niemann, *Explaining Decisions in the European Union*, 31.
[52] Stanley Hoffmann, 'Chapter 3: Obstinate or Obsolete? France, European Integration, and the Fate of the Nation-State', in *Euro-Skepticism: A Reader*, ed. Ronald Tiersky, Europe Today (Lanham, Md: Rowman & Littlefield, 2001), 37.

"buffer against uncertain external developments" such as "globalisation, migration, environment destruction or international terrorism" which in order to be effectively addressed required common approach and common solution.[53]

> "Perceived competition with other international players tends to encourage EU Member States to pool their strengths together and resources through further co-operation/integration with the intention of advancing the Union's competitive position." [54]

On top of that, Niemann also points out that, member states might find themselves in such a position that national institutions might simply be limited to provide satisfactory solutions to the above mentioned problems, and even fulfil such essential obligations as to deliver public goods, e.g. welfare.[55] Chapter 4, of this thesis, will investigate what role and how great was the influence of the "exogenous spillover" on the integration process of the EU during the euro zone crisis. It is imperative to note however, that "exogenous factors are often closely linked to, and not always separable from, endogenous ones".[56]

2.2.6 Interplay between agents and structures

No less important are the so-called political, social, and cultivated spillovers, which as Niemann states, "provided the much needed lubricant between structures and agents and constituted an important platform for the unfolding of structural pressures"[57]. While political and cultivated spillovers were already devised in the original NF theory, social spillover was "split off from political spill-over, in order to better explain (reflexive) learning and socialisation processes".[58]

2.2.7 Political spillover

First, the original NF idea about the "political spillover" is that governmental and non-governmental elites would over time, through the learning process and the influence from endogenous pressures, shift their expectations, political activities, and possibly even their

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[53] Niemann, *Explaining Decisions in the European Union*, 33.
[54] Ibid.
[55] Ibid., 49.
[56] Ibid., 50.
[57] Ibid., 10.
[58] Ibid., 5.

loyalties to the EU level institutions which would better realise their interests; especially when "problems of substantial interest cannot be satisfactorily solved at the domestic level".[59] RNF expanded this thinking by incorporating the exogenous and endogenous pressures, and by adding advocacy coalitions (e.g. trade unions, trade associations)[60].

2.2.8 Social spillover

Secondly, the development of organised interest at the EU level is replenished by the "social spillover" which postulates, that civil servants through the process of socialisation and deliberation (e.g. intense co-operation during council committees) would not only gradually build "elite enmeshment"[61], but also lay down values and norms, prescribing certain behaviour.[62] Hence, due to the high level of communication and socialisation, their pursuit for consensus does not necessarily have to be characterised by intergovernmental bargaining but more as a norm regulated actions.[63]

> "[N]ational officials involved in EU decision-making are generally characterized by a substantial degree of collective responsibility which is reflected in the overall willingness to shift and reformulate their positions." [64]

Another thought connected to this reasoning is that under the pressure of endogenous and exogenous forces, civil servants in "their quest to arrive at the most `valid´ solution to the problem at hand"[65] must arrive at some decision. Though, incapable of long-term planning, equipped with (highly) imperfect knowledge, uncertainty about the future and time pressure (deadlines)[66] their decisions contribute to unintended consequences.

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[59] Ibid., 34.
[60] Ibid., 36–37.
[61] In mental health sciences, enmeshemnt implies "a condition where two or more people weave their lives and identities around one another so tightly that it is difficult for any one of them to function independently". Source: Gulf Bend Center, 'Glossary (Mental Health): Enmeshment', accessed 15 August 2015.
[62] Niemann, *Explaining Decisions in the European Union,* 41.
[63] Niemann and Schmitter, 'Neofunctionalism', 56.
[64] Ibid., 60.
[65] Niemann, *Explaining Decisions in the European Union,* 41.
[66] Ibid., 43.

2.2.9 Cultivated spillover

Thirdly, a cultivated spillover[67] is understood to take place when the well established supranational institutions are able to exert such influence as to shape the "agents' behaviour, preferences and identities"[68] with an aim "to gain their support for realising integrative objectives"[69]. This idea has been largely underestimated under the original NF theory, being limited only to the European Commission. However, under the RNF, this kind of influence has been upgraded to include the Court of Justice of European Union (CJEU), the Council presidency, the European Parliament but also the European Council (incorporated by the Lisbon Treaty in 2009 into the EU structure) or epistemic communities (i.e. networks of knowledge-based experts that work alongside the many committees of the EU institutions). Thanks to a number of unique abilities such as: entrepreneurial leadership, being in the centre of policy network, being an institutional mediator, possessing superior expertise, or providing legitimacy to the EU, defending general objective of the EU treaties, etc... the EU institutions are able to cultivate relations between national civil servants and interest groups in favour of upgrading "common interest". In other words, they convince the actors to delegate more powers to the supranational institutions to advance the integration process.

2.2.10 Countervailing forces and the concept of "spillback"

Another novelty of the RNF involves treating the integration process dialectically; as a process that is able to go forth as well as back (in contrast to the original NF assumptions about an "automatic spillover"). Despite the insightful propositions of various agencies and structures that have been identified to have the capacity to promote integration process, it is necessary to state, that all the factors mentioned above might, under certain conditions, go in the opposite direction – roll the integration process back, in what Arne Niemann calls a "spillback". Niemann attributed such an effect to several "countervailing forces". First one being the rise of sovereignty consciousness which manifests often with greater identification with national traditions, cultural identities and ideologies (aka nationalism) and lower trust in

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[67] Cultivated spillover is sometimes also referred as technical spill over
[68] Niemann, *Explaining Decisions in the European Union,* 38.
[69] Ibid., 42.

the EU.[70] Second, domestic constraints posed by domestic lobby groups, opposition parties, media, public or simply national bureaucrats who may opt to protect their own personal interests instead.[71] Thirdly, the sheer diversity between member states (e.g. country´s economy, demographics, legal tradition or administrative structures) may constitute a considerable challenge to the harmonisation of proposed rules, due to the costs associated with adjustment to common policies.[72] In the remaining grouping termed "negative integrative climate", Niemann names aspects such as negligence of the principle of subsidiarity[73], growing Brussels bureaucracy or the potential influence of "wider national publics".[74] Altogether, the balancing between a positive spillover and a negative spillback determines in which direction and how far the (dis)integration[75] process goes:

> "In the absence of strong countervailing pressures even weak integrative forces may drive the integration process forward."[76]

…but in case of strong countervailing forces, European integration could pause or even roll back.

[70] Ibid., 48.
[71] Ibid.
[72] Ibid., 49.
[73] According to the principle of subsidiarity decisions ought to be taken as closely as possible to the citizens. Source: The Publications Office of the European Union, 'March 2010.
[74] Niemann, *Explaining Decisions in the European Union*, 49.
[75] The term (dis)integration signifies that the process can go both ways: integration or disintegration.
[76] Niemann, *Explaining Decisions in the European Union*, 47.

2.3 Methodology

In my view the most effective way to approach the subject of EU integration during the recent crisis (which is still technically not over) is to look at the most important features that characterize the EU for that period. In other words, we want to treat eurozone crisis as a time-framed qualitative case study, and guided by the RNF ask ourselves: what key new features and developments took place during the selected period and how do they relate to the preceding integration structures? Variables proposed by the RNF will help us to identify institutional developments during the crisis time and explain the level of (dis)integration. The resulting findings will then enable us to answer the two folded hypothesis: First, whether there was indeed more integration of the EU observed during the eurozone crisis, and secondly, whether the primary driver behind this integration were forces of the exogenous spillover.

2.3.1 Methods

Accordingly, the "choice" of scientific approach to conduct the study of the eurozone crisis integration that would capture it in its manifoldness can neither be *strictly* positivist or *strictly* interpretivist. For the sake of clarity, compatibility with the used RNF theory and the preference to produce "hard evidence", this thesis will use a qualitative case study research method that leans closer towards positivist rather than interpretivist tradition. In other words, the intention is to collect data that can be identified, observed, measured, tested and repeated. This of course does not mean that other forms of data, that cannot be well captured such as convictions, attitudes, or emotions, will be overlooked. On the contrary, an extra effort is made to look for the concealed information that could uncover a more detailed picture than the one formal documents and settings of the EU institutions and their employees paint. The world is not completely objective and neither completely contextual.

> "[W]hereas all other animals live in an objective world of rivers, trees and lions, we humans live in dual world. Yes, there are rivers, trees and lions in our world. But on top of that objective reality, we have constructed a second layer of make-believe reality, comprising fictional entities such as the European Union, God, the dollar and human rights."[77]

[77] Yuval N. Harari, 'Why Humans Run the World', June 2015.

The next important issue concerns the operationalization of variable identified by the RNF. In case of the eurozone crisis this would require us to look primarily at: (1) the treaties forged or abolished between the member states including secondary legislation (i.e. regulations or directives) that were passed by the EU and are legally binding for the MSs; (2) supranational institutions built or dismantled, (3) official intentions of the elites that held the decision making power in the EU, such as the members of the European Council, the Commission, the Council of European Union (the Council), the European Parliament and the European Central Bank, or other important institutions such as the International Monetary Fund that were involved in that context.

In additional, we should also take into account (4) events, visible patters, or incidents external to the EU that exerted substantial influence on the EU. These could be virtually of any sort, though most likely associated with security, economic prosperity, or environment issues. They could be tangible and observable in the real life in the form of physical matters such as increased violence, unemployment, natural disaster. Alternately, they could be ideational and recognised only in the form of thought (i.e. ideology) communicated through the channels of communication or as numbers on the paper/computer display without manifesting its existence materially (e.g. statistics on economic performance).

This inevitably makes the research more susceptible to bias as the collected evidences are exposed to researcher's identity, preferences, beliefs, etc. This is unavoidable and may only be poorly mitigated to the extent of researcher's awareness and desire (as well as the readers' ability to spot these traces). The selection of events "external to EU" is entirely dependent on the researcher's ability to identify them and evaluate their relevance to the conducted research with sincerity to provide their balanced account in relation to other forces and in proportion to their influence on the EU integration process. In other words, I am determined to do the outmost to select and present the external events as objectively as possible if having found sufficient evidence of their influence on the EU integration process.

2.3.2 Variables

The details of qualitative case study method are simple and straightforward on the theoretical level, but in practice, they are much more elusive and cumbersome. After all, every phenomenon is made up of numerous components and a line between one and another is never precise. Yet, in order to conduct a reasonable analysis the research will try to distinguish the relevant components, of the EU (dis)integration process during the crisis time, by differentiating between the established variables, to form causal mechanisms whose examination will enable us to link causes to the outcomes.[78]

The dependent variable is represented by the change in the (dis)integration of the EU, which can take three forms of deepening, widening, enlargement or the opposite of these. The causal independent variables are dialectically divided as outlined in the theory section. On the one side, we have the five pro-integration spillovers: (1) endogenous (functional) spillover, (2) exogenous spillover, (3) political spillover, (4) cultivated spillover, and (5) social spillover. While on the other side we have the four anti-integration spillbacks (1) sovereignty-consciousness; (2) domestic constrains; (3) diversity; and (4) negative integrative climate. The indicators for the dependent variable, change in European (dis)integration, are the transfers of decision making powers to/from the supranational institutions. For each causal variable the indicators would be different. One example for each:

Pro-integration forces:

1) endogenous (functional) spillover: interdependence between area A and B is not at the optimal level where the resulting tension is neutralises by deepening or widening in the less integrated sector (e.g. new EU institution is created)

2) exogenous spillover: a worrying issue with origins outside of the EU that influence MSs to seek a collective response at the EU level to resolve the dilemma faced.

3) political spillover: trust and/or preference to address new problems through the EU over the national institutions.

4) cultivated spillover: the ability of the EU's civil servants to push forward their agenda.

5) social spillover: enmeshment between civil servants measured via frequency of formal and informal interactions where positive ties to are developed at EU level.[79]

[78] (Dis)integration process means that the process can go both way, either integration or disintegration.

[79] Niemann, *Explaining Decisions in the European Union*, 64.

Countervailing forces:

(1) sovereignty-consciousness: growing euro-scpeticism or even nationalism

(2) domestic constraints: opposition from national agents to delegate powers to the supranational level

(3) diversity: augment difference in ideology or economic performance between MSs

(4) negative integrative climate: general dissatisfaction with EU policies (e.g. protest)

In order to evaluate the strength of the above variable on the EU (dis)integration process spillovers and spillbacks will be compared to each other where appropriate. The difficulty of this approach, as already mentioned, lies in separation and distinction between and within various positive spillovers and negative spillbacks, both are volatile and their assessment cannot be clear cut, plus, in the end it all depends on how each spillover and spillback is perceived and played out by the actors. Lastly we should also consider the multiple causality assumption according to which “the same outcome can be caused by combinations of different factors”[80] which further complicates the collection and evaluation of data.

[80] Ibid., 54.

3 Chapter 3: Impact – origins of the crises – EMU

3.1 Impact of the crisis

3.1.1 Unemployment, GDP growth, deficit and emotional state

The fallout from the "storm" (the crisis) was so bad that the very survival of the EU was put into question. Millions of people lost their jobs as companies shut down, many more were forced into the reduced working hours and into prolonged vacations.[81] According to the Eurostat, between 2008 - 2013 the unemployment rate for EU 28 has "steadily and markedly increased" from 7% to 10.9%, the record level of 26.6 million.[82] For the eurozone area this figure, between 2011 - 2013, was on average 10% higher, though, the variation among the MSs (member states) was and remains still very high. [83] For example, Austria and Germany were able to contain and even reduce their unemployment rates during the crisis below 10%; while for Spain and Greece the unemployment rate almost tripled and now both are having a hard time keeping it below 20%. (Please see appendix 1 for the visual representation) The youth[84] and the poor[85] in particular have been hit hard by the crisis while the inequality gap expanded as well.

The year 2009 was probably the most difficult for Europe in terms of economic activity. When the recession[86] hit the EU in its full power, profit margins of businesses got squeezed and the "industrial production dropped back to the levels of the 1990s"[87]. Every single state of the EU was running negative balance of payments[88] with 4.4% government deficit on average. (See appendix 2) And situation was not going to improve significantly over the next five years. The EU continued to stagnate, experiencing a second, milder

[81] Angelika Kümmerling and Steffen Lehndorff, *The Use of Working Time-Related Crisis Response Measures during the Great Recession* (2014), iv.
[82] Eurostat, 'Unemployment Statistics', July 2015.
[83] Ibid.
[84] United Nations, ed., 'Employment & Youth: The Situation of Young People in the Labour Market and Key Trends' (2013), 16.
[85] Federico Cingano, *Trends in Income Inequality and Its Impact on Economic Growth*, (2014), 8.
[86] Recession is defined as "a period of temporary economic decline during which trade and industrial activity are reduced, generally identified by a fall in GDP in two successive quarters" Source: 'Define: Recession', *Oxford Dictionaries*..
[87] European Commission, *EUROPE 2020: A Strategy for Smart, Sustainable and Inclusive Growth* (2010), 5.
[88] Balance of payments is defined as "the difference in total value between payments into and out of a country over a period" Source: Maurice Waite, ed., *Paperback Oxford English Dictionary*, 7th ed (2012), 48.

recession in 2012 and an average GDP[89] growth rate oscillating between -0.5% and 2.1%.[90]

A special qualitative Eurobarometer study "Coping with the crisis" from July 2014 conducted in seven countries (France, Germany, Greece, Ireland, Portugal, Romania, Spain) revealed that in addition to material loses, most if not all respondents sustained psychological and emotional impact from the crisis mentioning negative feelings such increased level of anxiety, stress, insecurity, depression, isolation, exclusion, desperation or helplessness. [91]

3.1.2 Three crises: financial, economic, debt

But what are the origins of this mighty crisis? That, unfortunately, is not an easy question. To help unravel it, it is useful to distinguish between the three key terms that are used to describe various phases of "the crisis". These are the financial crisis, the economic crisis, and the sovereign debt crisis respectively. In a nutshell, financial crisis was the first phase, whose severity and duration seriously undermined the economic growth and gave birth to the economic crisis. In a desperate effort to rectify these two crises, to avoid a complete meltdown of the financial sector and to encourage the recovery of the economy, many member states provided extensive fiscal stimulus which for several of them, namely Greece, Ireland, Portugal, Spain, and Cyprus (i.e. GIPSC) turned out to be too much to handle often due to their pre-existent decrepit situation.

3.2 Reasons and origins of the financial, economic and debt crises

3.2.1 Financial crisis

According to the Larosière report[92] the reasons for the financial crisis[93] are complex

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[89]GDP is defined as "The total market value of all final goods and services produced in a country in a given year, equal to total consumer, investment and government spending, plus the value of exports, minus the value of imports. Source: Investorwords, 'Define: GDP', *Glossary*, 2015.

[90] European Commission, *European Economic Forecast - Spring 2015* (Brussels, 2015), 23 see table 1.3.

[91] Eurobarometer Qualitative Study, *Coping with the Crisis*, (2014), 13–21.

[92] Larosière report, is de facto a blueprint for the new EU financial union. It was delivered on 25th February 2009, as request by the European Commission in October 2008, when it was clear that the financial crisis is no anywhere near to dissipate but on the contrary is on the tandem to transform into the economic crisis. A high level expert group, headed by Jacques de Larosière (former director of the IMF), was to investigate the global financial crisis and propose recommendations how to avoid it in the future. The findings became an important reference point upon which the European Commission was able push forward the creation of numerous mechanisms and agencies tasked to strengthen the supervision of financial systems, as elaborated in chapter 3 (the Banking Union)along with other institutional innovations.

[93] Financial crisis can be defined as "a situation in which the value of financial institutions or assets drops rapidly"

and are attributed to several factors with origins being traced to the US.[94] In essence, the very low interest rates during early 2000s (both in the US & the EU) made the availability of credit very cheap. This encouraged higher borrowing and hoarding of money for investments. With the abundance of cheap money chasing scarce productive assets, yields[95] were driven down, making the investors (e.g. commercial banks, pension funds, insurance companies, mutual funds, hedge funds, etc.) to forage after riskier assets.

> "Exceptionally low interest rates combined with fierce competition pushed most market participants – both banks and investors – to search for higher returns, whether through an increase in leverage[96] or investment in more risky financial products."[97]

As a result, many subprime mortgages[98] became accessible for the low income households at much higher interest rates, indicating the risk that the borrower (new household owner) might default and not repay the loan, without the government stepping in to regulate the hazardous activity. In order to make these mortgages more attractive for investors financial institutions (e.g. investment banks) used "complex securitization financing techniques"[99], such as turning mortgages into collateralised debt obligations (CDOs)[100], to ease the higher risk. However, because the transparency[101] of these CDOs was poor credit rating agencies (CRAs) failed to accurately price the risk and contributed to the inflation of the housing bubble[102]. And when the large scale sub-prime mortgages delinquencies took

Source: Investopedia, 'Define: Financial Crisis', *Dictionary*, 2014, http://www.investopedia.com/terms/f/financial-crisis.asp.

94 Jacques de Larosière et al., *The High-Level Group on Financial Supervision in the EU* (2009), 6.

95 Yield can be defined as "the income return on an investment. This refers to the interest or dividends received from a security and is usually expressed annually as a percentage based on the investment's cost, its current market value or its face value." Source: Investopedia, 'Definition of Yield', October 2013.

96 Financial leverage refers to the use of debt to acquire additional assets that enables the investor to amplify profits or losses. Source: Harold Averkamp, 'What Is Financial Leverage?', n.d..

97 de Larosière et al., *The High-Level Group on Financial Supervision in the EU*, 8.

98 A subprime mortgage is a type of loan granted to individuals who have poor credit ratings and would not be able to qualify for conventional mortgages. Source: Shauna Carther, 'What Is a Subprime Mortgage?', *Investopedia*, n.d., http://www.investopedia.com/ask/answers/07/subprime-mortgage.asp#ixzz3gqXORrGa.

99 de Larosière et al., *The High-Level Group on Financial Supervision in the EU*, 7.

100 Collateralized debt obligation can be difined as "a structured financial product that pools together cash flow-generating assets and repackages this asset pool into discrete tranches that can be sold to investors". Very often these are mortgages that have been pooled together to spread the risk while retaining high return.
Source: Investopedia, 'Collateralized Debt Obligation - CDO', January 2014.

101 de Larosière et al., *The High-Level Group on Financial Supervision in the EU*, 10.

102 Housing bubbles often take place when the interest rates to borrow money are low, the lending standards are loose, the prices of real estate's are on the rise and are expected to continue to rise. There is a tendency for people to loan

place over 2007, the bubble began to pop and the steady flow of money from these CDOs mortgages, stopped.[103] The "uncertainty about the ultimate size and location of credit losses undermined investor confidence"[104] all around the world, including the EU banks who have also invested in these financial "ticking bombs". In sum, the guilt is shared between "the greed-fattened banks, the sleeping regulators"[105], the credit rating agencies and the households themselves.

3.2.2 Economic crisis

The bang came in September 2008 when Lehman Brothers the fourth largest bank in the US declared bankruptcy and shattered the credo "too big to fail"[106] leading to a "wide-spread breakdown of trust and a crisis of confidence"[107] that deeply froze inter-banking loans.[108] The resulting "credit crunch" had a detrimental effect not only on the banks, which started to face bankruptcy[109], but also on many businesses which could not obtain loans for their business operations. This was especially true for Europe where the backbone of the economy is comprised by small and medium sized enterprises (SMEs), which "rely heavily on

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money and buy property they would otherwise not be able to afford (i.e. subprime mortgage) because they expect high-return on this property in the future. Historically the price of real estate's have been on average constantly growing, hence the residential property has been considered as good long-term investment choice. The bubble bursts when the demand for residential houses outpaces the supply, making the price of houses grows rapidly and instigating the supply to meet this new rising demand. As a result the real estate market overheats to the point where the demand suddenly drops but supply continues to increase (because it takes time to adjust the production) causing the prices of property to instantly drop in its value. Source: Adam J. Levitin and Susan M. Wachter, 'Explaining the Housing Bubble', (2010): 80.

[103] Joel Havemann, 'The Financial Crisis of 2008: Year In Review 2008', 2013.

[104] de Larosière et al., *The High-Level Group on Financial Supervision in the EU*, 11.

[105] Matt Taibbi, 'The Last Mystery of the Financial Crisis', (June 2013).

[106] Marc Labonte, 'Systemically Important or "Too Big to Fail" Financial Institutions' (June 2015).

[107] de Larosière et al., *The High-Level Group on Financial Supervision in the EU*, 112.

[108] A short and simple story of the causes and effects of the 2008 financial crisis depicted in animation video: Jonathan Jarvis, *Crisis of Credit Visualized*, 2012.

[109] Quickly running out of cash, insufficient liquidity reserves, stock indexes hastily dwindling, and banks liabilities (i.e. debt) becoming higher than their assets (i.e. actual value of the financial institution) made many banks critical to the economy seek help from governments.

Liquidity reserves are cash and other liquid deposits "held by a bank, company or government in order to meet expected future payments and/or emergency needs"Source: 'Definition of Reserves', Financial Times: Lexicon, (n.d.).

Major examples to face bankruptcy problem include: Northern Rock (GBR), Royal Bank of Scotland (GBR), Anglo Irish Bank (IRL), Fortis (BEL/LUX/NLD), Dexia (FRA/BEL) Hypo Real Estate Group (DEU), Bankia (ESP). Full list available at: European Commission, 'State Aid: Overview of Decisions and on-Going in-Depth Investigations in the Context of the Financial Crisis' (European Commission, 3 September 2013), http://europa.eu/rapid/press-release_MEMO-13-762_en.htm.

bank lending to finance investment and working capital"[110] (unlike their American counterparts, which are less dependent on bank loans for they can raise capital by selling stocks due to their larger size). And when economic was unfolding along with financial crisis a third crisis – the sovereign debt crisis – was quietly building up.

3.2.3 Sovereign debt crisis

As the income into the states' budgets was shrinking and the government spending (e.g. welfare, transportation, pensions, unemployment benefits, etc.) could not be reduced, the decision of some of the EU governments to step in "to support their private banking sector and boost their economies with the vast amounts of public money"[111] proved (to be) pernicious. According to the European Commission's 2012 State Aid Scoreboard, the approved amount of state aid to the financial institutions for the period 1 October 2008 - 1 October 2012 reached an astonishing €5 trillion (40% of EU GDP).[112] From this amount, committed by MS into the banking system, 1.6 trillion (12.8 % of EU GDP) has been utilised between 2008-2011.[113]

Much of these money national governments had to borrow from financial markets that would need to be repaid on a later occasion.[114] However, since some MSs appeared to be in such a bad state, with already high levels of public debt and government deficits continuing to accumulate with little-to-no prospect for quick recovery, the long term government bonds (i.e. loans) were downgraded to such levels that money borrowing from international creditors was possible only at an ever increasing interest rates that made it impossible for some states to finance their soaring debts (see appendix 4). This was primarily the case of five eurozone members: Greece, Ireland, Portugal, Spain and Cyprus (GIPSC) who quickly lost access to affordable financing and were forced to seek monetary assistance from the Troika[115] to avoid

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[110] Tim Bending et al., *Unlocking Lending in Europe* (2014), iv.
[111] Heinrich Best, John Higley, and Heinrich Best, eds., 'Is Europe the Lesser Evil? Limits of Elite Crisis Resilution in a Limitless Crisis', (2014), 37.
[112] European Commission, 'State Aid Scoreboard: Report on State Aid Granted by the EU Member States (2012 Update)' , 9.
[113] Ibid. (Guarantees accounted for the largest part amounting to roughly €1 trillion, followed by recapitalisation €322.1 bn, impaired assets €119.9bn and liquidity measures € 89 bn.)
[114] European Commission, 'Bank Recovery and Resolution Proposal: Frequently Asked Questions' (June 2012).
[115] Trojka refers to the European Commission, the European Central Bank and the International Monetary Fund.

the imminent sovereign default.[116] The EU needed to react, react fast and decisively.

3.3 Deeper underlining context of the EU set-up

3.3.1 The EMU context

Before diving to evaluating the MSs and the EU responses using the RNF theory, we should examine/discuss one more thing. We have learned that the impact of the crisis on the EU was tremendous and have some idea about its nature. But we have not yet discussed why the recovery from the recession proved to be so difficult and why it slipped into the debt crisis. Let us therefore discuss this by taking a short/brief flashback at the set up of the Economic and Monetary Union of the European Union (EMU) for there lay some answers to this inquiry.

If we would look back into the EU history we would see that one of the reason to establish the EMU, (Maastricht Treaty in 1992) were the fluctuation of exchange rates and the currency instability among the member states after the fall of the Bretton Woods system[117] in 1971. The case for EMU creation was further pressed by the adoption of the Single European Act in 1986 to establish a single market by 1993 (i.e. endogenous functional spillover to use RNF terminology).[118] This state of affairs however posed a danger. A unified market without single monetary policy could be too much for the European Monetary System (EMS)[119] to handle all that free flowing capital.[120] Hence, the creation of Economic and Monetary Union seemed to be a sensible solution. Besides, there are several inherent advantages to share a single currency among the member states.

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[116] André Sapir et al., *The Troika and Financial Assistance in the Euro Area: Successes and Failures.* (2014), 49.

[117] Bretton Wood Agreemt (July 1944 - 15 August 1971) laid down a system of fixed exchange rates were US dollar was pegged to gold (i.e. US dollars could be exchanged for gold at fixed price), making it an international reserve currency.
Source: 'Definition of Bretton Woods', *Financial Times: Lexicon*, n.d..

[118] Tommaso Padoa-Schioppa, 'The Genesis of EMU: A Retrospective View',(1997), 2.

[119] European Monetary System (13 March 1979 – 1 January 1999) was a precursor to the EMU. The ESM regime pooled monetary sovereign of participating member states into the artificial European Currency Unit (ECU) and allowed fluctuation of exchange rates between currencies +/- 2.25% under the Exchange Rate Mechanism (ERM). euro was created on 1 January 1999 in digital/electronic form.
Source: European Commission, 'Phase 2: The European Monetary System',October 2010.

[120] MS might undercut each other in common market be devaluing their currency to make their product more competitive.

3.3.2 The EMU advantages

Firstly, transaction costs and uncertainty from the currency conversion are eliminated.[121] Secondly, higher monetary stability along with long term expectations promote foreign direct investment (FDI)[122] within and into the union. [123] Thirdly, prices of goods and services denominated in one currency make the comparison easier and more transparent which leads to more trade, competition and efficiency. [124] Fourthly, lower rates of inflation and lower long-term interest rates on government bonds encourage economic (i.e. GDP) growth. Fifthly, there is a higher potential for the means of payments (i.e. euro) to become a reserve currency.

3.3.3 The EMU costs

Yet, before such project could be launched two crucial downsides of the single currency area needed to be accommodated. Firstly, a member state loses control of its monetary policy[125] to a common monetary authority – the European Central Bank (ECB) and cannot manipulate the supply of money to change the inflation according to its needs (e.g. increase inflation to make debt payments easier). Secondly, due to the heterogeneity of the member states and a restricted mobility and flexibility of factors of production (e.g. labour force) in the event of macroeconomic shocks (i.e. crisis) the impact would be asymmetric and hit some regions harder than the others.[126] To overcome these shortcomings, "strict" Maastricht convergence criteria[127] have been set up to prepare member state for the monetary

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[121] Josip Visković, 'The Optimum Currency Area and the Credibility of Maastricht Criteria' (2012), 367.

[122] Foreign direct investment can be defined as a "cross-border investment by a resident entity in one economy with the objective of obtaining a lasting interest in an enterprise resident in another economy" Source: OECD, 'Foreign Direct Investment Definition', 2013.

[123] Visković, 'The Optimum Currency Area and the Credibility of Maastricht Criteria', 367.

[124] Ibid.

[125] Monetary policy involves the control of money supply (i.e. printing money) by a central bank primarily through the change of interest rates to pursue certain inflation policy. Source: Tejvan Pettinger, 'Define Fiscal and Monetary Policy', February 2012.
Inflation is defined as "a general increase in prices and fall in the purchasing value of money". Source: Oxford Dictionaries, 'Define: Inflation', n.d.

[126] Visković, 'The Optimum Currency Area and the Credibility of Maastricht Criteria', 366.

[127] The five criteria to enter EMU have are: (1) price stability inflation - no higher than the average of lowest three member states +1.5%; (2) government deficit as a ratio to GDP not to exceed 3%; (3) public debt - gross total government debt not to exceed 60% as a ratio to GDP; (4) exchange rate stability - participation in the Exchange Rate Mechanism II for two years without devaluation of currency; (5) stability of long-term interest rates - to be maximum 2% higher than the lowest three states. Source: The Publications Office of the European Union, 'Introducing the Euro:

union which would then be preserved in the Stability and Growth Pact (1997) to ensure continuous fiscal[128] discipline after entering the EMU. Unfortunately, their implementation, as we shall see later, turned out to be somewhat disrespected and insufficient.

3.3.4 Illusion of the real economic divergence

While it is true that all of the outlined benefits did take place at various degrees after joining the EMU, for example strong converge in unemployment rates[129]. Other macroeconomic variables, such as current account balances[130] began to significantly diverge (between 1998 – 2007) across the euro area countries.[131] And after the crisis erupted, within two years all the fiscal consolidation over the twenty years was erased[132], the process of unemployment convergence has in fact reversed [133] (see appendix 1)

How can we explain this? The optimal currency area theory (OCA), propounded by Robert Mundell in 1961, would argue that characteristics of EMU simply do not classify it to be an optimal currency area. Since "an essential ingredient of a common currency, or a single currency area, is a high degree of factor mobility"[134] we should have seen the factors of production, such as labour force, to move from the region with high unemployment rate to the region with low unemployment, and this was not the case in part due to "wage and price rigidity"[135] and other barriers such language difference. Inter-regional and inter-industry mobility was and still remains rigid and immobile in the EU and eurozone.

Peter Praet, the de facto chief economist of the ECB, notes other intrinsic problems which exhibited an illusionary economic converge that did not lead to greater synchronisation

Convergence Criteria', July 2006.

[128] Fiscal policy involves government expenditure and taxation. Source: Pettinger, 'Define Fiscal and Monetary Policy.'

[129] Ángel Estrada, Jordi Galí, and David López-Salido, 'Patterns of Convergence and Divergence in the Euro Area', (December 2013):602.

[130] Current account balances can be defined as "the sum of the balance of trade (goods and services exports less imports), net income from abroad and net current transfers". Together with capital account, and financial account comprise balance of payments. Source: Investopedia, 'Definition of Current Account', February 2015.

[131] Estrada, Galí, and López-Salido, 'Patterns of Convergence and Divergence in the Euro Area', 618.

[132] European Commission, *EUROPE 2020: A Strategy for Smart, Sustainable and Inclusive Growth*, 5.

[133] Estrada, Galí, and López-Salido, 'Patterns of Convergence and Divergence in the Euro Area', 626.

[134] Robert A. Mundell, 'A Theory of Optimum Currency Areas', (September 1961): 661.

[135] Werner Becker, Horst Löchel, and David Gregosz, *Crisis Management in the Euro Area: Why Europe's Policy Is on the Right Track*, 116 (2013), 3.

and compatibility of business cycles[136] as was reckoned. According to his speech from 2014, as the nominal interest rates converged[137] between higher and lower income countries capital flowed through integrated interbank markets from more matured economies (i.e. Germany, France and Britain) towards "catching-up" economies (i.e. Greece, Ireland, Portugal, Spain) "where the marginal product of capital[138] was higher".[139] [140] Yet, due to the incomplete single market and lack of competition, the price signals were distorted and financial resources became disproportionately over-concentrated in the labour intensive and non-tradable/services such as construction, real estate, retail, transportation or leisure sectors which were "experiencing significant productivity losses".[141] [142] In other words, after joining the eurozone, private sector in the "catching-up" countries were able to take advantage of low interest rates and borrow cheaply from retail banks to invest in local-oligopoly-incumbent firms. This debt-fuelled GDP growth "did not translate in total factor productivity" and largely overheated[143] the economies making the inflation in "catching up" economies (GIPSC) to run "considerably higher than the euro area average on a cumulative basis".[144] When the crisis struck, capital dried out, along with the demand for goods and services, flipping the economic situation upside down. This was further amplified by the fact that the "catching up" countries have low product differentiation and their specialisation is in "low

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[136] Business cycle is understood as "a cycle or series of cycles of economic expansion and contraction". Source: Oxford Dictionaries, 'Define: Business Cycle', n.d..

[137] For example Greek Long-term interest rate (10-year government bonds) steadily fell from 25% in 1993 to 3.5% in 2006 (see appendix 4).
Source: European Central Bank, 'Greece, Long-Term Interest Rate', June 2015.

[138] Marginal product of capital (MPC) is defined as "an additional output resulting from the use of an additional unit of capital (assuming all other factors are fixed)". Meaning to have low capital-to-output ratios.
Source: The Free Dictionary by Farlex, 'Marginal Product of Capital', n.d.

[139] Peter Praet, 'The Financial Cycle and Real Convergence in the Euro Area',2014).

[140] To see how huge was total bank exposure to Portugal, Ireland, Greece and Spain by Germany, France and Britain in 2010 (around €1.4 trillion) see for example the following source: Garry Tang et al., 'International Banking and Financial Market Developments', *BIS Quarterly Review* 3 (September 2010): 14–16, http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.173.7941&rep=rep1&type=pdf.

[141] Praet, 'The Financial Cycle and Real Convergence in the Euro Area.'

[142] This claim has been supported by Estrada, Galí and López-Salido findings who found strong converge in the price levels (i.e. inflation) of tradable goods but not in non-tradable goods. Source: Estrada, Galí, and López-Salido, 'Patterns of Convergence and Divergence in the Euro Area', 613–15.

[143] The use of contractive monetary policy, i.e. increase interest rates, would have been handy to cool down the booming economies but the expansion wasn't that high and was anticipated. Besides, by raising the interest rates the ECB would have had inauspicious effect on other countries that were situated lower in the business cycle.

[144] Praet, 'The Financial Cycle and Real Convergence in the Euro Area.'

value-added, standardized consumption goods"[145] that are hard to compete for exporters on international market with relative strong euro.

A similar opinion was highlighted by Paola Subacchi, on the BBC Broadcast on 20th August 2014, who argued that many of the EU problems predated the crisis saying that "the world economy, the global economic order is completely different from what it was 30-40 years ago" and some of the countries (i.e. GIPSC) have still not adjusted (i.e. delaying structural reforms) to the globalisation and fierce completion. [146]

3.3.5 Monetary union without Fiscal union

Without going any deeper to inspect the EMU, let me conclude this section by saying the following. It seems peculiar and alarming at the same time, that such events (i.e. crisis) have not been adequately foreseen and that the monetary union was allowed to be formed without prior fiscal harmonisation at equal level. The two are in a symbiotic relationship[147] providing potent methods of resolution to economic crisis while their separation leads to exacerbation of the crisis and systemic paralysis. To me, it looks, as if, member states were forced to form monetary union against their wishes and under pressure, willing to take "mispriced" short term risks for long term benefits.[148] Padoa-Schioppa, one of the foundings fathers of the euro, noted a in 1995 that "something like a monetary union was implicit from the very start of the European Communities."[149]

Michael Chang in 1999 accentuated that the creation of monetary union reflected "more political rather than economic/technocratic nature" since according to 1988 the Bundesbank's annual report[150] the currency union was not really necessary, and yet it was built. Michael Sauga, Stefan Simons, and Klaus Wiegrefe from the Spiegel newspaper give some good evidence that the monetary union was a side effect of a German reunification in 1989-1990 driven by France which wanted to keep reinforced Germany at the arm's length

[145] Ferdi De Ville and Mattias Vermeiren, 'The Eurozone Crisis and the Rise of China in the Global Monetary and Trading System: The Political Economy of an Asymmetric Shock', October 2014, 6.
[146] Andrew Walker, *The Countries Hardest Hit by the Eurozone Crisis*, n.d., sec. 4:33–5:34.(video)
[147] Symbiotic relationship (in biology) refers to a prolonged association where the (two) different species are interdependent on each other. e.g. sea anemones and hermit crabs. Source: The Free Dictionary by Farlex, 'Symbiosis', n.d.
[148] Michele Chang, 'Dual Hegemony: France, Germany and the Making of Monetary Union in Europe', 1999, 21–26.
[149] Padoa-Schioppa, 'The Genesis of EMU', 3.
[150] Deutsche Bundesbank, 'Report of the Deutsche Bundesbank for the Year 1988' (February 1989).

via a shared currency bond.[151] Herman Van Rompuy, the President of European Council, confirmed that both political and economic arguments were determinative: "the decision to create a common currency was just as much about war and peace in Europe, as about Robert Mundell's "optimal currency area" theory".[152]

To defend the EU current design, which of course contains many serious flaws (e.g. democratic deficit) let's reverse the question and ponder what would happen with MSs if there was no EU at all; would member states be more prosperous? Well that is impossible to answer but Campos, Coricelli and Moretti have suggested that the per capita "incomes would have been on average 12% lower today if European Integration had not happened" with additional 2% down for eurozone members; except for Greece, which would have been the only one better-off not to participate in economic and political integration process. [153] In any case, lets now turn our attention to the main theme of this thesis to find out how much (dis)integration there was and how can we explain it.

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[151] Michael Sauga, Stefan Simons, and Klaus Wiegrefe, 'The Price of Unity: Was the Deutsche Mark Sacrificed for Reunification?', September 2010.
[152] Herman Van Rompuy, 'Speech by Herman Van Rompuy, President of the European Council at the Stockholm School of Economics' (May 2012), 3.
[153] Nauro F. Campos, Fabrizio Coricelli, and Luigi Moretti, 'Economic Growth and Political Integration: Estimating the Benefits from Membership in the European Union Using the Synthetic Counterfactuals Method', *Institute for the Study of Labor (IZA)*, April 2014, 21, 24, 32, http://papers.ssrn.com/sol3/Papers.cfm?abstract_id=2432446.

4 Chapter 4 – Dialectical process: integrative vs countervailing forces

This chapter will now dialectically analyse the (dis)integration of the EU using the RNF theory during the time of crisis (15th September 2008 - 15th July 2015). The findings are presented in a manner that show how the immediate responses of the EU and MSs authorities to extinguish the eurozone default crisis were followed-up with a variety of long term measures aimed to bring the EU back on the path of stability and growth. We shall see what outcome came out from the tensions between the detected four integrative forces (represented by endogenous, political, social and cultivated spillovers) and the four countervailing forces (represented by sovereignty consciousness, domestic constraints, diversity and "negative integrative climate" spillbacks); how much each facilitated or obstructed the process of EU (dis)integration. These explanations are provided intermittently in order to sufficiently describe the numerous institutional innovations. Next chapter will specifically address the exogenous spillover to better distinguish its forces from others and thus address the second hypothesis (whether the primary driver behind the integration were forces of the exogenous spillover)

4.1 Battling crisis within the existing framework

4.1.1 Making sense 1 – Keynesian approach

Any kind of crisis management first begins with the making sense of the problem and only then the selection of appropriate tools to resolve it. [154] In the initial phase, before the debt crisis crawled out in October 2009 and caught everyone by surprise, the European Commission early on "took the initiative to provide a framework for a coordinated crisis control policy"[155] and on 26 November 2008 proposed the European Economic Recovery Plan (EERP) to address the looming economic crisis (and to lesser extent financial crisis). The plan followed a Keynesian rationale and was directed towards the demand side of the

[154] E. M. Swinkels, 'Sense Making in the Euro Crisis A Personal Approach towards Transboundary Crisis Management' (2012).
[155] European Commission - Directorate-General for Economic and Financial Affair, ed., *Economic Crisis in Europe: Causes, Consequences and Responses*, European Economy 2009,7 (2009), 60.

economy with an objective to contain the recession from deepening and help restore confidence of the financial sector. In it, the Commission called on the European Heads of State and Government to provide "timely, temporary, targeted, and co-ordinated"[156] budgetary expansion at national (€170 bn) and EU (€30 bn) level totalling €200 billion[157] for the next 1-2 years. The emphasis here is on word "co-ordinate" - to take advantage of synergy effect[158] and avoid the free-rider problem, so that some member states would not spend public money and rely on fiscal expansion of their neighbours.[159] Commission recommended that these resources would be allocated to stir up the short term demand and reinforce socioeconomic safety nets[160] via domestic and supranational institutions (i.e. the European Social Fund, European Globalisation Adjustment Fund).[161] The fact that this fiscal stimulus was quickly endorsed by the European Council on 11-12 December 2008 and MSs decided to pledge double the amount, more than €400 billion[162] (3.3% of EU GDP) during the Spring European Council meeting in March 2009 for the supranational recovery plan, demonstrates the cultivate and political spillover, i.e. Commission leadership and MSs decision to follow. Though rather a limited spillover, for it was evident that the timing of public spending differed greatly (e.g. UK, Spain already began in September while Germany started only in January 2009[163]) and member states continued to battle the financial crisis separately, without any co-ordination whatsoever, providing unprecedented rescue packages to failing banks; e.g. United Kingdom €700 (8 October 2008) or Germany €500 (17 October 2008) [164]. There wasn't any common EU fund to rescue banks[165] and neither political will to create one

[156] European Commission, 'A European Economic Recovery Plan', November 2008, 8.
[157] Ibid., 6.
[158] Synergy effect is "An effect arising between two or more agents, entities, factors, or substances that produces an effect greater than the sum of their individual effects."
Source: Business dictionary online, 'Definiton: Synergistic Effect', 2013.
[159] Charles Wyplosz, 'Economic Recovery Plans: Key Principles', 91–100.
[160] Examples: tax cuts, temporary prolong unemployment benefits, increase transfers to low income households, etc.
[161] Additional resources would come from The European Investment Bank (EIB) €30 billion; and European Bank for Reconstruction and Development (EBRD) €500 million to support infrastructure, automotive or construction projects.
[162] European Council, 'Presidency Conclusions: 19-20 March 2009' (April 2009), 3.
[163] European Commission - Directorate-General for Economic and Financial Affair, *Economic Crisis in Europe: Causes, Consequences and Responses*, 67–71.
[164] Gustav A. Horn, 'Assessment of the Banking Rescue Packages and the Economic Recovery Plans of the Member States: The Examples of the UK and Germany', January 2009, 54–55.
[165] Note that such fund was later on agreed. The Single Resolution Fund is planned to enter in operation on 1.1.2016. More in the section about the Banking union.

(Germany and UK opposed while France was in favour[166]). In addition some of the protectionist "measures taken by the EU27[167] have had discriminatory effects also on individual EU member states"[168]. Hence, such position can be equally interpreted as a spillback of diversity and sovereignty consciousness which kept the EU architecture in a status quo, but not for very long.

4.1.2 The real Greek deficit - catalyst of the debt crisis

Upon the inauguration to the post of Prime Minister of Greece in October 2009, Andreas Papandreou revealed that the Greek deficit is estimated to be 12.5% and 3.7% as originally though.[169] When this information was confirmed[170] and further revised to 13.6% with public debt at 115%[171], it resonated widely and became a catalyst to the sovereign debt crisis. A series of criticism fell on Greece for its data (non-)recording. For example large expenditures on military equipment between 1997-2003[172] or €2.8 billion loan from Goldman Sachs in 2001 Group Inc.[173] that were never reported and allowed Greece to enter the eurozone with public debt higher than 100%. Furthermore, it was not expected to be reduced but to keep increasing due to the generous and undisciplined public sector that allowed to raise wages considerably, did not battle tax evasion[174] or corruption[175] and continued the ride up the expansionary business cycles until financial crisis hit and caused abrupt slide down. (This self-interest can be interpreted as form of sovereignty consciousness - positioning the wellbeing of own country on top of the EU community). Yet, Greece was not the only one to blame for what was about to come, since other countries contributed to the difficult situation

[166] Lucia Kubosova, 'EU Big Four Gather for Financial Crisis Talks',October 2008.
[167] Croatia joint EU in 2013
[168] Giovanni Graziani, 'The EU Protectionist Response to the Financial and Economic Crisis', (2014), 184.
[169] European Commission, *Report on Greek Government Deficit and Debt Statistics*, (2010), 3.
[170] The inspection of Greek public finance was requested by Economic and Financial Affairs Council (Ecofin) and was carried out by financial auditors of the Commission during (10th) the Excessive Deficit Procedure (EDP). Following the findings Greece decided to set up an independent national statistical service that would be accountable to the parliament of Greece - Hellenic Statistical Authority (ELSTAT). Shortly after becoming in operation in July 2010 it further revised deficit for 2009 to be at 15%, though this figure is believed to be politicaly motivated to justify harsh austerity measures following the first Economic Adjustment Programme for Greece (bail-out) on May 2010.
[171] European Commission - Directorate-General for Economic and Financial Affair, (2010), 6.
[172] European Commission, *Report on Greek Government Deficit and Debt Statistics*, 24.
[173] Nicholas Dunbar and Elisa Martinuzzi, 'Goldman Secret Greece Loan Shows Two Sinners as Client Unravels', March 2012.
[174] The Economist, 'A National Sport No More', November 2012.
[175] Transparency International, 'Corruption Perception Index, 2012', 2012.

with their own vulnerability which they failed to mitigate to the acceptable level. Besides the other four countries that would also receive bailout[176], both Belgium and Italy had a public debt higher than 100% (of GDP) prior to the adoption of the euro and all the other members, except for Finland and Luxembourg, violated the Stability and Growth Pact (SGP) criteria (of either 3% deficit and/or 60% debt) on several occasions before the crisis[177]. Even though politicians are here to blame, their actions may be vindicated to some extent by the fact the citizens expectations are somewhat different as to the level of public spending they are entitle to.

4.1.3 Making sense 2 – Austerity approach

In the second phase, when Greece formally turned for financial assistance to EU/IMF (International Monetary Fund) on April 23rd, 2010, the conceptualisation of the crisis nimbly shifted from the deep recession to “insurmountable public debt”.[178] Anticipating that the contagion of public debt crisis would spread and infect other enfeebled countries (e.g. Ireland, Portugal, Spain, Italy) with a potential to trigger a chain reaction of country defaulting. Credit rating agencies, such as Standard and Poor's, Moody's or Fitch began to harshly downgrade credit ratings of periphery countries government bonds to as low as the status of “junk”. EU leaders, particularly those of the eurozone, found themselves in a peppery situation where the whole euro area was at stake. Here is how Herman Van Rompuy, President of the European Council, recalls the feelings of the unexpected debt crisis:

> “When I entered office in early 2010, soon after the Greek crisis erupted, I found an empty toolbox. A weakened Stability and Growth Pact for budgetary surveillance; no macroeconomic surveillance at all; no rescue funds to deal with a financial crisis. So we had to develop all those instruments in the midst of a crisis. It was like building a life-boat at sea.”[179]

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[176] Ireland(2010), Portugal (2011), Spain (2012), Cyprus (2013)

[177] European Commission - Directorate-General for Economic and Financial Affair, *General Government Data: General Government Revenue, Expenditure, Balances and Gross Debt (Part II: Tables by Series)*, 2012, 166.

[178] Ayse Kaya and Geoffrey Herrera, ‘Why the 2008 Crisis Was a Bad Crisis for New Ideas’, October 2014, 1.

[179] Van Rompuy, ‘Speech by Herman Van Rompuy, President of the European Council at the Stockholm School of Economics’, 3.

4.2 Going beyond the existing EU framework

4.2.1 The EFSF/EFSM/ESM

Indeed, "building a life-boat at sea" characterises very well the situation that came into being. I would only add "in the midst of a storm that would not easily dissipate". The irony is that instead of building a fund[180] that would bail out banks, eurozone MSs were now forced to construct financial safety nets for the whole countries. European Financial Stability Facility (EFSF)[181] and European Financial Stabilisation Mechanism (EFSM)[182], respectively, which in close co-operation with the International Monetary Fund (IMF) provided huge loans to Greece[183], Ireland[184] and Portugal[185] with maturity (to repay) loans up to 30 years[186]. Yet,

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[180] On the defence side, setting up pan-EU bank rescue fund with correct mandate would not be a matter of days or weeks due to its legal nature (mutualisation of risk); time also becomes very precious commodity during the crisis and financial markets need see a large and robust guarantee at table to convince them of safety of their capital if they would participate.

[181] European Financial Stability Facility was agreed in May 2010 as a special purpose entity (i.e. limited liability company in Luxembourg to be precise) that became fully operation since August 2010 with a lending capacity up to €440 bn which was later (on June 24, 2011) increased to €780 bn. By issuing debt obligation (e.g. bonds) on the financial market the EFSF raised funds which are then provided to eurozone MSs in financial difficulties at much lower interest rates and under conditionality (i.e. structural reforms) until June 2013 when it was overtaken by European Stability Mechanism (ESM). Hence, the above €780 bn sum, provided by the eurozone MSs, serves merely as guarantee for investors in case of MS default. Source: European Financial Stability Facility, *European Financial Stability Facility (EFSF)- FAQ* (2013), 1.

[182] European Financial Stability Mechanism was agreed in the same month as European Financial Stability Facility and operates by similar principle with following differences. It is run by the European Commission which can borrow up €60 bn on financial markets on behalf of the union for any MS using the EU budget as a guarantee (i.e. collateral). So far it was activated twice, for Ireland (€ 22.5 billion) and Portugal (€ 24.3 billion) with 3 years distribution. In case of default the losses would be covered by all MSs of the union not only the eurozone MSs. However, since 4 August 2015 non-eurozone MSs would receive compensation in case of such non-payment. See: Council Regulation (EU) 2015/1360 amending Regulation No. 407/2010 establishing EFSM). Source: European Commission, 'European Financial Stabilisation Mechanism (EFSM)', July 2015.

[183] May 2010, first bailout called "Greek Loan Facility", Greece obtained €77.3 bn in the form of bilateral loans from Eurozone MSs (except for Slovakia, Ireland and Portugal) and €30 bn from IMF (total 107.3 bn)
March 2012, second bailout, Greece obtained additional €100 bn loan from EFSF and €28 bn from IMF (total €128 bn). It also negotiated a swap of government bonds with private investors worth €197 billion with face value reduction amounting to 53.5% (i.e. Greece debt reduction of some €100 billion)
August 2015, third bailout, Greece started to receive €86 billion from the ESM. The IMF participation has not yet been confirmed.
Sources: European Commission, 'Financial Assistance to Greece', Economic and Financial Affairs, August 2015.
Eurogroup, 'Eurogroup Statement' (February 2012), 2.
International Monetary Fund, 'IMF Executive Board Approves €28 Billion Arrangement Under Extended Fund Facility for Greece', March 2012.

[184] December 2010, Ireland received €85 bn from EFSM (€22.5 bn), the EFSF (€17.7 bn), bilateral contributions from the United Kingdom (€3.8 bn), Sweden (€0.6 bn) and Denmark (€0.4 bn) as well as funding from the IMF (€22.5 bn) Source: European Commission, 'Post-Programme Surveillance for Ireland', July 2015.

[185] May 2011, Portugal received €78 bn from EFSM (€26 bn), EFSF (€26 bn) and IMF (€26 bn) Source: European Commission, 'Post-Programme Surveillance of Portugal', July 2015.

since the EFSF was set up only for a temporary period and would expire by the end of June 2013, a long term solution was required. Hence, in December 2010, the European Council agreed to amend the TFEU (Article 136) and forge a new treaty outside of the EU framework between eurozone MSs that would establish a permanent firewall able to "safeguard financial stability within the euro area" - European Stability Mechanism (ESM)187. From 27 September 2012 the ESM became operational and started to provided loans to Spain[188], Cyprus[189] and Greece.

These three rescue mechanism and especially the ESM, which is planned to be "fully integrated within the EU Treaties" by 2025, represent a major endogenous, political and cultivated spillover. Endogenous spillover because the has been a functional pressure to stabilise EMU. Political spillover because the best way to achieve this goal (i.e. stable EMU) has been acknowledged by setting up a temporary and later permanent crisis resolution mechanisms at the EU level. Cultivated spillover because, in addition to the empowered Balance of Payments (BoP)[190] scheme, the ESFM is also under the Commission administration.

In terms of the spillback it is worth to mention that during this quantum leap of risk-sharing a strong resistance at the domestic level was observed. For example, Slovakia's parliament breeched the Greek Loan Facility Agreement adopted by the whole Eurogroup and did not participate in the first bailout for Greece[191]. In October 2011 Slovakia's parliament[192]

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[186] European Financial Stability Facility, 'Lending Operations - Loan Details (Greece, Ireland, Portugal)', February 2015.

[187] European Stability Mechanism is intergovernmental organization (controlled by finance ministers of the eurozone MSs) which from 1 July 2013 fully assumed the responsibilities of EFSF. It is available for all MS that ratified TSCG and use euro as currency. Its maximum lending capacity for one beneficiary is €500 bn (out of €700 bn) and as of December 2014 the ESM was enabled to provide direct recapitalisation to banks (as a last resource measure). Source: European Stability Mechanism, 'European Stability Mechanism (ESM)', 2015.

[188] July 2012, Spain received €41 bn loan from EFSF/ESM, but unlike the other countries, these money were used specifically directed towards Fund for Orderly Bank Restructuring (FOBR) and were used to bailout banks. There was no IMF participation. Source: European Stability Mechanism, 'Spain's Exit', 2015.

[189] May 2013, Cyprus received around €9 billion from ESM (€9 bn) and IMF (€1 bn) European Stability Mechanism, 'Cyprus', 2015.

[190] From 2002 the Commission could provide medium-term loans (up to €12 bn) to non-eurozone MSs under the balance of payments assistance (BoP). In response to the crisis the BoP was increased to €25bn (2008) and then to €50 bn (2009) where Hungary (€5.5 bn) Latvia €2.9 bn and Romania (€2.9 bn) have been granted financial assistance. Source: European Commission, 'Balance of Payments', August 2014.

[191] Olli Rehn, 'Statement by Commissioner Olli Rehn on Today's Vote by Slovakia's Parliament Rejecting the Participation in the Loan for Greece' (August 2010).

[192] BBC Europe, 'Slovak Rivals Reach Deal to Back EU Bailout Fund', October 2011.

also voted against the expansion of the EFSF, while Finland[193] demanded collateral from Greece in exchange for its contribution to the bail-out programs. Both matters have been eventually resolved and all eurozone countries participated and warranted each other with their public money. Another, domestic constraint came from Thomas Pringle, an Irish politician, who attacked the ESM arguing that it is not valid since TFEU amendment (Article 136) did not take place via ordinary revision procedure but the simplified one, yet, The Court of Justice of the European Union (CJEU)[194].

What these joint programs have done is that, from the very first rescue package to Greece, in May 2010, the eurozone member states irreversibly committed themselves to a very forced solidarity that kept pulling in more financial support from their public pursues, tightening them even more to a common fate. Jean-Claude Juncker, President of the European Commission confirmed this line of reasoning at Catholic University of Leuven on May 4th 2015:

> "We should make sure that everyone understands that the economic and monetary union is irreversible, that the euro is a currency that is here to stay, which is not going to be abolished or suspended." [195]

A path dependency in all its beauty that can be well captured by the phrase: "all for one and one for all, united we stand divided we fall". [196] Needless to say, that this course of action, however unpalatable it might have been, was effectively the only viable one, since, had it not been undertaken Greece would had most certainly go bankrupt. Olli Rehn, European Commissioner for Economic and Monetary Affairs and the Euro, stated this fact plainly: "To those who speculate about other options, let me say this clearly: there is no Plan B to avoid default"[197]. And Greek default would mean nothing else than a forced exit from the eurozone, which leads us to the question "Would anyone dare to risk the junctures and forces that would be unleashed by opening a potential Pandora's box[198](i.e Grexit)?" Key politicians, such as

[193] Kati Pohjanpalo, 'Greece Pays Finland Collateral Money', April 2012.
[194] See: Case C-370/12 Pringle v Ireland [2013]
[195] Jean-Claude Juncker, 'Juncker: If Greece Leaves, Anglo-Saxons Will Try to Break up Eurozone' (May 2015).
[196] Alexandre Dumas, The Three Musketeers 1844
[197] Olli Rehn, 'Statement of Commissioner Olli Rehn on Greece' (28 June 2011).
[198] Pandora's box in Greek mythology, was a jar that contained all evils (e.g. death, illness) of the world which upon opening by Pandora were set free to beset the world at the bottom of which was left only hope.

Angela Merkel expressed her unwillingness to find this out and allow thus the euro to be endangered:

> "The euro is far more than a just a currency. It is the symbol of European unification and it's becoming the symbol for half a century of peace, freedom and prosperity. It is everything but self-evident when we look at the developments elsewhere. That is why I am saying over and over again, if the euro fails, Europe will fail." [199]

It is very arguable that this state of uncertainty of what might happen next after Grexit, with a possibility that everything might fall completely apart, had a strong influence on the mindset of the officials in charge of the crisis resolution. The latest findings from the field psychology suggest that under such acute stress individuals feel much more vulnerable become risk aversive and tend to develop pro-social behaviour and preference for cooperation since thus they have better chances of attaining their goals[200] [201].

4.3 Advancing the EU collaboration

As the crisis unfolded (i.e. one bailout after another), the frequency of special meetings kept increasing between the key EU and MS officials. For example, between 2010 and 2012 the number of EU summits (i.e. European Council meetings) has doubled to an average of 9.[202] This intensified interaction combined with common challenges "increased peer pressure among European leaders"[203] made social spillover a potent uniting force. For example, Mateo Renzi - Italian Prime Minister, upon taking the Italian Presidency of the Council of Ministers of the European Union in July 2014, proclaimed that he would like to bring MSs together: "For my children's future I dream, think and work for the United States of Europe".[204] For our research more important are the new configurations that have significantly expanded the existing framework of rules by which the MSs would be bound to

[199] Angela Merkel, 'Angela Merkel: Europe Facing Worst Crisis since War', November 2011, l. 30:52. (video)
[200] von Dawans et al., 'The Social Dimension of Stress Reactivity: Acute Stress Increases Prosocial Behavior in Humans', *(*June 2012): 651–60.
[201] Benjamin A. Converse, Jane L. Risen, and Travis J. Carter, 'Investing in Karma When Wanting Promotes Helping', 2012.
[202] European Commission, 'The Financial and Economic Crisis - a Chronological Overview (January 2010 - December 2012)', September 2013.
[203] Van Rompuy, 'Speech by Herman Van Rompuy, President of the European Council at the Stockholm School of Economics', 3.
[204] Marta Bonucci, 'Italian PM Vows to Push for United States of Europe during Presidency', (May 2014).

play. Here are few examples were social, cultivated and political spillovers advanced the EU integration.

4.3.1 The European Semester

One of the first and most important innovations has been the European Semester[205] - a macroeconomic surveillance program proposed by the Commission in June 2010[206]. This legislative measure induced the MS to gather since 2011 on yearly basis to closely co-ordinate and align national fiscal policies (in peer review format) towards common EU objectives and granted the EU Commission to closely monitor and even to "veto" national budgets.[207] Each year this social spillover has been solidifying the revamped institutional architecture of the EU as the focal point of all the newly implemented fiscal rules and surveillance processes (Six-pack, TSCG and Two-pack, read below).

4.3.2 The Eurogroup and the Euro Summit

Another innovation, not as far reaching as the European Semester but equally significant to push the institutionalisation one step further has been accomplished by the Treaty of Lisbon (2009), were the Eurogroup (ministers of the euro area) meetings have been formalised to gather (informally and in private with Commission and ECB representatives) "to develop ever-closer coordination of economic policies within the euro area" [208]with a Eurogroup President elected every two and a half years. The brand new Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG) entered in force on January 1, 2013 to which I will return in a moment, in addition stipulates that "at least two Euro Summit meetings per year, to be convened, unless justified by exceptional circumstances, immediately after meetings of the European Council".[209]

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[205] The European Semester is annual six month meeting that takes place since 2011 between the European Commission and the Member States during which the parties discuss and co-ordinate their budgetary policies (i.e. growth, competition, fiscal, structural, etc.. policies) to meet the objectives of the Stability and Growth Pact and the Europe 2020 strategy.
Source: European Commission, 'European Semester: A New Architecture for the New EU Economic Governance – Q&A' (January 2011).
[206] Ibid.
[207] Council of the European Union, 'How the European Semester Works', February 2015.
[208] Protocol (No 14) on the Euro Group Council of the European Union and European Commission, eds., *Treaty on the Functioning of the European Union (Consolidated Version),* C 326/47 (2012).
[209] Council of the European Union, ed., *Treaty on Stability, Coordination and Governance in the Economic and*

4.3.3 Merkozy

The level of social spillover has been so high as to create the term "Merkozy". Coined by the media since Deauville agreement[210] (2010) to describe the political marriage of Angela Merkel and Nicolas Sarkozy, the representatives of the two most important states of the EU, who despite their different ideologies and persistent arguing, nevertheless, publicly demonstrated joined positions and repeatedly reassured that "Greece remained an integral part of the eurozone"[211] while the new members are welcomed. Note that eurozone enlargement took place even during the crisis time. After Slovenia (2007), Cyprus (2008) and Malta (2008) joined; Slovakia (2009), Estonia (2011), Latvia (2014) and Lithuania (2015) all joined the euro area, which at present has 19/28 MSs. This expansion of Euro area could be classified as another form of the spillover: "geographical or enlargement spillover[212]")

4.4 Economic Fiscal reforms strengthening Stability and Growth Pact

When MSs (of the eurozone) unwillingly acceded to the principle of solidarity the responsibility for a permanent mutual bailout fund worth €700 billion had to be sealed not just through a more frequent and intimate co-operation, accountability had to be established. Following the advice "trust but verify" Frau Merkel, Chancellor of Germany, in her speech on November 2011, resolutely proclaimed that "[we] need to further develop the European Union's structure. This does not mean less Europe. It means more Europe."[213] This has been addressed towards fiscal consolidation - the reform of the Stability and Growth Pact (SGP) whose 3% deficit and 60% debt limit have been continuously violated and never penalised. Jean-Claude Trichet, on 1 December 2003 (just one month after assuming the post of ECB president) cautioned the European Parliament that:

Monetary Union, 2013, 7.

[210] On 19 October 2010, in Deauville (France), N. Sarkozy and A. Merkel made a deal that France would support treaty amendment to make permanent bail-out fund (i.e. ESM) while in exchange Germany would relinquish demand of automatic sanction for countries that breached deficit and/or debt requirements to semi-automatic. Source: The Economist, 'Germany, France and the Euro: Behind the Smiles', December 2011.

[211] Kim Willsher and Allan Hall, 'Meet Merkozy - as Nicolas Sarkozy and Angela Merkel Try to Unite to Save the Euro', December 2011.

[212] Niemann and Schmitter, 'Neofunctionalism', 61–62.

[213] Merkel, 'Angela Merkel', sec. 1:01–1:05.

> "The failure to respect the rules and procedures foreseen in the Stability and Growth Pact risks undermining the credibility of the institutional framework and confidence in the sustainability of public finances across the euro area." [214]

Unfortunately, neither warnings nor the subsequent 2005 reforms[215] proved to be sufficient enough to keep the public finances *"in Ordnung"* (in order). It appears that, it is simply not politically feasible for politicians under the intergovernmental setting to reduce public spending and bring fiscal discipline to the level compatible to the monetary union; a far more responsible approach was required at the EU level.

4.4.1 Fiscal discipline

The reforms or rather "pact layering"[216] of the SGP, came in the form of Six-pack, TSCG and Two-pack. Together they extended the reach of the Commission to scrutinise MS economic governance and installed high macro-economic policy co-ordination and surveillance (i.e. SGP's preventive arm) with strong enforcement measures (the SGP's "corrective arm"). For example, sanctions of the Excessive Deficit Procedure (EDP) have been upgraded to the semi-automatic level and may be ruled out only by a revised qualified majority voting (RQMV)[217] of the Economic and Financial Affairs Council (ECOFIN).[218] So that in case of serious non-compliance with the provisions fines can rise up 0.5% of a given country's GDP in the form of interest bearing deposits and "suspension of commitments or payments from the EU's structural and investment funds"[219].[220] These semi-automatic penalties conspicuously serve as a backstop to prevent disordered economic and fiscal

[214] Jean-Claude Trichet, 'Testimony before the Committee on Economic and Monetary Affairs of the European Parliament, with the President of the European Central Bank, in Accordance with Article 113(3) of the Treaty on European Union' (December 2003).
[215] SGP reform in 2005 included: the medium term objectives (MTO) where calculated for every MS, in case of long-term cost-saving effects deviation from MTO were allowed, early warning system enabled the Commission to issue an opinion without the Council consultation
[216] Caroline de la Porte and Elke Heins, 'A New Era of European Integration? Governance of Labour Market and Social Policy since the Sovereign Debt Crisis', (2015): 18.
[217] Reversed qualified majority voting needs 55% of member states, representing at least 65% of the EU population. Source: Council of the European Union, 'Qualified Majority', January 2015.
[218] European Commission, 'Excessive Deficit Procedure - Commission Recommends Abrogation of EDP for Bulgaria and Germany, Lifting of Cohesion Fund Suspension for Hungary', *Economic and Financial Affairs*, June 2012.
[219] E.g. the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund.
[220] European Commission, 'Stability and Growth Pact', 30 July 2015.

governance of any MS. One of reason why the fines have not been set to be automatic was because a situation might take place in which certain MSs, despite all the effort, could be still violating the minimum economic requirements and the fines would not help to meet them.

4.4.2 The Six-pack

The Six-pack, a set of 5 regulations and 1 directive that came into force on December 2011, specifies that MS budgetary balance needs to converge to and avoid "significant deviation"[221]from Medium-Term Budgetary Objective (MTO) that are developed for each state. It's new Macroeconomic Imbalance Procedure (MIP) allows the Commission to "quantitatively assess national economies"[222] through the scoreboard of eleven indicators of external and internal imbalances (e.g. nominal unit labour costs, unemployment rate, etc.) which are then published in an Alert Mechanism Report (AMR) every year[223]. MS that are deemed to have high macro-economic imbalances will be subject to in-depth reviews by the Commission which will then suggest recommendations for correction.

4.4.3 The TSCG

The TSCG, in force from 1st January 2013 and running in parallel with Six-pack, further specifies that yearly structural deficit may not exceed -0.5 %, though, in cases of "exceptional circumstances"[224] the requirement may be temporarily suspended by taking into consideration country specific economic context. However, in exchange for such flexibility the treaty stipulates that:

> "Contracting Parties' obligation to transpose the "balanced budget rule" [0.5% structural deficit] into their national legal systems, through binding, permanent and preferably constitutional provisions, should be subject to the jurisdiction of the Court of Justice of the European Union" [225]

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[221] Significant deviation is specifically defined on pages 7-8. (Essentially it refers to structural balance deviation of 0.5% in one year) Source: European Commission, 'Specifications on the Implementation of the Stability and Growth Pact and Guidelines on the Format and Content of Stability and Convergence Programmes', September 2012, 8.
[222] de la Porte and Heins, 'A New Era of European Integration?', 16.
[223] European Commission, 'Fourth Alert Mechanism Report on Macroeconomic Imbalances in EU Member States' (November 2014).
[224] Council of the European Union, *Treaty on Stability, Coordination and Governance in the Economic and Monetary Union,* 5.
[225] Ibid.

This requirement is mandatory for all eurozone MSs as a prerequisite to access the ESM. Though, other non-eurozone MSs, except for UK, Czech Republic and Croatia, decided to ratify the treaty as well. Such direct interference into national budget policies represents a major limit to governments' manoeuvring to implement national reforms without consulting the Commission. Violation of this Fiscal Compact allows the Court of Justice of the European Union (CJEU) to impose a penalty up to 0.1% of GDP[226]. This is another treaty that is going to become part of the EU law.[227]

4.4.4 The Two-pack

The Two-pack, in force from 30 May 2013 only for eurozone members, builds upon the Six-pack and the TSCG by introducing "a common budgetary timeline and common budgetary rules for euro area Member States".[228] It outlines deadlines when Euro area MSs have to submit their draft budgetary plans (DBPs) for the following year. It also specifies that these need to be monitored by the independent institutions. Commission will then issue opinions which MS will need to take into account and in case MS has serious financial difficulties the reporting and monitoring by Commission increases according to the new "enhanced surveillance" system.[229]

4.4.5 The Euro-Plus-Pact

One more agreement that is worth to mention is the Euro-Plus-Pact, agreed on March 2011 between eurozone MSs and several other EU states (except for UK, Sweden, Czech Republic, Hungary, and Croatia) with a goal to bring member states to work together on fostering competitiveness, employment, public finances and tax policy.[230] Unlike the previous pact, this one has been set up via Open Method of Coordination (OMT), a form of governance which relies on voluntary commitment of its members, in this case to conduct national reform

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[226] Ibid., 16.
[227] Jean-Claude Juncker, 'Completing Europe's Economic and Monetary Union (The Five Presidents' Report)' (June 2015), 20.
[228] European Commission, '"Two-Pack" Enters into Force, Completing Budgetary Surveillance Cycle and Further Improving Economic Governance for the Euro Area' (May 2013).
[229] Sergio De la Parra, 'The Two Pack on Economic Governance: An Initial Analysis', May 2013, 13.
[230] European Commission, 'European Council Conclusions 24-25 March 2011' (European Commission, 25 March 2011).

programmes. This mode of governance, however, "largely failed to deliver the expected results in view of its intergovernmental, non-binding nature" [231] and as of 2015 it has been reported to be in a "dormant"[232] state. This non-performace is clearly a form of spillback. But, it also shows that the effective co-operate on sensitive issues without incentives and guidance from the Commission cannot be achieved on voluntary basis. More importantly, the Euro-Plus-Pact will not be abandoned, on the contrary, it is planned to be re-launched and incorporated in the EU law by 30 June 2017 with a stronger mandate.[233] In addition, there is an intention to create independent national bodies in each euro-member state that would be in charge of tracking and assessing performance and policies in the field of competitiveness and economic progress. [234] They would bear the name of "Euro Area System of Competitiveness Authorities" and be subject to co-ordination from the Commission.[235] What this initiatives well demonstrates is that whenever is something agreed among MSs at the EU level it very likely to remain and undergo reforms rather than being dismantled.

4.4.6 Public externality

While this "massive shift of power to the EU level"[236], with the Commission as the beneficiary, can be rightly seen as a deepening stage of the EU integration process, which launched a debate about the extent and type of new European political-fiscal architecture, it is expected that politicians (especially those at the EU level), despite their animosity, will "always" find some compromise through bargaining process (however intense it might be[237]). The public on the other side is not compelled to search for one, as they do not perceive such responsibility and can freely express their views on the arrangements their leaders agreed on.

If we would look at the EU integration in terms of social cohesion and democracy we would see that the crisis period and the ingenuity of the state representatives inflicted a major blow to the fragile spirit of the EU "demos". Not only the decisions to rescue private banks

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[231] Juncker, 'Completing Europe's Economic and Monetary Union (The Five Presidents' Report)', 7.
[232] EPSC Strategic Notes, 'The Euro Plus Pact: How Integration into the EU Framework Can Give New Momentum for Structural Reforms in the Euro Area', (May 2015): 1.
[233] Juncker, 'Completing Europe's Economic and Monetary Union (The Five Presidents' Report)', 20.
[234] Ibid., 7–8.
[235] Ibid.
[236] Sebastian Dullien, *What Is Political Union?* (2012), 2.
[237] Suzanne Lynch, 'Analysis: Tsipras's Gamble Backfires as Greece Nears Exit', June 2015.

with public money created the feeling of injustice the subsequent bail-out of the GIPSC countries contaminated the relations between the neighbouring countries. Economic divide between the richer North/core and the poorer South/periphery became a fertile ground for political polarisation. On the question[238] “Has the crisis widened the gap between countries in Europe?” the Eurobarometer[239] collected following findings:

> “The national mood is relatively buoyant in Scandinavian countries (85% in Sweden, 74% in Denmark) and Germany (82%). On the other hand, in the countries worst affected by the crisis positive sentiment is at an all-time low – Greece (2%), Cyprus (3%), Portugal (3%), Croatia (3%) and Spain (4%). [240]

The tax payers of the wealthier nations did not want to pay for bail-outs of another state that was not able to manage its finances:

> “There was widespread support amongst the German electorate for a return to economic stability and budgetary prudence; but the suggestion that Germany should seemingly sacrifice this objective by footing the bill for spendthrift Greeks was abhorrent.” [241]

and neither the recipients of poorly performing countries wanted to accept these loans as they entailed structural reforms – harsh austerity measures[242] which have been imposed by the “key centres of power notably the German Government, the European Commission[243] and the European Central Bank (ECB)” who quickly switched from Keynesian doctrine to “strict ordo-liberal stance comprising anti-inflationary monetary policy and tight fiscal discipline”.[244] As a result a number of anti-austerity mass movements took place after each deal was struck in Greece[245], Portugal[246], Spain[247], Ireland[248], Cyprus[249] but also in Luxembourg[250] or

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[238] Though on other very similar question “Has the crisis brought Europeans together or driven them apart?” Erobarometer provide contrasting findings saying: “In several countries that have benefited from EU financial assistance, there is a stronger feeling of togetherness with other European citizens. This applies to people in Cyprus (60%), Greece (54%) and Ireland (50%). The figure is also high in Italy (52%), another country that has experienced financial difficulties.” Eurobarometer, ‘Eurobarometer - 40 Years’, Public opinion, 8.
[239] Erobarometer are public opinion surveys carried out on regular basis for the European Commission.
[240] Eurobarometer, ‘Eurobarometer - 40 Years’, 3.
[241] Huw Macartney, *The Debt Crisis and European Democratic Legitimacy* (2013), 46.
[242] Austerity measures included spending cuts, pensions reduction, cut in public sector salaries, raising value-added tax, retirement age, privatisation and other unpopular measures aimed at reducing government deficit.
[243] Officials such as Olli Rehn, European Commissioner for Economic and Monetary Affairs and the Euro
[244] Ben Clift and Magnus Ryner, ‘Joined at the Hip, but Pulling Apart? Franco-German Relations, the Eurozone Crisis and the Politics of Austerity’, (June 2014): 137–138.
[245] Amy Goodman, ‘This Is A Coup: Greeks Denounce Bailout Deal That Calls for New Round of Austerity’, July

Germany[251] or whenever the Troika came for a "visit".

4.4.7 Austerity pushed too far?

Many prominent economists[252] [253] have been quick to criticise that austerity has been pushed too far and is self-defeating. Not only it harms social well-being, it discourages private sector spending and triggers a downward growth spiral which just digs deeper and makes it hard to kick-start the economy back. The defenders would point out that there is little point in pumping public money in the economy, at the expense of increasing deficit/debt, that will not immediately get started. Besides, the public sector might be too big and inefficient and in need of restructuralizasion. Its spending could be crowding-out private investment and provide a shield over uncompetitive businesses that should leave the market.[254] Both sides have solid arguments and the debate between Keynesian and Classical views never ends since the right choice depends at which point the economy is in the business cycle and what are the expectations.

4.4.8 Bypassing treaty boundaries

In addition there are two-folded controversies that go along with the bilateral loans. First, they make the EU effectively a "transfer union" (i.e. transferring finances from one country to another), and secondly, they are in breach of the "no bail-out" clause enshrined in Article 125 of the TFEU which states that: "The Union shall not be liable for or assume the commitments of the central governments..."[255] The legal basis for bail-out was justification by Article 122 (para 2) of TFEU:

2015.

[246] Axel Bugge and Mark Trevelyan, 'Portuguese Teachers Protest against Education Cuts', January 2013.

[247] Cristina Quicler, 'Spanish Rallies Turn Violent as Million People Protest in 80 Cities', July 2012.

[248] Sarah Lazare, 'Tens of Thousands Flood Dublin Demanding Abolition of Austerity Tax On Water', *Common Dream*, March 2015.

[249] Nicolai Kwasniewski, 'Anger in Cyprus: "They Can"t Just Penalize Us Because of the Banks!'', March 2013.

[250] Natalia Drozdiak and Sarah Sloat, '"Blockupy" Protests Break Out in Frankfurt as ECB Opens New Building', March 2015.

[251] Don Melvin, 'Thousands of European Workers Protest Austerity Plans in Luxembourg', June 2011.

[252] Paul Krugman, 'Austerity and the Greek Depression', 10 July 2015.

[253] Mark Blyth, 'The Austerity Delusion', June 2013.

[254] Giancarlo Corsetti, 'Has Austerity Gone Too Far?', April 2012.

[255] Council of the European Union and European Commission, *Treaty on the Functioning of the European Union (Consolidated Version)*, para. 1.

> "Where a Member State is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or *exceptional* occurrences beyond its control, the Council, on a proposal from the Commission, may grant, under certain conditions, Union financial assistance to the Member State concerned." [256]

We should also keep in mind that the presence of the IMF in conducting the recovery programs for GIPSC does not lie only in its contribution and technical expertise but even more so in providing credibility to the bail-outs. Christine Lagarde, Managing Director of the International Monetary, admitted in an interview that:

> "What we have done for Europe at large I think is a very massive plan, totally unexpected, totally counter-treaty, because it wasn't scheduled in the treaty that we should do a bailout program, as we did." [257]

4.4.9 Euro-scepticism

What is really disturbing is that, due to the economic hardship and deeply unpopular measures adopted to avert the Euro collapse, the confidence in the EU project, overall, has significantly decreased, from 69% in 2007 to 51% in 2013.[258] The euro-scepticism mood has strengthened across entire Europe[259] and fuelled the position of radical right (UK Independence Party, Danish People's Party) and left (National Front in France, Syriza party in Greece) which found their way to European Parliament in great numbers during 2014 elections.[260]

People, as source of all legitimacy, are simply reluctant to trust (EU) politicians which are not directly accountable to them, and yet, are the source of austerity measures that national governments have been forced to accept. Take for instance the announced referendum[261] in Greece at end of 2011 about second bail-out programme which under the pressure from Troika (but also Germany and France) was within three days called off. Such luck of democracy represents a leading hindrance towards a legitimate and democratic EU integration. And it is becoming increasingly evident that politicians are running a risk that

[256] Ibid., para. 2.
[257] Paul Solman, 'As IMF's New Chief, Will Lagarde "Keep Smiling"?', June 2011.
[258] Eurobarometer, 'Eurobarometer - 40 Years', 21.
[259] José Ignacio Torreblanca and Mark Leonard, *The Continent-Wide Rise of Euroscepticism* (2013).
[260] The Economist (online), 'Europe's Elections: The Eurosceptic Union', *The Economist*, 29 May 2014.
[261] Rachel Donadio and Niki Kitsantonis, 'Greek Leader Calls Off Referendum', *The New York Times*, November 2011.

further integration in sensitive areas (such as pensions), without fixing the democratic deficit, can be contra-productive . “Permissive consensus” can no longer be taken as for granted. Public interest must be reflected, but first people need to well informed to determining the right course of action for the EU.

4.5 Role of the ECB

Which EU institutions exercised its power to the maximum, testing its limits, arguably went beyond its mandate and, as result got empowered? You might guess the Commission, with all its new powers to babysit the national budgets, but no, the answer is the E-C-B. Even before the European Economic Recovery Plan (EERP) has been launched, the ECB (European Central Bank)[262] took an active role in bolstering the economy. From October 2008 till May 2009, it had been systematically slashing the interest rates on its main refinancing operations (MROs)[263] from 4.25% to 1.00%.[264] But when the debt crisis gained strength in the beginning of 2010 the Keynesian fiscal policy was immediately replaced by austerity and this is when the ECB began to take matters into its hands. Since its main monetarily policy tool (MROs) was already at its low, it became a blunt tool that could do very little to untie the credit crunch and encourage banks to start lending money. As crisis progressed, the ECB gradually employed a number of “non-standard monetary policy measures” that proved to be remarkably effective.

4.5.1 Opening up the monetary toolbox

For example, early on it started to provide long term refinancing operations (LTRO) – super cheap loans to banks with maturity up to 3-years and fixed interest rate of 1% “with no

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[262] Eurosystem compromises the ECB and 19 MSs central banks

[263] Refinancing operations (i.e. repurchase agreements) is an open market operation executed by the ECB (Eurosystem) through which the ECB controls money supply. It works in the following way. The ECB sets interest rates and banks that wish to borrow loans from the ECB (Eurosytem) at this interest rate provide appropriate security (i.e. collateral of the bank that is worth the amount the banks requested) which they pledge to repurchase back when the maturity of the loan they received expires. The ECB distinguishes between main refinancing operations (MRO) (maturity 1-4 weeks) and longer-term refinancing operations (LTRO) with maturity (maturity 1-36 months). The lower the interest rate and the longer the period of maturity the more banks will be incentivised to borrow money from the ECB which will lead to liquidity injection into economy and rise in inflation (i.e. price level). Source: European Central Bank, ‘Glossary: Main Refinancing Operation’, 2015.

[264] ECB, ‘The ECB’s Response to the Financial Crisis’, *European Central Bank* Monthly bulletin (October 2010): 64–65.

strings attached" [265]; allowing banks to invest or lend the borrowed money as they pleased.[266] These, in June 2014 were expanded by targeted longer-term refinancing operations (TLTROs) that would in addition to banks provide loans to non-financial private sector in the euro area[267]. Such measure was undertake in response to the onset of 2012 recession which brought the inflation rate to 0.6%[268] and frightened the ECB about the prospect of deflation to such extant that by the end of 2014 it cut the interest rates on (MROs) to a record low 0.05% and introduced negative rate on bank deposits of -0.2%[269].

4.5.2 Controversial programmes: the SMP and the OMT

The ECB also lunched two rescues programs the Securities Markets Programme (SMP) and the Outright Monetary Transactions (OMT) designed to buy government bonds on secondary market[270] (i.e. from banks) in the eurozone. These however were very controversial monetary tools since they border with treaty (Article 123) violation a created much furor. The whole idea behind them is that banks hold government bonds of countries that could default and in order to mitigate further risk they tighten credit lending. To easy banks and restore liquidity – restore "an appropriate monetary policy transmission mechanism"[271] the ECB would under these programs dispose toxic government bonds (i.e. loans that might never be paid) from banks which could then buy "healthier" assets and start operate as usual.

The difference between the two is that the SMP was implemented for a limited period, from May 2010 till September 2014, when the government yields for periphery countries (Greece, Ireland, Spain, Portugal, Italy) began to spike allowing ECB to extract a total of €214.2 billion[272]. The OMT on has never been implemented but it neither has an expiry date (it could be used in future). It was announced on 2 August 2012, shortly after Mario Draghi, the president of ECB, declared a legendary sentence at the Global Investment Conference in London on 26 July 2012, that: "within our mandate, the ECB is ready to do whatever it takes

[265] David Enrich and Charles Forelle, 'ECB Gives Banks Big Dollop of Cash', March 2012.
[266] In December 2011 and March 2012 ECB provided €1,018.7 billion in the two three-year longer-term refinancing operations (LTROs) Source: European Central Bank, 'Monthly Bulletin 14 March 2013', March 2013.
[267] European Central Bank, 'Expanded Asset Purchase Programme', 2015.
[268] Eurostat, 'Harmonised Index of Consumer Prices (HICP) - Inflation Rate', 2015.
[269] European Central Bank, 'Key ECB Interest Rates', *Monetary Operations,* 2015.
[270] In the secondary market investors trade previously issued securities without the issuers involvement.
[271] European Central Bank, 'Technical Features of Outright Monetary Transactions',September 2012,.
[272] European Central Bank, 'Consolidated Financial Statement of the Eurosystem as at 20 April 2012', April 2012.

to preserve the euro. And believe me, it will be enough”[273]. When the OMT overtook the SMP duty in September 2012 no-one really qualified under its conditionality anymore[274], but its presence and full readiness to be used had a favourable influence on the financial markets. According to the study of *Arvind Krishnamurthy (Stanford University), Stefan Nagel (University of Michigan), Annette Vissing-Jorgensenn (University of California Berkeley)*, these two measures, and to lesser extent LTROs, “reduced sovereign bond yields dramatically”[275] and “reduced sovereign default risk”.[276]

4.5.3 The ECB’s legal challenge

Despite the success of the SMP and the OMT, a cold shower came from members of the German parliament who on 10 February 2014 lodged a case against the OMT, arguing that it “exceeds the European Central Bank’s monetary policy mandate”[277] and thus violates the Treaty on the Functioning of the European Union (TFEU).The accusation can be boiled down to the infringement of Article 123 which prohibits the ECB to purchase government bonds. In their view, but also many others such as Jens Weidmann[278], the president of the German central bank, the ECB violated the Article 123 since it had been able to finance government debt[279], though, indirectly by purchasing government bonds on the secondary market (i.e. from banks and not directly from governments as that that would be a primarily bond market and a direct violation of the treaty). Nevertheless, by and large, the effect had been the same as “the ECB would tell institutional investors like pension funds that if they bought fresh bonds from troubled governments, the ECB would in turn buy those bonds from the

[273] Mario Draghi, ‘Speech by Mario Draghi, President of the European Central Bank at the Global Investment Conference in London 26 July 2012’ (July 2012).
[274] European Central Bank, ‘Technical Features of Outright Monetary Transactions.’
[275] Arvind Krishnamurthy, Stefan Nagel, and Annette Vissing-Jorgensen, ‘ECB Policies Involving Government Bond Purchases’.
[276] Ibid., 33.
[277] Peter Gauweiler and Others (European Court of Justice 2015).
[278] Deutsche Bundesbank, ‘Deutsche Bundesbank - Topics - Monetary Policy Must Not Be Taken Hostage by the Markets’, February 2014.
[279] The monetary financing of governments would give negative incentive (reduce the pressure) to conduct the necessary reforms to attain lower yields on its government bonds and overall be more competitive – undermining to pursue sound budgetary policy. Source: Court of Justice of the European Union, ‘Judgment in Case C-62/14 Gauweiler and Others: The OMT Programme Announced by the ECB in September 2012 Is Compatible with EU Law’ (Luxembourg: ECJ, 16 June 2015), 3, http://curia.europa.eu/jcms/jcms/P_160008/.

investors."[280] Exactly this had been taking place under the SMP, and already then posed a question of financial and functional independence of the EB. If the MSs would default, the ECB as the holder of the government bonds would sustain serious loses which would then translate on the individual MSs which are the ECB's shareholders.[281] "This would lead to a loss of credibility concerning its ability to independently pursue stable monetary policy"[282] since the loss (value of SMP was some €214.2 billion) would be greater than the ECB's disposable capital (around €100 billion[283] including the reserves) and MS would have to cover the losses (in proportion to the size of economy and population) and thus exert influence on the ECB's conduct[284].

4.5.4 Treaty violation? – No, although...

So far, both, the opinion of advocates-general of the CJEU Pedro Cruz Villalon (14 January 2015) and the preliminary judgment (not final) of the CJEU (16 June 2015) have backed the ECB. The ruling of the court was that:

> "This programme [OMT] for the purchase of government bonds on secondary markets does not exceed the powers of the ECB in relation to monetary policy and does not contravene the prohibition of monetary financing of Member States." [285]

The reason can be summarised by the fact the since "the primary objective of the European System of Central Banks (hereinafter referred to as 'the ESCB') shall be to maintain price stability"[286] the ECB used the OMT as a monetary means to achieve this objective[287].

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[280] Nils Zimmermann, 'Is the ECB Allowed to Prevent Eurozone Bond Market Panics?', June 2015.
[281] Leon Helm, 'The ECB's Securities Markets Programme: An Analysis of Economics, Law and Central Bank Independence' (2012), 62.
[282] Ibid.
[283] European Central Bank, 'Consolidated Financial Statement of the Eurosystem as at 6 April 2012', April 2012.
[284] On the opposite side, the benefits of bonds are not equally distributed:
"Most of the purchases are being conducted by national central banks, which will buy their own governments' bonds and collect interest payments and other profits." ..."One unresolved issue is how to deal with any losses suffered in countries like Germany, where many government bonds with maturities of seven years or less carry negative interest rates and thus will return less money than they cost. Opposition to the bond-buying program remains fierce in Germany." Source: Jack Ewing, 'Quiet Start to Central Bank Bond-Buying Program for the Eurozone', *The New York Times*, 9 March 2015, http://www.nytimes.com/2015/03/10/business/international/ecb-bond-buying-program-quantitative-easing.html.
[285] Court of Justice of the European Union, 'Judgment in Case C-62/14 Gauweiler and Others: The OMT Programme Announced by the ECB in September 2012 Is Compatible with EU Law', 1.
[286] Article 127 Council of the European Union and European Commission, *Treaty on the Functioning of the European Union (Consolidated Version)*, para. 1.

However, the court reaffirmed that "such purchases may not be used to circumvent the objective of prohibiting the monetary financing of the Member States [Article 123]"[288] but it also, in effect, ruled out that the ECB can do so, if well justified.

4.5.5 The EAPP – 3rd generation controversial programme

It is compelling to say that after the positive opinion from advocate general[289], and when the fears of deflation (-0.6% on January 2015 in eurozone[290]) have been fulfilled, despite the actions undertaken in June 2014, the ECB continued to test its limits by announcing on 22 January 2015 an emergency expanded asset purchase programme (EAPP)[291]. The EAPP was launched on 9 March 2015 the EAPP and began to purchase public and private sector securities up to the amount of €60 billion every month until September 2016 with the "aim of achieving inflation rates below, but close to, 2% over the medium term".[292] This quantitative easing (QE) "money artillery", with expected injection of €1 trillion, is practically a third generation scheme, after SMP and OMT,[293] that has already started to acquire government bonds and so far has been successful to drive the inflation up, the government yields down (see appendix 5) as well as the value of euro[294]. The media have already crowned Mario Draghi to the title of "Super Mario"[295] for his bold and impudent actions and crafty conduct of "monetary orchestra". Note that the ECB's leverage has taken place even before Draghi's incumbent, when Jean-Claude Trichet in August 2011 sent confidential letters to Spanish Prime Minister José Luis Rodríguez Zapatero[296] and Italian

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[287] Court of Justice of the European Union, 'Judgment in Case C-62/14 Gauweiler and Others: The OMT Programme Announced by the ECB in September 2012 Is Compatible with EU Law', 2.

[288] Court of Justice of the European Union, 'Judgment in Case C-62/14 Gauweiler and Others: The OMT Programme Announced by the ECB in September 2012 Is Compatible with EU Law.'

[289] David Jolly and James Kanter, 'Europe's Highest Appeals Court Backs Bond-Buying Program', June 2015.

[290] European Central Bank, 'Measuring Inflation in the Euro Area: The Harmonised Index of Consumer Prices (HICP) - Annual Percentage Change', June 2015.

[291] Expanded asset purchase programme consist of (1)covered bond purchase programme (CBPP3); (2) the asset-backed securities purchase programme (ABSPP); and (3) the public sector purchase programme (PSPP) Source: European Central Bank, 'Expanded Asset Purchase Programme.'

[292] Ibid.

[293] This will be carried out under the public sector purchase programme (PSPP) which will allow to buy government bonds of the eurozone MS, securities from EU institution and national agencies.

[294] European Central Bank, 'ECB Reference Exchange Rate, US dollar/Euro', August 2015.

[295] Martin Sandbu, 'Three Deft Tricks That Earned Draghi His "Super Mario" Nickname',January 2015.

[296] Jean-Claude Trichet, 'Letter to Spanish Prime Minister José Luis Rodríguez Zapatero', Strictly confidential (Reclasified for release on 19 December 2014), (August 2011),.

Prime Minister Silvio Berlusconi[297] who was shortly after replaced by technocrat Mario Monti. By the tone and urgency for reforms that should be implemented by decree-laws (enter in force before national parliaments would approve) "revealed the extent to which the ECB was acting as a shadow government".[298]

4.5.6 The ECB's reinforced status

Altogether, there are several important implication of this state of affairs. Firstly, it shows that when a straight thread of treaty violation cannot be established, but nevertheless has the possibility to be developed, the CJEU is likely to side with its supranational counterpart - the ECB, especially when the stability of the EMU is at stakes. Secondly, it is well arguable that in the effort to bring the EU economies from the doldrums, the ECB used some of its conferred powers to employ tools (the SMP, the OMT and the EAPP) that overhanged the invisible line and as a result contributed to additional risk-sharing and further indirect fusion of the member states economies. Herein, in addition to the EFSF/ESM risk-sharing mechanism of the eurozone, the ECB under the SMP/OMT/EAPP bond purchasing programs assumed additional risk of potential MS default, but this time on behalf of the whole Union. Thirdly, despite the settlement of the case at the EU level, the Federal Constitutional Court of Germany (BVerfG), which viewed the OMT in the initial proceeding as illegal[299], will need to make a final judgment on the OMT compatibility with the German law; though now it will need to take the above two decisions (DG opinion, ECJ preliminary judgment) into account.[300] The expansion of the ECB's code of conduct not only within monetary domain but also into the field of economics or politics shows the strength of endogenous spillover. The ECB's achievement to restore confidence of international financial markets,

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[297] Jean-Claude Trichet, 'Letter of the European Central Bank to Silvio Berlusconi,'August 2011.
[298] Dullien, *What Is Political Union?*, 2.
[299] The objections of the court were that one of OMT's requirements is conditionality that the government bonds would need to come form eurzone countries that are in the adjustment program (EFSF/ESM) which would make OMT not just a monetary tool but also an economic tool since the ECB would engage with economic policy conditions of the EFSF/ESM (i.e. restructuring reforms) which are under the competence of the Commission and the Council to monitor and not the ECB.
See section "1. Transgression of the European Central Bank's Mandate" especially paragraphs 75-78.
Source: Senat Bundesverfassungsgericht, 'Bundesverfassungsgericht - Decisions - Principal Proceedings ESM/ECB: Referral for a Preliminary Ruling to the Court of Justice of the European Union', (14 January 2014).
[300] Valentina Pop and Brian Blackstone, 'EU Court Declares ECB's 2012 Bond-Buying Plan Legal', June 2015, Economy.

which can be derived from falling government bond yields (see appendix 5), also contributed to the political spillover since now investors know that the EU institutions provide "additional" protection to their MSs bond investment. ECB will not allow MS to default easily. Though, the scarecrow is still present since in the event of the BVerfG's final judgment to recognise the ECB's transgression according to German basic law, the accomplishment of the domestic constraint would create uncertainty how the issue between the ECB and the Bundesbank (the central bank of the Germany) would be resolve since Bundesbank would have to follow the BVerfG decision and hence disobey the ECB's command to indirectly purchase government bonds.

4.6 Financial reform and the Banking Union

With the information so far presented you can probably see that at the centre of the crisis has been the bank-sovereign relationship. Even before the eurozone was launched, banks gradually engaged in operations that kept stretching their capabilities while sovereign states continued to run unsound budgets. This combination proved detrimental when the financial crisis hit. Financial sector was instantly paralysed (i.e. significantly reduced credit lending) and sovereigns by taking over considerable burden from the banks have in turn been debilitated to the level that questioned their liability[301]. In the beginning of Chapter 4 we have seen considerable amount of measures taken by the MSs to strengthen their commitment for sustainable budgets, such creating a permanent solidarity firewall – the ESM, which were consolidated under the surveillance of the Commission and the guarantee by the CJEU. Yet, as we are about to find out the leap accomplished in the economic and fiscal unification might have already been surpassed by the profound and far-reaching reforms in the financial sector.

4.6.1 The ESFS

In the first instance, right after the publication of Larosière report, the Commission highlighted the "gaps in preventing, managing and resolving crises and the difficulties caused by a lack of cooperation, coordination, consistency and trust between national supervisors", arguing that the existing advisory groups – the Committee of European Supervisors (also

[301] Liability means duty to repay debt owed.

known as Lamfalussy level 3 Committees) are "not sufficient to ensure financial stability in the EU and its Member States".[302] Following this communication to the European Council, the Commission on May 2009[303] put forward an ambitious proposal for a new and stronger European financial supervisory framework - European System of Financial Supervision (ESFS). This has fully materialised by January 2011 in the form of two pillar structure.

In the first pillar, the task to perform a "macro prudential supervision" of the entire EU financial system was given to the European Systemic Risk Board (ESRB)[304], a completely new independent institution established under the auspices of the ECB.[305] In the second pillar, the task to perform "micro prudential supervision" of individual financial institutions within the EU has been handed over from the three Committees of European Supervisors to the three newly created European Supervisory Authorities (ESAs)[306]: the European Banking Authority (EBA)[307]; the European Securities and Markets Authority (ESMA)[308]; and the European Insurance and Occupational Pensions Authority (EIOPA)[309], each independent with its own legal personality and a mandate to "act only in the interests of the Union as a whole".[310] These two branches along with the competent national supervisory authorities constitute "a decentralised, multi-layered system of micro- and macro-prudential" network (i.e. ESFS), representing a deepening integration of financial markets -endogenous spillover.[311]

4.6.2 Building block of the Banking Union

In the second instance, when Spain could no longer sustain the worsening banking

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[302] European Commission, 'Communication for the Spring European Council - Driving European Recovery' (March 2009).
[303] European Commission, 'Communication from the Commission - European Financial Supervision' (May 2015).
[304] ESRB task is to identify development of systemic risks in the Union (chaired by the ECB president)
[305] Rudolf Maier, 'European System of Financial Supervision (ESFS)', April 2014.
[306] The Committee of European Supervisors was replaced by the European Supervisory Authorities as follows:
the Committee of European Banking Supervisors (CUBS) was replaced by the European Banking Authority (EBA),
the Committee of European Securities Regulators (CESR) was replaced the European Securities and Markets Authority (ESMA)
the Committee of European Insurance and Occupational Pensions Supervisors (CEIOP) was replaced by The European Insurance and Occupational Pensions Authority (EIOPA)
[307] EBA focuses on supervision of bank, credit institutions,investment firms or payment institutions
[308] ESMA focuses on supervision of capital market and credit rating agencies
[309] EIOPA focuses on supervision of insurance undertakings.
[310] Maier, 'European System of Financial Supervision (ESFS).'
[311] Ibid.

situation and was forced to seek assistance from the EFSF/ESM to recapitalise[312] its banking sector (e.g. inject additional €19 billion into Bankia[313]), the Commission began to push for the creation of the Banking Union – the most ambitious project since the lunch of the Euro. It took several proposals and reports, including "A Roadmap towards a Banking Union"[314] (September 2012), "Liikanen Report"[315] (October 2012); "A Blueprint for a deep and genuine EMU – Launching a European Debate" (November 2012), "Towards a Genuine Economic and Monetary Union" (Decemebr 2012) and powerful speech by Manuel Barroso (President of the Commission) to European Parliament on 12 September 2012, to convince MSs representatives that the EU, and in particular the eurozone, need to move in the direction of centralisation as certain powers (e.g. uniform banking governance across the EU) could no longer be adequately exercised at the national level and need to be delegated to the supranational level. [316] This subsidiarity argument in combination with the desire to "break the link between banks and sovereigns"[317] commenced building of a Banking Union for eurozone on April 2013 when the Council and European Parliament reached a political agreement to delegate national regulative and supervisory powers of all their banks to the ECB. (As for the non-eurozone MSs they can join the Banking Union, but so far none opted to do so)

The first element of the Banking Union became the Single Supervisory Mechanism (SSM). A preventive mechanism that from 4 November 2014 makes the ECB responsible[318] for all the banks in 19 MSs using the Euro, ensuring that each fulfils the requirements of the Single Rulebook.[319] In practice**,** out of the 6 000 banks, the ECB directly supervises only the

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[312] Spain
Recapitalisation entail providing injection of capital into the financial institution to improve its balance sheet
[313] Miguel Jiménez, 'Bankia to Ask for a Further 19 Billion Euros in Bailout Funds', May 2012.
[314] European Commission, 'Communication from the Commission to the European Parliament and the Council: A Roadmap towards a Banking' (September 2012).
[315] Formally: Report of the European Commission's High-level Expert Group on Bank Structural Reform, chaired by Erkki Liikanen
[316] José Manuel Barroso, 'State of the Union 2012 Address' (September 2012),.
[317] Herman Van Rompuy, 'Towards a Genuine Economic and Monetary Union' (December 2012), 5.
[318] The ECB has authority only over banks not other financial institutions such as insurance companies
[319]Single Rule Book is a set of legislative directives and regulations, among the most important Bank Recovery and Resolution Directive (2014), Capital Requirements Directive (2013), Capital Requirements Regulation (2013), which all financial institutions in the EU must fulfil. European Banking Authority EBA is the main developer of the Single Rule Book.
Source: European Banking Authority, 'Interactive Single Rulebook', 2015.

123 largest banks[320], which nevertheless represent 85% of total banking assets, while the remaining banks are monitored by national supervisors. [321] The second element of the Banking Union is the Single Resolution Mechanism (SRM). A corrective mechanism governed by a newly established the Single Resolution Board (SRB) which is planned to enter into force on 1 January 2016 when the Single Resolution Fund (SRF) will become operational. The task of the SRM will be to deal with the bank failure, according the Single Rulebook, and through the SRF, that within 8 years is supposed to collect ("bail-in") €55 billion from all the banks in the banking union, provide orderly resolution.[322] This measure ensures that private sector will undertake responsibility to provide their finances through the common fund (the SRF) to cover bank insolvency and governments would not need to commit taxpayers' money to bail-out banks. (Note, that in the interim period before the SRF would be fully operational and in case more resources would be required to restructure failing banks the ESM can from December 2014 under strict condition provide additional €60 billion[323])

The third element of the Banking Union proposed by the Commission has been a European Deposit Insurance Scheme (EDIS)[324]. The idea to make the level of deposit protection, which has been from 2009 set at minim €100 000 per customer across the whole EU (to prevent run on savings), shift from the national to the supranational level[325]. However this suggestion has not been perceived as necessary by the European Parliament and the Council and further discussion is expected to take place only from 2019.[326]

4.6.3 The European Commission entrepreneurship

Such brakes the Commission experiences on the regular basis as not all of its proposals are welcomed by (all) MSs. Take for instance the widely debated idea of Stability

[320] These significant banks have assets of more than €30 billion or constituting at least 20% of their home country's GDP
[321] ECB - Banking supervision, *ECB Annual Report on Supervisory Activities - 2014* (Frankfurt: European Central Bank, 2015), 4, https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssmar2014.en.pdf?a88c90797b71eea2e8c133ef20a370d1.
[322] Council of the European Union, 'Single Resolution Mechanism', July 2015.
[323] European Stability Mechanism, 'European Stability Mechanism (ESM).'
[324] Juncker, 'Completing Europe's Economic and Monetary Union (The Five Presidents' Report)', 11.
[325] European Commission, 'Deposit Guarantee Schemes – Frequently Asked Questions' (April 2014).
[326] 'Directive 2014/49/EU - on Deposit Guarantee Schemes' (Brussels: European Commission, 16 April 2014), http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014L0049.

Bonds (i.e. Eurobonds) presented by Commission in Green paper on 23 November 2011 in which it proposed to consider "pooling sovereign issuance among the Member States"[327] and thus fully or partially mutualise the debt of the eurozone MSs. This measure was greeted by highly indebted MSs (Greece, Italy), as they would "benefit from the stronger creditworthiness of the low-yield Member States"[328] and help reduce their borrowing costs. But other MSs (Germany, Austria, Netherlands) opposed such idea for several reasons, including higher interest rates, poorly converged budgets, or moral hazard, and the whole project was postponed.[329] Sovereignty consciousness was strong enough in this case. It was also strong enough to make the Council to reduce the EU's budget (multiannual financial framework) for 2014-2020 from €994 billion to €960[330] (3.4%). Though, Sweden[331], United Kingdom, Netherland, Germany originally proposed three times higher reduction (€100 bn).

Nonetheless, the Commission, the driving engine of the EU integration, continues to find ways how to make the EU to be more efficient and productive. For example, on 25 June 2015[332] it got approved the creation of The European Fund for Strategic Investments (EFSI) which will over the next three year strive to fill the investment gap by mobilise €315 bill[333] for small and medium-sized enterprises (SMEs)[334]. To support this "Investment Offensive" the new Junker Commission is now trying to push forward the case for Capital Market Union (CMU) whose gradual creation would require harmonisation of capital markets rules across the MSs, but in return, would help easy and diversify cross-border investment and thus strengthen the Banking Union and promote overall growth[335].

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[327] European Commission, 'On the Feasibility of Introducing Stability Bonds (Green Paper)' (November 2011), 2.
[328] European Commission, 'European Commission Green Paper on the Feasibility of Introducing Stability Bonds' (November 2011).
[329] Oisín Gilmore, 'Disagreements and Progress on Eurobonds at EU "Informal Dinner"', May 2012.
[330] Council of the European Union, 'Multiannual Financial Framework for 2014-2020', February 2015.
[331] Stefan Lunte, 'Fighting over the European Multiannual Financial Framework for 2014-2020', March 2013.
[332] European Parliament and the Council, 'Regulation (EU) 2015/1017 on on the European Fund for Strategic Investments, the European Investment Advisory Hub and the European Investment Project Portal and Amending Regulations (EU) No 1291/2013 and (EU) No 1316/2013 — the European Fund for Strategic Investments' (Brussels: Official Journal of the European Union, 25 June 2015).
[333] The Commission will provide €16 billion in guarantee and EIB €5 billion to leverage around leverage €294 bn.
[334] Richard Willis and Christof Roche, 'EIB Approves EUR 10 Billion of New EIB Loans and Launches European Fund for Strategic Investments with European Commission', 22 July 2015, http://www.eib.org/infocentre/press/releases/all/2015/2015-175-eib-approves-eur-10-billion-of-new-eib-loans-and-launches-european-fund-for-strategic-investments-with-european-commission.htm.
[335] European Commission, 'Capital Markets Union', *Banking and Finance,* 9 March 2015, http://ec.europa.eu/finance/capital-markets-union/index_en.htm.

5 Chapter 5 - Exogenous spillover

So far we have inspected the aspects of (dis)integration within the union and have not yet explicitly discussed the exogenous forces on the EU during the crisis time – anything outside of the EU that had influenced the (dis)integration process of the EU. Let me therefore kick this chapter off by the following contention of Philippe C. Schmitter and subsequent general remarks about the position of powers between state and non-state actors:

> "[T]his crisis was triggered from outside of the European Union. This is not a crisis of European Integration, but it is a crisis of the world capitalist system that began in the United States, and then had successive impacts on other countries, especially on Europe. Whereas previous crises were more endogenous, they were more part of the integration process itself, and always the solution was to resolve the crises within the family. Crises came as a result of integration and unequal distribution of benefits. In this case the timing and the nature of the crisis came from outside." [336]

While I do agree with the above statement that the crisis has its origins beyond the EU and its nature is the product of globalisation, all the encountered signs support this conviction, I do consider that it is also the inherent failure of the EU integration. The reason being, to use an analogy from the civil engineering is that, MSs as co-proprietors ventured to modernise their residential complex into the EMU with hope to reap of its benefits in the long run, but agreed to pool resources (i.e. sovereignty) only to the point the EMU would be operational and no more; building thus an unsustainable structure that would be durable (i.e. capable to function) only under nice and sunny weather (i.e. no global crisis). Too much trust was put in the preventive mechanism (i.e. the SGP) while very little consideration has been given to establish emergency measures (i.e. the EFSF/ESM) in the edifice.

5.1.1 Complexity of the globalised world

To further elaborate, what is peculiar about this crisis is that it is not possible to point to one single culprit, but rather it is the feature of the system that we have created (and seem to lose control of[337]). The progress and complexity of which has been growing exponentially

[336] Philippe C. Schmitter and Florin Zubascu, Democracy and European Union Politics: a talk with Philippe C. Schmitter, 14 March 2013, http://ceuweekly.blogspot.cz/2013/03/democracy-and-european-union-politics.html.
[337] By losing control I mean that the system as if embraces a "life of its own". An organic-like system which we have

over the course of history (and especially the last turbulent 150 years) and may be well discerned from contemporary thriving metropolitan cities, the Internet or the tax codes; neither of which we are capable to fully grasp. This system of ours, governed by the global neo-liberal logic of free-market capitalism[338], changes the development of various international actors[339] through the process of globalisation and puts them under growing strain as the result of their mutual interaction.

5.1.2 Rise of non-state actors

One of the immediate consequences is that as the role of the state changes, in some respects it is undergoing "declinism"[340]. Take for instance the bailed-out countries. "No one imagined that, as a result, sovereign public debt would be treated the same as commercial private debt"[341] and the fate of a country, would lie in the hands of financial markets, which would determine the conditions (i.e. level of interest rate) under which they would be willing to provide loans. The rise of non-state actors shifts the balance of power away from states and especially the smaller ones.

> "Governments today actively compete with each other by pursuing policies that they believe will earn them market confidence and attract trade and capital inflows: tight money, small government, low taxes, flexible labor legislation, deregulation, privatization, and openness all around." [342]

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created and are the means by which it operates - being the law givers and the subjects of these laws - , and yet are unable to wield its development, for it is overly problematic to comprehend, changes constantly, and requires a mass co-ordinated approach to navigate. A good metaphor would be to think about it as an accelerating "train" into which we are slowly transfered as we begging to mature. We begin to wonder where we are, what is this vehicle and what are these passengers amidst whom we are now drifting, finding ourselves, soon, striving to catch up with the pre-existing world to soothe down our frustration from our perceived backwardness and the available opportunities. Thereby, (paradoxically) contributing to its complexity and propelling its evolution.

[338] The world-system theory of neo-Marxist Immanuel Wallerstein reflect this view; that the world we live in today is characterized by a complex network of economic exchange relationships governed by global market economy "with multiple political centers and multiple cultures".
Source: Immanuel Maurice Wallerstein, *World-Systems Analysis: An Introduction* (2004), 99.

[339] International actors: state and non-state actors (i.e. intergovernmental organizations (IGOs), international non-governmental organizations (INGOs), non-governmental organisations NGO Multinational corporations (MNCs) primarily)

[340] Declinism is "the belief that a particular country, society, or institution is in a state of significant and possibly irreversible decline" Source: Oxford Dictionaries, 'Define: Declinism', n.d..

[341] Zoe Lefkofridi and Philippe C. Schmitter, 'Transcending or Descending? European Integration in Times of Crisis', (February 2015): 7.

[342] Dani Rodrik, 'How Far Will International Economic Integration Go?', (2000): 182.

In the interview about the eurozone, Thomas Piketty, a French economist, on the question "How could Hollande and Merkel inspire voters to support more Europe?" replied:

> "They need to explain to voters, for example, that even Germany and France can no longer manage to efficiently tax multinational companies, because the companies are playing countries off against each other." [343]

If a country would raise costs or low the profits for the multinational companies (MNCs), the MNCs would simply look somewhere else to make their foreign direct investments (FDI). The international rating agencies (such as the mentioned Standard and Poor's, Moody's, Fitch) would through their expertise (ratings of countries) provide the alternative and in essence indirectly determine the well-being of a country.

The G-20 summit summoned on April 2009 in London to address the financial crisis is a prime example of the need to co-operate not only on the national or regional but the international level. One of its conclusions was the expansion of Financial Stability Forum into stronger Financial Stability Board that would in addition include emerging economies (currently 24 states plus EU[344]) to better oversee the global financial developments. Though, more effort and co-operation is required in other fields.

5.1.3 Changing balance of power between states

It however remains that on the international level anarchy rules and balance of power does not change only between states and non-state actors but also among the states themselves. The rise of BRICS (Brazil, Russia, India, China, and South Africa) in terms of their economic and political weight in the international arena invariably makes all the other less significant. Ferdi De Ville and Mattias Vermeiren, found that the increased "EMU-China monetary and trade relations have been a contributing factor in the eurozone debt crisis by forcing the GIPS countries [Greece, Ireland, Portugal and Spain] to run increasing extra-regional trade deficits"[345].

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[343] Thomas Piketty, Thomas Piketty on the Euro Zone: 'We Have Created a Monster', interview by Julia Amalia Heyer and Christoph Pauly, trans. Christopher Sultan, March 2015.

[344] Financial Stability Board, 'FSB Members', 2015.

[345] De Ville and Vermeiren, 'The Eurozone Crisis and the Rise of China in the Global Monetary and Trading System', 1.

According to latest World Bank report the eurozone, after five years of stagnation, is expected to continue its recovery process from 2014 with real GDP growth rise as high as 1.8% in 2017[346], similar to that of Japan. Russia and Brazil, that have been experiencing difficulties this year, are estimated to rebound and grow as high as 2.0-2.5% along with South Africa and U.S. for next two years[347]. Though, the two rising behemoths, China and India, will be far more productive. China is predicted to decelerate modestly to 6.9%[348] and India to continue its cyclical recovery with growth rate rising up from 7% to 8%[349].

Even though it is encouraging to see EU's nominal GDP growth 1.6% this growth is uneven[350] and in comparison with other major economies the EU's performance is the lowest and has been such for longer period now. The "competitiveness crisis" is directly related to prosperity which in turn is linked to security. With 60 years of peace and the achieved level of interdependence it goes without saying that it is very unlikely that European democracies would fight between each other. Whilst, crisis confirmed that if any substantial peril to arise it would be likely generated from the outside of the EU since the times MSs would have to worry about increasing power of their neighbours have been in certain respected reversed – the weakness of the neighbour is undesirable for it means a weaker "ally". This fear of slowly slipping power has well manifested during the crisis among many top officials. See below speech excerpts:

> "In the 20th century, a country of just 10 or 15 million people could be a global power. In the 21st-century, even the biggest European countries run the risk of irrelevance in between the global giants like the US or China. History is accelerating. It took 155 years for Britain to double its GDP per capita, 50 years for the US, and just 15 years for China." [351]

- José Manuel Barroso
President of the European Commission

[346] World Bank Group, *Global Economic Prospects: The Global Economy in Transition.* (2015), 4.
[347] Ibid.
[348] Ibid., 8.
[349] Ibid., 4.
[350] Eurostat, 'Flash Estimate for the Second Quarter of 2015' (August 2015), 1–2, 2015.
[351] Barroso, 'State of the Union 2012 Address.'

"More than other regions, we Europeans are at great danger of falling behind in the international rankings. The financial and economic crisis and the sovereign-debt crisis mainly affected the Western industrialised nations. ... In this global competition, Europe will only be able to survive if it acts as a whole ... No nation state can solve the major problems and challenges of our time by itself. The sovereignty principle which has been developed since the Peace of Westphalia does not guarantee enough stability." [352]

- Wolfgang Schäuble
Minister of Finance, Germany

"In the 21st century identity and security cannot be defended via national structures. You need powers that go further than national level and this power must be Europe." [353]

Martin Schulz
President of the European Parliament

5.1.4 Prospective external forces

Let us also not forget that this global competition is not the only exogenous force acting upon the EU. In the past, some major global events such as the 1973[354] and 1979[355] oil crisis brought the European Communities into a period of eurosclerosis – period of economic and integration stagnation. Others such the fall of Berlin Wall in 1989 gave a new momentum for European Communities to go beyond the economic union and pursue monetary and political unity (e.g. Common Foreign and Security Policy). Even the distant 9/11 terrorist attack in the US in 2001 resonated just enough to form an ideational impulse for MSs leaders to reconsider EU's security, particularly in field of asylum and immigration[356]. The recent 2011 Arab spring revolutions across Northern Africa and Middle East (MENA region), the formation of Islamic State of Iraq and the Levant (ISIS) in 2013, Russia's annexation of Crimea in 2014 and subsequent War in Eastern Ukraine all have influence the EU's policies.

The growing irregular immigration[357] to the EU over the past five years, which has dramatically increased over the past months, has grown to be a real EU problem. Yet, MSs

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[352] Wolfgang Schäuble, 'The State of Europe – What Governance Is Needed in the European Union?' (Berlin, 27 May 2014).
[353] Council of the EU, *The EU Institutions Explained by Their Presidents (video)*, 2013, l. 8:01–8:15. (video)
[354] In 1973, following Arab-Israeli conflic, OPEC countries declared oil embargo on some MS and the US driving the prices 2-4x up.
[355] In 1979, the outbreak of the Iranian Revolution increased oil prices around the world markedly.
[356] Shahin Ali, 'Securitization of EU Immigration Policy since 9/11' (November 2014).
[357] Frontex, 'Annual Risk Analysis 2014', Frontex (May 2014), 7.

leaders have not been able to agree on the proper Migration police[358], resorting only to increase the budget[359] and powers[360] of Frontex[361]. In the latest attempt to distribute 40 000 migrants occupying Italy and Greece via a quota system the EU leaders agreed to share the refugee burden only the voluntarily set conditions.[362] It is very unlikely that such sensitive issue as migration will be agreed at the EU level anywhere soon and MSs will continue working within existing intergovernmental framework.

Somewhat more unity MSs demonstrated on 17 March 2014[363] when they agreed to impose mild sanctions against Russia (until 23 June 2016) for 1994 Budapest Memorandum violation that was warranting Ukraine's sovereignty and integrity. The effort to resolve the conflict between the parties, however, did not come from the Brussels (High Representative of the Union for Foreign Affairs and Security Policy), but rather from individual MSs with Germany[364] in the upfront[365]. The EU does not have foreign or security strategy, these policy areas remains fully at the national level of the 28 MSs. The EU rarely speaks with one voice and even less acts as an international actor, the EU institutions have power only within the EU outside their representative's act only as observes. Notwithstanding, some limited progress should be highlighted, particularly in the field of energy. In March this year MSs have committed themselves to start building an Energy Union, with objective to develop affordable, secure and sustainable energy[366] by reducing dependence on natural resources,

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[358] European Commission, 'Why a New European Agenda on Migration?', *Migration and Home Affairs*, 18 May 2015, http://ec.europa.eu/dgs/home-affairs/what-we-do/policies/european-agenda-migration/index_en.htm.

[359] Currently Frontex operates at more than €100 mil, making it the most funded EU agency Source: Frontex, 'Frontext Budget for 2015', 2015.

[360] Budget for Triton search and rescue operations in November 2014 was tripled to €120mil. In 2013 European Parliament approved a €340-million program of the European Border Surveillance System (Eurosur) for the period of 2013-2020 that would facilitate a comprehensive information exchange system between member states, through the use of the newest satellites and unmanned aerial vehicles (i.e. drones) to monitor the EU-borders more efficiently.Source: European Parliament and the Council, 'Regulation (EU) No 1052/2013 - Establishing the European Border Surveillance System (Eurosur)', L 295/11 (October 2013).

[361] Frontex (European Agency for the Management of Operational Cooperation at the External Borders of the Member States of the European Union) is a EU's external border management agency which tasked to assist MSs to ensure uniform level of security of their frontiers.

[362] Ian Traynor and Nicholas Watt, 'Mediterranean Migrants: EU Leaders Agree Voluntary Intake after Heated Talks', June 2015,.

[363] Maja Kocijanicic and Eamonn Prendergast, 'EU Sanctions against Russia over Ukraine Crisis', June 2015.

[364] Ulrich Speck, 'German Power and the Ukraine Conflict', *Carnegie Europe*, 26 March 2015, http://carnegieeurope.eu/2015/03/26/german-power-and-ukraine-conflict.

[365] Elizabeth Pond and Hans Kundnani, 'Germany's Real Role in the Ukraine Crisis', *Foreign Affairs*, 2015, https://www.foreignaffairs.com/articles/eastern-europe-caucasus/germany-s-real-role-ukraine-crisis.

[366] Council of the European Union, 'European Council Meeting 19-20/03/2015', June 2015, 19.

such as oil or gas imports (coming from Russia), diversifying energy mix by incorporating green methods of energy generation, and perhaps in the future negotiating contract for the whole EU to obtain better deals. The more stable the EU will be internally the stronger the exogenous forces will be acting on the EU. To deal with these MSs will seriously need to consider developing closer Political Union and strive slowly to become leading global actor.

Conclusion

To set the scene for the main findings of this thesis, allow me first to recapitulate the context of the whole eurozone crisis by engaging in a mental visualisation of the very complex setting that came into being after the formation of the Economic and Monetary Union (EMU) by referring to the field of biology, as it allows to ingeniously depict how the EU's immune system became flaccid and susceptible to infection (i.e. crisis) and how MSs decided to cure the uncovered wounds. For the sake of simplicity, image Member States (MSs) as bodily organs which are mutually interdependent to nourish each other's economies via the infinite number of interconnected blood vessels. Think of the exchanged nutrients as capital (i.e. money) and the largest blood vessels as banks. After the formation of the EMU (1993) blood vessels got dilated (economic interaction increased) and the pulsation of nutrient intensified making the EU economies grow. Much of this flow of nutrients was poorly secured as the white blood cells (i.e. government rules and regulations) were unevenly distributed and largely obsolete, allowing overtime the accumulation of various pathogens (excessive risk) in the system.

When the financial crisis erupted in September 2008 suddenly the tenuous blood vessels rapidly contracted (banks stopped lending loans) and stream of nutrients to MSs declined (business activities sunk) causing malnutrition (economic crisis). To restore the operation of these essential to life connections, MSs decided to supply substantial amount of their energy reserves to unblock the seriously impaired blood vessels. Meaning they used public money to bailout failing banks, in order to restore the confidence of the financial markets and resume credit lending to businesses and thereby generate economic growth. However, due to the high sustained damage (large deficit) and the poor energy reserves (e.g. high debt) some MSs (Greece, Ireland, Portugal, Spain, Cyprus) got such inflammation that was leading to their collapse (default), making the fever pounce the whole EU system. MSs would not dare to abandon the level of integration they have achieved due to the high associated risk of further degradation of the crisis, that could potentially bring down the whole EU, and instead plucked up the courage and devised a extensive series of treatment (i.e. reforms) to remedy the present and prevent future infections (i.e. financial, debt, economic crises). The only way out from the crisis thus was to forward – more integration and transfer of power to the (new) EU institutions.

To help the MSs in economic distress, the high representatives of MSs (especially those of the eurozone), decided, in the course of their intensified collaboration through the EU existing mechanisms (e.g. the Council summits), to create three bail-out funds: European Financial Stability Facility (EFSF), European Financial Stabilisation Mechanism (EFSM), European Stability Mechanism (ESM) which in co-operation with IMF provided large sums of capital in the form of pooled loans and/or guarantees and acted as supranational plasters that would tape the wounds of neighbours from further bleeding. This solidarity move permanently enshrined in the ESM intergovernmental treaty, that is expected to be incorporated into the EU law framework by 2025, represented a shared responsibility (among the eurozone MSs) of high significance and gave incentive to the MSs to revamp the Stability and Growth Pact (SGP) - the essential component of the EMU and install tighter fiscal discipline (with some limited flexibility) that would be secured with appropriate credible warranties – supranational instutions. Accordingly, with the ratification of the Six-pack, the TSCG, the Two-pack, the MSs agreed on new measures that would help them to secure long term stability and growth. These include: national debt brakes of the structural deficit not to exceed 0.5% or a new form of macro-economic policy co-ordination during the European Semester that enables the European Commission to closely surveille MSs budgets and if deemed necessary initiate Macroeconomic Imbalace Procedure or Excessive Deficit Procedure that could result in semi-automatic sanctions up to 0.5% of GDP.

The greatest externality of the above decisions was that the public increasingly got frustrated not only on the EU/MS leaders, who used their public money to bail out private banks and as a result had to undergo structural reforms or harsh austerity measure in case of the bail-out countries, but also at their neighbours to/from whom they either had to provide or accept large sums of money. While during the important decisions the public was not consulted appropriately and had to accept the ready-made decisions negotiated by the Troika which fuelled their scepticism to the EU and thus can be rightfully seen as form of disintegration of a European "demos". Mass protests and even challenges at the Court of Justice of European Union (CJEU), however did not prevent the creation of new supranational instutions (and neither caused the fall of the existing ones). The democratic deficit in combination with deteriorating public consensus represent leading hindrance towards further integration of the EU which the pro-integration minded elites (the Commission) will have to deal with.

"Never again" to experience the dangerous and costly mishap of the financial crisis, MSs also agreed to permanently break the link between banks and their governments by creating the Banking Union. To unite the fragmented financial markets and ensure their resilience MSs ventured to give way their sovereignty over the (largest) banks to the European Central Bank (ECB) and the associated newly created intuitions (e.g. European Systemic Risk Board), when they came to realise that the upgrade from the system of the Committee of European Supervisors to the European Supervisory Authorities was not enough to ensure their optimal performance and more robust supervision was required. Today the Banking Union consists of two robust pillars of the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM) with the Single Resolution Fund (SRF) ready to be launched in 2016. The ECB's proved itself well during the crisis by making use of its monetary policy tool kit, though at times controversial, making its status firmly solidified. The institutional build-up is still in the process, though now with less momentum; the European Commission, as prudent and ambitious entrepreneur of the EU integration, keeps trying push for improvements of the union by proposing new ways how to make the union more efficient, and its skills have recently enabled to addopt the creation of European Fund for Strategic Investments which could be in the near future complemented by Capital Markets Union as well as Energy union help EU resume its bygone economic growth.

What the lenses of the revised neo-functionalist theory enabled us to see in this tough period for the EU is that, the initial impulse for the vast EU institutional build-up came from the outside of the EU – exogenous spillover, in the form of globalisation (international capital flows, the pressure of global financial markets, changing balance of powers not in favour of MSa) transmitted from the distress in the US financial sector. But, the expectation of the elites in charge of the crisis management that such threatening situation should return in the future induced them to turn their attention to the existing EMU project, which was revealed to them by the crisis to contain serious internal faults and underdeveloped structure which in their eyes necessitated profound-collective-internal economic, fiscal, and financial reforms both in depth, e.g. reform the SGP (deepening), and breadth, e.g. introduction of the Banking Union (widening) – endogenous spillover. In other words, the floating pathogens of globalisation were able to penetrate the EU's immune system via its poorly constructed EMU architecture and paralysed some of its organs (MSs) to which MSs collectively reacted by strengthening their defence barriers – strengthening existing institutions through reforms or creating new supporting institutions which have been viewed to provide better solution than national alternatives (that have failed during the crisis). Herein, both the exogenous spillover and the endogenous spillover were pivotal but each played a different role in moving the EU integration process forward along with the cultivated, political, social spillovers which together were much stronger than the countervailing forces.

Altogether we can say that the EU integration during the eurozone crisis was an elite driven process proppeled by pro-integration spillovers that contributed to the multispeed Europe (higher integration among the eurozone MSs). It also showed that once certain supranational institutions have been created they are not going back and if they do not operate at the necessary standa they are very likely to be upgraded (e.g. Euro-Plus-Pact). It is expected that under the accelerating and rapidly changing international environment, which tends to produce adverse phenomena (irregular migration to the EU, military conflict in the proximity of the EU),MSs will react by establishing new instruments, procedures and institutions that will bring MSs closer together under the common EU roof to tackle the future challenges together.

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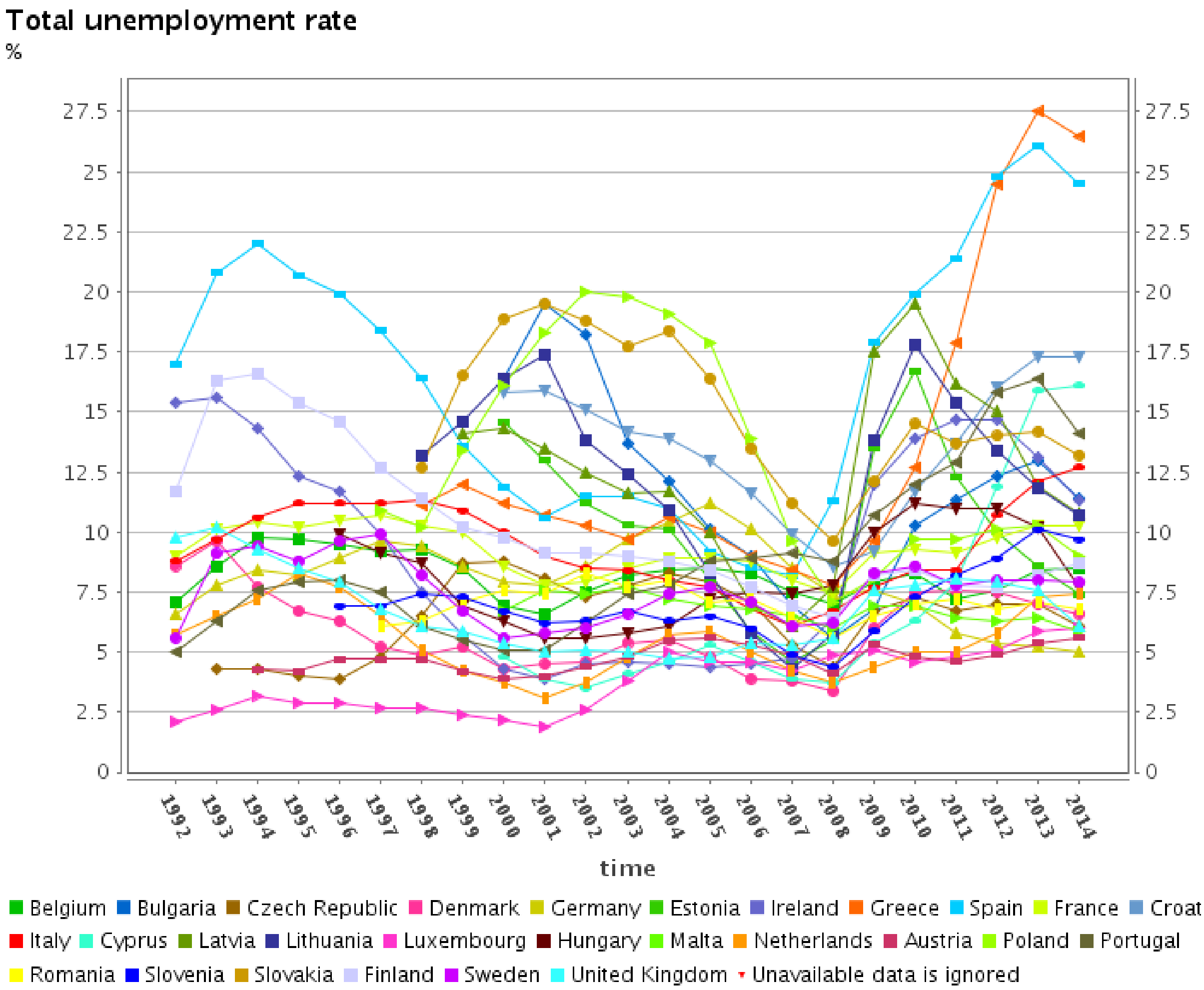
6 Appendices

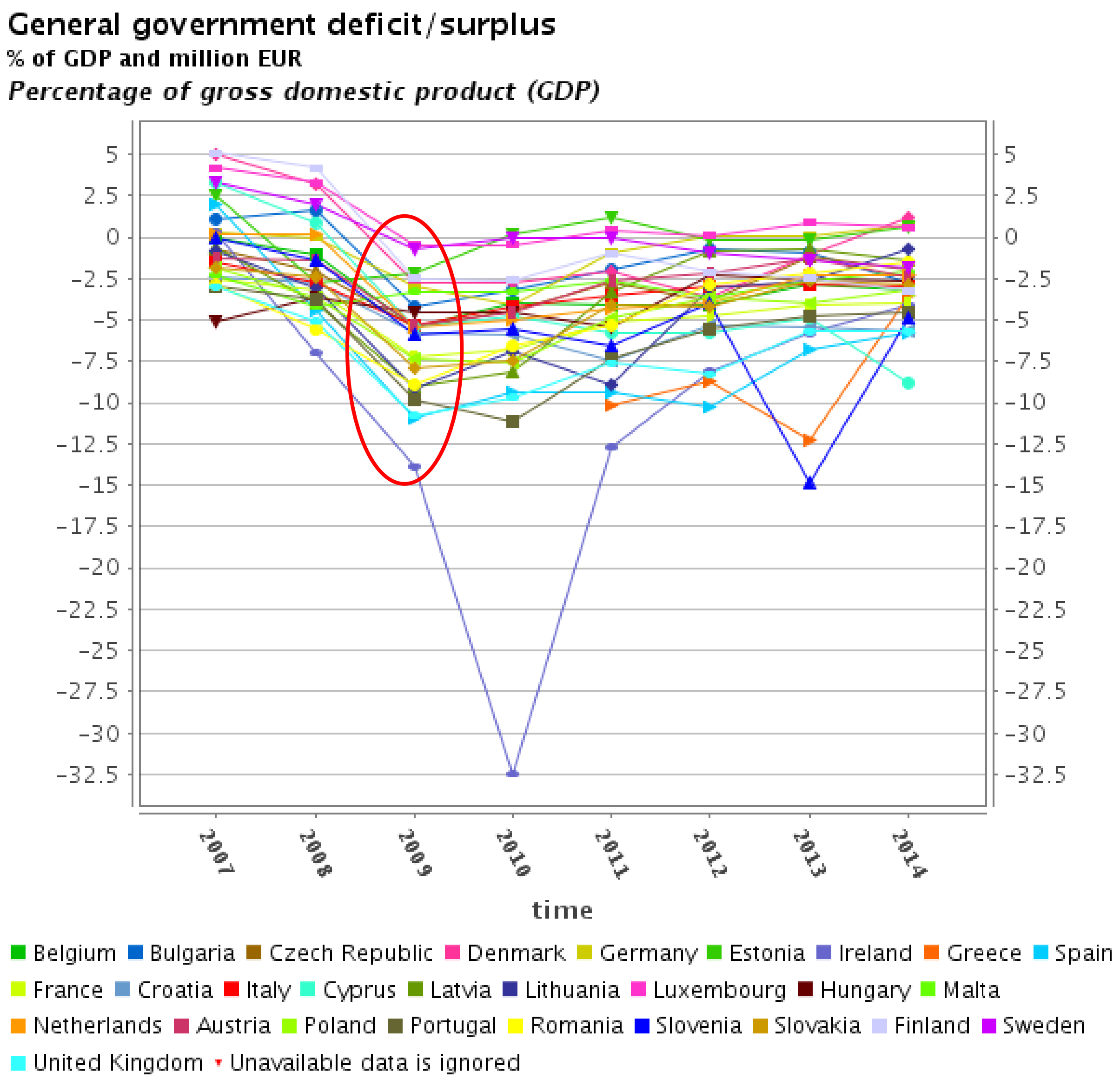
6.1.1 Appendix 1 – EU 28 Total unemployment rate



Note how since the launch of the Economic and Monetary Union the unemployment rates, especialy among the periphery countries (Spain, Portugal, Greece, or Ireland), have been steadily converging to the level of the core countries (Germany, Austria, Denmark, Luxembourg), suggesting also of their increasing economic growth. But in 2008, when the crisis erupted, the process completely reveresed and the uneymployment rate of the periphery countries began rapidly to diverge, suggesting of their poorer economic performace.

Source: Eurostat. 'Total Unemployment Rate.' *Graph*, 2 March 2015. (Date accessed: 27.8.2015) http://ec.europa.eu/eurostat/tgm/graph.do?tab=graph&plugin=1&language=en&pcode=tsdec450&toolbox=type.

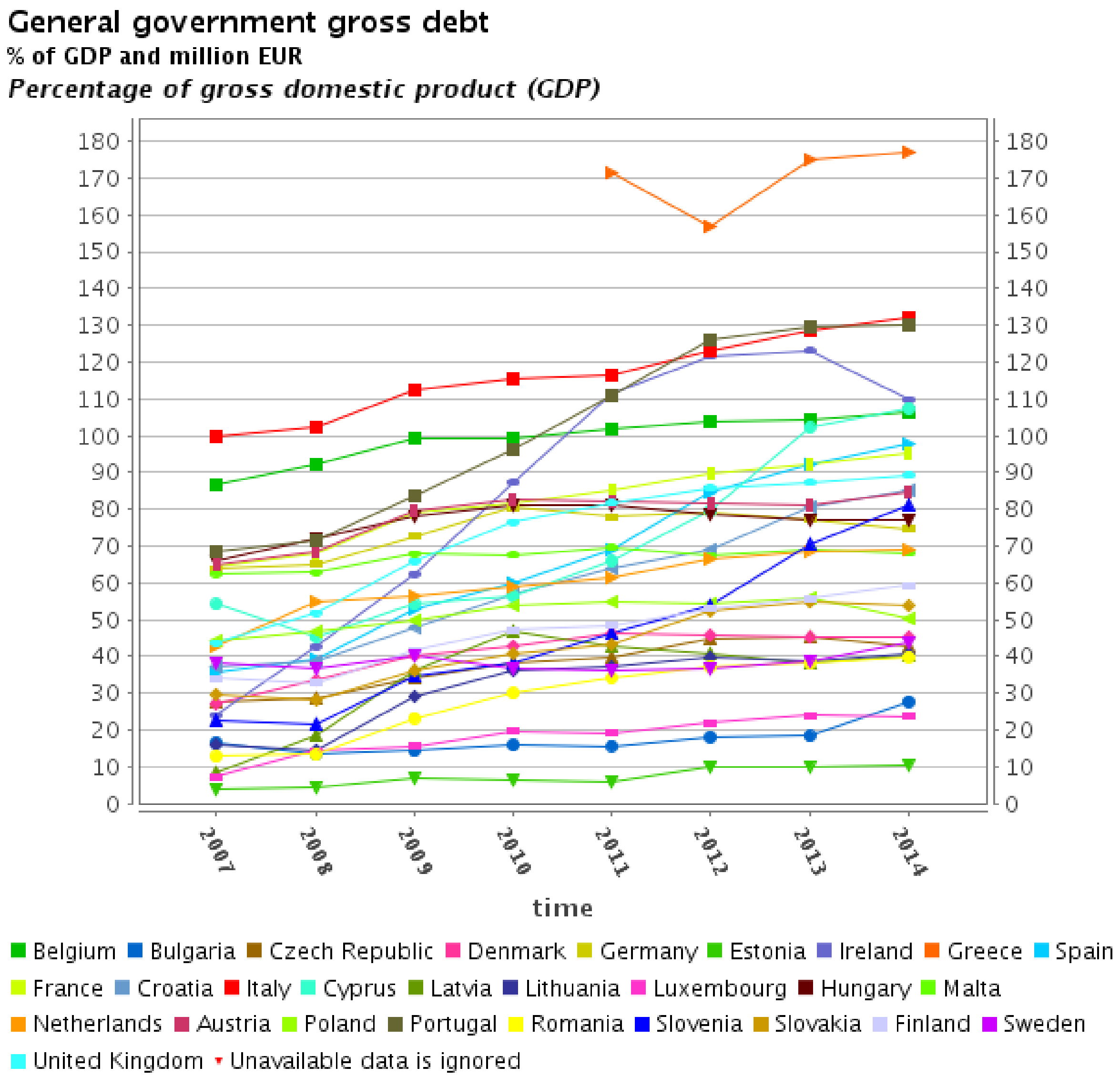
6.1.2 Appendix 2 – General government deficit/surplus



Note how in 2009 every single state was running deficit. The -32.5% deficit for Ireland in 2010 was due to the bail-out of banks such as (Anglo Irish Bank) that made the government deficit enourmously high. Slovenia became is similar with position -15% deficit in 2013 bailing its banking sector later than other member states.

<u>Source:</u> Eurostat. 'General Government Deficit/surplus % of GDP and Million EUR.' *Graph*, 2 March 2015. (Date accessed: 27.8.2015) http://ec.europa.eu/eurostat/tgm/graph.do?tab=graph&plugin=1&pcode=tec00127&language=en&toolbox=data.

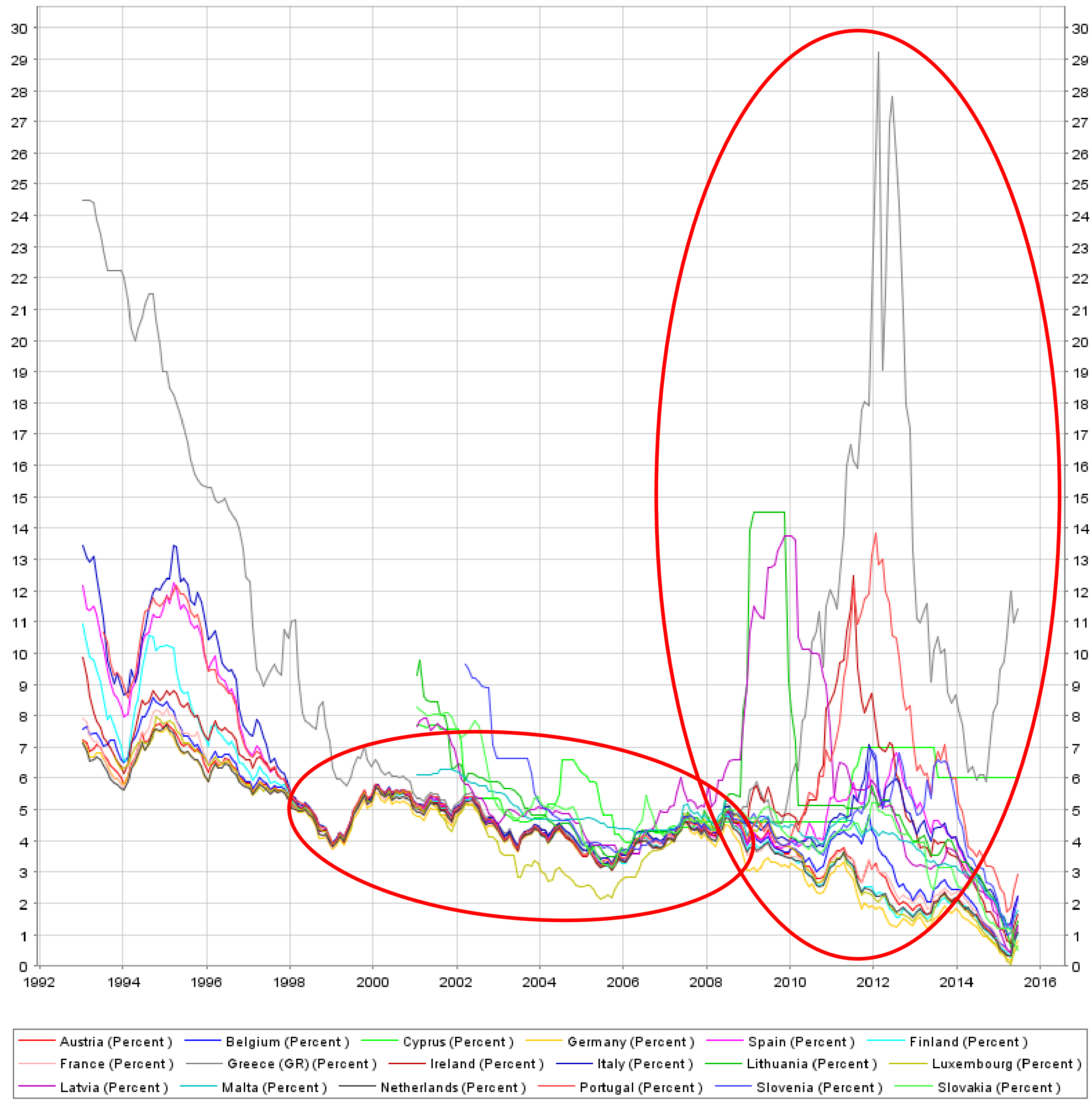
6.1.3 Appendix 3 – General government gross debt



As you may read from the graph, since 2007 the public debt kept steeply riseing for most EU countries. The debt of Spain, UK, and Slovenia for example doubled between 2007-2012, while that of Irealnd has quintupled (increased five fold from -24% to -122%). Note that debt higher than 100% is considered as unsustainable and prone to default. The average public debt in 2014 for the EU was -82% while for the eurozone -92% which just shows how indebted European states have become and how crucial it is for them to maintain economic growth.

Source: Eurostat. 'General Government Gross Debt as % of GDP.' *Graph*, 2 March 2015. (Date accessed: 27.8.2015) http://ec.europa.eu/eurostat/tgm/graph.do?tab=graph&plugin=1&pcode=tsdde410&language=en&toolbox=data.

6.1.4 Appendix 4 – Eurozone long-term interest rate on 10 years government bonds for period 1992-2015



The two highlighted circles represent the period after the euro currency was introduction and the eruption of the crisis in 2008. You can see that until the crisis the interest rates have been falling converged but after the crisis the yields for some countries, namely Greece, Cyprus, Portugal, Ireland and Spain went beyond 7% may be considered as the threshold for governments to issue their bonds in relation to their economic growth. Note that since 2015 only Greece and Cyprus have not regained access to financial markets.

Source: European Central Bank. ‘Eurozone Long-Term Interest Rate on 10 Years Government Bonds for Period 1992-2015.’ *Statistical Data Warehouse,* June 2015.
http://sdw.ecb.europa.eu/browseChart.do;jsessionid=2EC4BB3DA28FE9798278B7FEFB3D248D?node=SEARCHRESULTS&type=series&start=01.01.1992&end=01-01-2016&submitOptions.x=81&submitOptions.y=4&trans=N&q=IRS.M.BE.L.L40.CI.0000.EUR.N.Z+IRS.M.DE.L.L40.CI.0000.EUR.N.Z+IRS.M.IE.L.L40.CI.0000.EUR.N.Z+IRS.M.GR.L.L40.CI.0000.EUR.N.Z+IRS.M.ES.L.L40.CI.0000.EUR.N.Z+IRS.M.FR.L.L40.CI.0000.EUR.N.Z+IRS.M.IT.L.L40.CI.0000.EUR.N.Z+IRS.M.CY.L.L40.CI.0000.EUR.N.Z+IRS.M.LV.L.L40.CI.0000.EUR.N.Z+IRS.M.LT.L.L40.CI.0000.EUR.N.Z+IRS.M.LU.L.L40.CI.0000.EUR.N.Z+IRS.M.MT.L.L40.CI.0000.EUR.N.Z+IRS.M.NL.L.L40.CI.0000.EUR.N.Z+IRS.M.AT.L.L40.CI.0000.EUR.N.Z+IRS.M.PT.L.L40.CI.0000.EUR.N.Z+IRS.M.SI.L.L40.CI.0000.EUR.N.Z+IRS.M.SK.L.L40.CI.0000.EUR.N.Z+IRS.M.FI.L.L40.CI.0000.EUR.N.Z%20IIf%20you%20have%20idea.